

# Why Do Pakistani Customers Patronize Islamic Banks- An Empirical Analysis

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**Abstract**—Throughout the world, the Islamic way of banking and financing is increasing. The same trend is also visible in Pakistan, where the Islamic banking sector is increasing in size and volume each year. The question immediately arises as why the Pakistanis patronize the Islamic banking system? This study was carried out to find whether following the Islamic rules in finance is the main factor for such selection or whether other factors such as customer service, location, banking hour, physical facilities of the bank etc also have importance. The study was carried by distributing questionnaire and 200 responses were collected from the clients of Islamic banks. The result showed that the service quality and other factors are as important as following the Islamic rules for finance to retain old customers and catch new customers. The result is important and Islamic banks can take actions accordingly to look after both the factors.

**Keywords**—Customers' perception, customer satisfaction, customer service, Islamic banking

## I. INTRODUCTION

FOR the last four decades, Islamic financial services industry has experienced remarkable growth and has come out as one of the most rapidly growing industries. Starting with the Dubai Islamic Bank in 1975, the number of Islamic financial institutions worldwide in the year 2005 exceeded over 300, with operations in 75 countries and total assets more than US dollars 400 billion [1]. Today, it is spread over most of the countries of the globe. Between 1995 and 2005, worldwide Islamic financial services grew at a high rate of 10%-15%. Out of all Islamic financial services, Islamic banks are the key institutions providing majority of the products and services.

Islamic banks perform similar functions and provide similar products and services to the clients just like those of the conventional banks. But, they follow Islamic principles while carrying out all the functions [2-4]. Islamic principles are based on the orders/instructions of the Holy Qur'an and the Hadith. Thus, Islamic banking system emerged to provide banking products and services in conformity with Islamic principles. Initially Islamic banks were concentrated in the Middle East, specially Bahrain and South East Asia, particularly Malaysia. Now, such Islamic mode of banking is also gaining popularity among the non-Muslim consumers around the world and is now increasingly found elsewhere. This includes developing countries where the financial sector is fully Islamic like Iran and Sudan or where Islamic and conventional financial systems coexist like Pakistan, Indonesia, Malaysia and the United Arab Emirates.

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The increasing worldwide popularity of Islamic banks is evident from the fact that many international giant banks have also started providing Islamic banking products and services [5]. This is mainly due to the ethical part of Islamic Banks. Many studies [6-7] carried out in non-Islamic or Muslim minority countries such as USA and UK and those studies have also highlighted the popularity of Islamic mode of banking due to the ethical aspect attached to it.

Pakistan was one of the three countries of the world that started the endeavor to have interest free banking in the country. Starting from 80s, the country has a long history of endeavors in implementing Islamic Banking system. Finally in December 2001 the State Bank of Pakistan (SBP) issued detailed criteria for establishment of full-fledged Islamic commercial banks in the private sector in Pakistan. At present, there are 6 Islamic banks in Pakistan namely, Al Baraka Islamic Bank, Bank Islami Pakistan Limited, Dubai Islamic Bank Pakistan Limited, Dawood Islamic Bank Limited, Emirates Global Islamic Bank Limited and Meezan Bank Limited. On the other hand, there are 61 commercial banks in Pakistan.

The question then immediately arises, whether this widening popularity of