

Islamic banking: A study of customer preferences and satisfaction in Pakistan

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Abstract

In the financial world, Islamic banking has appeared as a strong alternative financial system and has recorded a remarkable growth within a short span of time. The interesting fact is that the Islamic financial system is not adopted by Islamic societies, but also by most of the non-Muslim societies. To provide a framework for discussion regarding the customer's perceptions of selecting Islamic bank the data for the study were collected by asking 119 respondents to rate their selection criteria of Islamic banking on 14 statements using a five-point Likert scale. Questionnaires were administered in two major cities of Pakistan (Peshawar and Karachi) and SPSS was used to analyze the data. Three major factors, (i.e. Islamic motive, image and convenience) responsible for the clients' selection of Islamic bank is acquired through factor analysis technique and they were further verified via 'satisfaction level' of Islamic bank customers by using linear regression.

Keywords: Rapid Growth, Islamic Banking, Customer Satisfaction.

Introduction

The 21st century brought both threats and opportunities for the conventional banking due to incorporation of Islamic banking practices in different countries like Malaysia, Pakistan, Bangladesh, Bahrain and even in non-Muslim regions of the globe (Ahmad and Rehman, 2010). Islamic banks provide the same fundamental services as other banks do in the conventional system with the exception that they have aligned all their transactions in accordance with the rules and principles of Islamic Shariah (Khan et al., 2007; Henry and Wilson, 2004). During the past four decades, Islamic banking has thrived with a rocket pace in terms of size and attracted a great deal of market share. The operations of Islamic financial institutions are now in more than 75 countries (El-Qorchi, 2005). Estimates suggest that global Islamic financial services grew at a rate of 10%-15% over the period from 1995 to 2005 (Khan et al., 2007).

In Pakistan, it has achieved an average growth of 76% per annum in the last six and half years (12/03-06/10) (Hanif, 2011). During the period of (12/03-06/10) the average rate of annual increase in assets was recorded around 76%. Similarly, for deposits it was 85% and for financial disbursements and investments annual increase was 66%. The branch network reached 948 by June, 2012 (SBP, 2012). The growth in the branches was shared evenly by the full-fledged Islamic banks and the conventional banks having Islamic banking branches (IBB, 2012).

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Table I: Islamic Banking Players (end-June) in number

Year (June)	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
Islamic banks (operating)	1	1	3	4	6	6	6	6	6	6
a) Branches of Islamic banks	8	10	32	48	122	223	389	479	539	635
Conventional banks operating Islamic banking branches	0	5	9	11	13	12	12	13	13	13
b) Total standalone Islamic banking branches of conventional banks	0	10	30	39	61	103	139	188	260	313
Total Islamic banking branches (a + b)	8	20	62	87	183	326	528	667	799	948
Base Index	100	250	775	1,088	2,288	4,075	6,600	8,338	9,988	11,850
Number of Times	1	3	8	11	23	41	66	83	100	119

Source: Extracted from: *Islamic Banking Bulletin, Bank Karachi: State Bank of Pakistan, June 2012.*

This rapid growth of Islamic banking system instigates and motivates one, whether to ascribe the rapid growth to the religious belief that investors hold about or it is the interplay of some other factors? Some studies have suggested that customers choose Islamic banks mainly on religious grounds, however, it must be noted that Islamic banking has been prevailing among non-Muslim countries and consumers (Khan et al., 2007; Dusuki & Abdullah, 2007).

The study is potentially relevant to Islamic banks in order to know the factors due to which the customers choose it and hence is the reason for the rapid growth of Islamic banking in Pakistan. Following are the research questions;

- 1) To understand determinants of growth factors of Islamic banking in Pakistan, the study examines the role of religious motivation, low service charges, location, and quality of services, friends and family influence in the selection of an Islamic bank by the customers.
- 2) The study also focuses on empirical investigation of the major determinants of Islamic banking on consumer satisfaction.

The study comprises of five sections. The first section describes the introduction of the study, section two presents a detailed review of the relevant literature, section three expresses the methodology and describes the methods, i.e. questionnaire, the sample selection, the data collection techniques and an overview of the statistical tests used in the study and section four is about the main findings of the study. The fifth section encompasses the conclusions and broader recommendations, which would hopefully be beneficial in improving the quality of products and services of the Islamic banks in Pakistan.

Literature Review

The amendments in the banking arrangements have formed a new aspect in the banking industry within which the institutions in the banking system have to compete, not only with financial institutions exterior to the banking sector, but also with themselves to keep their existence in a competitive environment (Haron et al., 1994). When banks enter the phase of the competition where the products and services on offer are almost identical, then satisfaction of the customers remains one of the major factors to regulate the performance of the banks. The vulnerability of success of the banks and competitiveness can also be determined by the degree of satisfaction of customers (Naser et al., 1999). In the context of Pakistan, the commercial banks face even more challenges, not only because of competition among themselves, but also, they have to compete with the new competitors that offer the same services and products but operate according to Islamic principles. Since the financial institutions and the banking sector are in the process of development through diversification of products and services, setting forth a competitive market, this situation necessitates Islamic banks to respond the market in the required fashion. The market excessively demands for innovation, market segmentation, efficient utility of information and communication technology and equip themselves with the required infrastructure to counter the potential threats of casting out (Zineldin, 1996).

Predominantly Islamic banks were confined to Muslim countries, however, with the passage of time European financiers and businessmen also started adopting different Islamic techniques and instruments of Islamic finance (Zaher and Hassan, 2001). Western conventional based financial institutions such as HSBS, Standard Chartered Bank, Deutsche Bank, Citibank, JP Morgan, ABN Amro and American Express have started introducing interest-free products to customers (Awan, 2009; Haron and Ahmad, 2000). Similarly, multinational corporations such as General Motors, IBM and Daewoo Corporation have begun to use interest-free services (Haron and Ahmad, 2000).

The results of the study performed by Awan (2009) for the period of 2006 to 2008 by using ratio analysis technique also confirmed the out performance of the Islamic banks over the conventional banks under study, in terms of performance and profitability. Similarly, by using 'Horizontal Analysis Technique' the results of the comparative study between the two types of banks revealed the higher growth rate of Islamic banking as compared to conventional banks in terms of its 'Deposits, Investments, Assets and Owners' Equity' in Pakistan for the period of 2004 to 2009 (Khan et al., 2012).

Different studies have been conducted in various countries with variable results. Some of the studies are of the view that religious believes plays an essential role in customer's choice for Islamic banking including Metawa & Almosawi (1997-1998) in Bahrain, Hegazy (1995) in Egypt, Metwally (1996) in Kuwait, Saudi Arabia and Egypt, Al-Sultan (1999) in Kuwait, Ahmad & Haron (2002) in Malaysia, Okumus (2013) in Turkey, and finally Khan et al. (2007) in Bangladesh found that religious principles remain at the heart of people's preference for Islamic banks. However, some of the studies, including Erol and El-Bdour (1989) in Jordan, Erol et al. (1990) in Jordan, Haron et al. (1994) in Malaysia and Ahmad &

Haroon (2002), have found that religion is not the primary source of motivation for selecting Islamic banks and they have identified some other factors.

Gerrard and Cunningham (1997) found that attitudes of Muslims and Non-Muslims towards the Islamic banking movement are different depending on the nature of the respective matter put to them. It was further suggested by them that Islamic banks should also aim for profit along with religious principles. Jalaluddin & Metwally (1999) performed a survey in Sydney to discover about the attitude of customers towards the 'Profit and Loss Sharing' mode of finance by Islamic banks. The results of the study revealed that apart from the religious motive small businesses in Australia are more motivated towards profit and loss sharing method of finance when business risk or interest rates are high.

Kaynak & Whiteley (1999) observed that the convenience of a bank was a primary motivation for customers in selecting a specific institution. In case of responses from Muslims, it was found that if more branches of Islamic banking institutions open throughout a country, it will encourage the people to utilize the services provided by these banks (Gerrard & Cunningham, 1997). From the estimation result, a 1 unit change in the branch office (if a branch office of the Islamic commercial bank increase by 1 unit), it would improve the position of Mudarabah deposits in Islamic commercial banks in Indonesia by 41,489.21 million Rupiahs (Rachmawati & Syamsulhakim, 2004).

Chen et al. (2005) studies explain 'the image of the bank' as one of the most important bank selection criteria for customers. The authors argue that customers may forgive the negative service quality if a company has a good image bearing in their customers' minds (Lu et al., 2009). Mihelis et al. (2001) measure bank image by credibility, technological distinction and the capability to satisfy upcoming requirements of customers. Similarly, Gan et al. (2011) found the positive relation between satisfaction and corporate image. Naser et al. (1999) also supported the results of Gan et al. (2011) i.e., the customer's satisfaction is mainly concerned with the bank's name and its image, confidentiality, and bank's reputation in case of Jordanian customers.

Customer choices for the selection of banks mostly depend on the quality of services offered by the bank either it is conventional or Islamic bank. Haron & Ahmad (1994) and Naser *et al.* (1999), suggests that the excellences of services are reflected in the cooperativeness and the courtesy of the bank staff, dress code, communication skills, and customer relationship. It was also found that there is strong direct and positive relationship between service quality and customer satisfaction. And the magnitude of the relationship between service quality and customer satisfaction is greater in Islamic banks ($r = 0.8640$) as compared to conventional banks ($r = 0.777$) (Ahmad & Rehman, 2010). Customers' perceptions of overall service quality are also significantly influenced by the environment in which the services are provided (Bitner, 1992). Similarly, LeBlanc and Nguyen's (1988) also found the significant relation between the quality of the physical environment and perceived service quality.

Data and Methodology

The data for the study was collected through self-administered questionnaires. Following the pretest some important changes were made to the survey questionnaire. Non-probability sampling method was used, and the selection of the sample was based on convenience. Customers were approached by explaining the nature of the study and asked if they would be prepared to fill in the questionnaire. The survey questionnaires were distributed particularly among ‘Islamic bank customers’ in Peshawar and Karachi.

The data collected were analyzed by using SPSS (version-16). The sample size of the study was 119 and for the analysis ‘Factor analysis’, ‘Descriptive statistics’ and ‘Linear Regression’ were used. Several researchers have used Factor analysis in their studies, including, Rashid (2009), Jallaluddin (1999), Al- Sultan (1999), Gerrard & Cunningham (1997), Metwally (1997), Haron et al. (1994), Erol & El-Bdour (1993).

Theoretical Framework

A diverse number of items were retrieved through literature and focus group discussion and principle component analysis was applied. The purpose of principle component analysis in the study was to find important dimensions due to which the customers choose Islamic banks and is the reason for the rapid growth. The 14 statements of ‘bank selection criteria of Islamic bank customers’ were condensed into three major factors, i.e., Islamic motive, Image, Convenience.

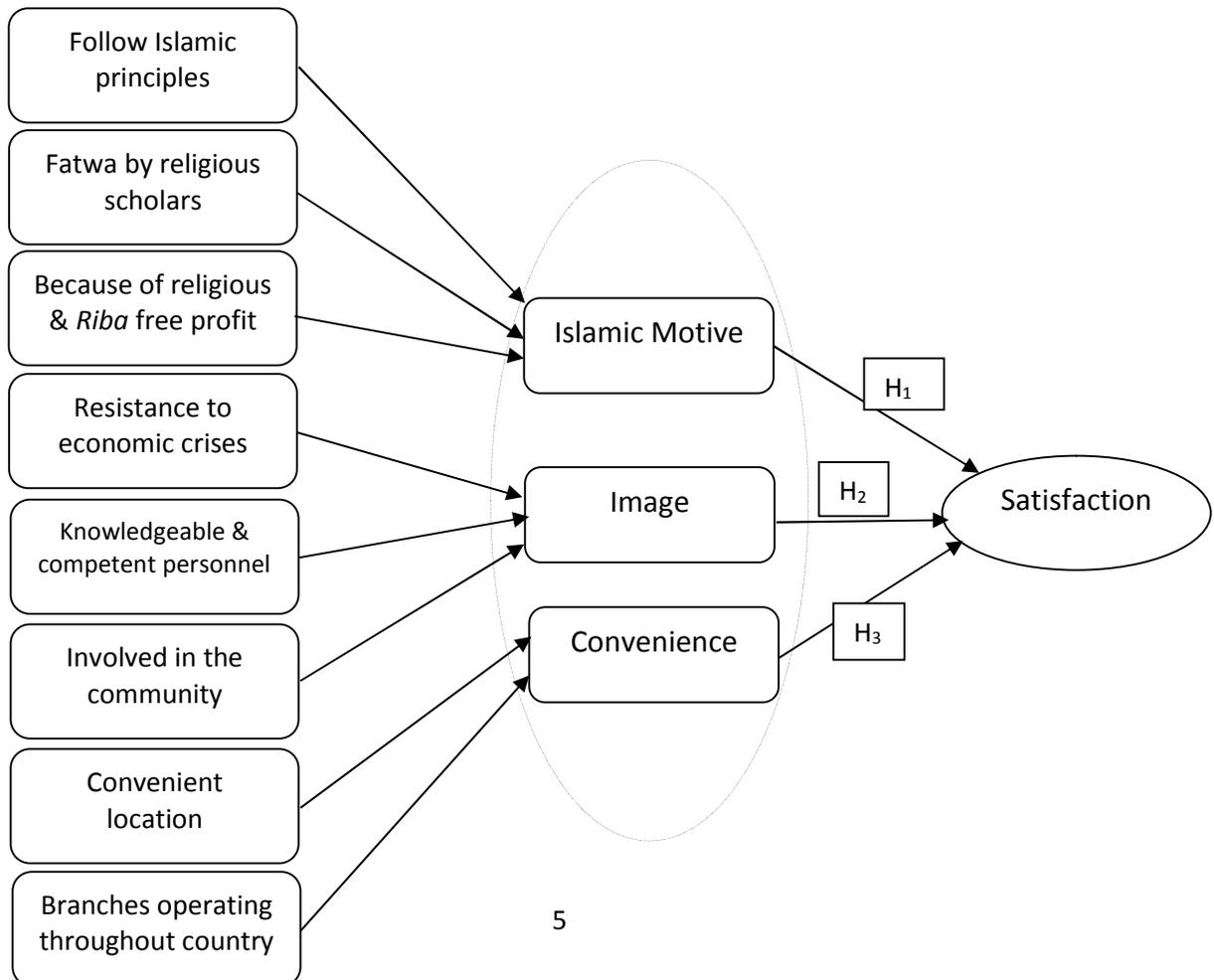


Figure 1: Theoretical Framework

Linear Regression was then used to find the impact of factors generated by the Factor analysis on the satisfaction level of Islamic bank customers. The questions in both parts were on a five-point Likert scale. In the linear regression the 'mean' of dependent variable (Satisfaction) were regressed with the mean of three independent variables generated by factor analysis (i.e., Islamic motive, image and convenience). Following were the hypothesis to be tested,

H1: Religious motive has an impact on the customer satisfaction.

H2: Image of Islamic bank has an impact on the customer satisfaction.

H3: Convenience of the Islamic bank has an impact on the customer satisfaction.

Results and Discussion

Customers' Profile

A summary of findings on customer profile along four variables: age, gender, level of income (average monthly income of the respondent), and level of education has been presented in Table II. The reason for using monthly income is that in Pakistan salaried employees are contracted based on the monthly payment. So, people tend to remember their monthly salaries that enables them to respond easily.

The aforesaid descriptive reveal that the majority (61.3%) of Islamic bank customers was in the age category of 25 to 35 years. One of the possible reasons that can be ascribed to the high concentration in this age category could be the more focus of Islamic banking on attracting fresh customers or it is due to the short history of Islamic banking in Pakistan which started in 2002. The percentage of respondents was predominated by males around 95%. About (31.9%) of the respondents have an average monthly income ranging between Rs. 11,000-20,000. It is to note that such income category in Pakistan generally includes entry and mid-level executives from both private and public sectors. Most of the respondents i.e., 47.1% were found to possess a masters or equivalent to master's degrees. 26.9% of the respondents were having a bachelor's degree.

Table II: Profile of the Respondents

Variable	Categories	Percent
Age	Under 25 years	21.0
	25-35 years	61.3
	36- 45 years	12.6
	Above 45 years	5.00
Gender	Male	95.0

	Female	5.00
Level of income	Rs 5,000-10,000	13.4
	Rs. 11,000-20,000	31.9
	Rs. 21,000-30,000	23.5
	Rs. 31,000-40,000	9.20
	Above Rs. 40,000	21.8
Level of education	SSC or Equivalent	5.00
	Intermediate or Equivalent	16.0
	Bachelors or Equivalent	26.9
	Masters or Equivalent	47.1
	MS/PhD	5.00

Customers' Track of Banking Relationship

The track of banking relationship can be presented across two variables: customers' previous relationship with conventional banks and customers' length of relationship with Islamic banks (Table III). The findings revealed that about 87.4% of the customers had a previous relationship with traditional banks, which indicates better performance of Islamic banks in attracting customers from the traditional banks. The respondents who were having relation with Islamic banks from 1-2 years were 56.3%. The probable reason may be the newly commencement of Islamic banks in Pakistan.

Table III: Customers' Track of Banking Relationship

Variable	Categories	Percent
Previous relationship with traditional banks	Yes	87.4
	No	12.6
Length of relationship with Islamic banks	1-2 years	56.3
	3-4 years	31.1
	5-6 years	5.90
	Above 6 years	6.70

Customers' Awareness and Usage of Islamic Banks' Products/Services

Table IV presents the detail about the awareness and usage of Islamic bank products and services. High level of customer awareness of current account (100%) and saving account (98.3) has been observed. Similarly, most of the customers (73.9%) only use current account. The usage in *Murabaha*, *Musharaka* and Letter of Credit is very low. The probable reason for such low usage and awareness of these products may be due to the use of Arabic language terms. High awareness (96.6%) and usage of ATM (79.8%) service can be ascribed to the growing popularity of ATMs for liquidity among both conventional and Islamic banks.

Table IV: Customers' Awareness and Usage of Islamic Banks' Products/Services

Types of Products/Services	Percent Aware	Percent Using
Current	100.0	73.9
Saving	98.3	49.6
Term	57.1	23.5
<i>Murabaha</i>	63.0	10.9
<i>Ijarah</i>	85.7	18.5
<i>Musharaka</i>	60.5	7.60
Letter of Credit	41.2	4.20
ATM	96.6	79.8
Online	88.2	51.3
Locker	63.9	16.0
Visa	84.0	54.6

Principle Component Analysis

Principle component analysis aims to condense the number of statements considered by respondents to a more feasible level by bringing together those statements which appear to measure the identical 'items'. Those statements which are brought together form a factor. Application of principal component analysis to survey results, proposes that variable which motivates customers to deal with Islamic banks rather than conventional banks can be summarized into three factors, i.e., religious motive, image and convenience (Table V).

Table V: Rotated Component Matrix

Variable	Religious Motive	Image	Convenience	Communality
Follow Islamic principles	.830			.731
Fatawa (recommendation) by religious scholars	.864			.765
Religious and profitability reasons	.623			.562
Resistance to economic crisis		.759		.587
Knowledgeable and competent personnel		.734		.571
Involved in the community (i.e., Charity)		.642		.450
Convenient location			.819	.693
Branches operating throughout the country			.759	.617

The results of the first factor are consistent with the former studies performed by Okumus (2013), Ahmad & Haron (2002), Naser et al (1999), Metawa & Almosawi (1998), Hegazy (1995), Haron et al. (1994) and Erol et al. (1990). The results of a third factor (i.e.,

convenience) further confirm and support the findings of Rachmawati & Syamsulhakim (2004); Gerrard & Cunningham (1997); Kaynak & Whiteley (1999).

In the analysis six items were loaded on more than one factor and were showing complex structure, therefore, were discarded from the analysis and the process was iterated (Table VI).

Table VI: List of Discarded Items

a. I chose an Islamic bank because of lower service charges	b. I chose an Islamic bank because of customer service quality	c. I chose an Islamic bank because of the friendly personnel
d. I chose an Islamic bank because of Islamic reputation and image	e. I chose an Islamic bank because my family members and friends recommended me	f. I chose an Islamic bank because it provides higher rates of return

Impact on Satisfaction Level of Islamic Bank

To check whether the satisfaction of Islamic bank customers is due to Islamic factor, image factor or convenience factor the linear regression has been applied. The results of linear regression indicate that Islamic motive has a significant positive relation to the satisfaction of Islamic bank customers. The unit change in Islamic motive contributes 12% variation in the satisfaction level of customers. These results clearly establish Islamic motives as the core source of consumer motivation for selection and their satisfaction level. The other two factors, i.e., image and convenience were also found to have significant impact on the satisfaction of customers and the unit change in 'convenience factor' brings about 45% change in the satisfaction level of customers and hence is the dominant factor. The impact of 'image factor' on the 'satisfaction level' of customers was found to have a significant but negative relation (Table VII). The possible reason may be that the Islamic bank's personnel are not enough competent to satisfy their customers and the finding is consistent with the results of the study performed by Awan and Bukhari (2011) i.e., the bank's staff lacks ability to provide credible information about religious compliance of Islamic banking financial services. The other statement loaded on the second factor (Image) was '*I choose Islamic banks because it is involved in the community*'. Islamic banks are not prominently involved in the community, like other banks, i.e., giving scholarships and donations that may play a vital role in the development of community and hence have a negative impact on the satisfaction level of customers. The other possible reason of negative influence of 'Image' on customer satisfaction could be because of relatively very low rate of appearance in the local media showing their lesser focus on image building. Some of the people also perceive that an Islamic bank have no distinct difference from conventional banks and is a mere change of name.

Table VII: Regression Coefficients

	Unstandardized Coefficients	Standardized Coefficients		
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Model	B	Std. Error	Beta	t	Sig.
(Constant)	2.091	281		7.439	.000
Islamic motive	123	.055	.149	2.243	.027
Image	-.107	.054	-.129	-2.002	.048
Convenience	465	.045	.687	10.421	.000

a. Dependent Variable: Satisfaction

Conclusion

The results of the Factor analysis and linear regression depict that religion is the primary motive in selection of Islamic banks in Pakistan. Resultantly, Islamic banking is increasing at a very fast rate in Pakistan. The image of the bank, although has negative impact on the satisfaction level of Islamic bank customers, can also be considered as an important factor because it came up as the second important dimension in the factor analysis. The customers of the Islamic banks also consider convenience as an important factor in selecting Islamic banks. So, keeping all these findings the policy makers or the management of the Islamic banks should have to ensure that the Islamic banks operates according to Islamic principles and should improve their image as it may influence the customers' criteria of selecting an Islamic bank.

The 'image' of the Islamic banking is a significant negative factor for the satisfaction of client. This situation demands effective measures on the part of Islamic banks that why they have remained unable to create a better image among the people. The problem seems to be present at the branch level of the banks as customers normally interact with the branches. Their dissatisfaction can be due to the attitude of the staff towards the customers and the Islamic banking. Islamic banks still lack skilled human resource and are relying on conventional banking for hiring. People being hired from a conventional bank do have experience of banking, but are unable to understand the Islamic banking which results in dissatisfaction of the clients when they are unable to explain and convince the banking of their bank as an Islamic one. Therefore, the banks should focus on developing human resource skilled in Islamic banking otherwise the image of the Islamic bank will remain a negative factor.

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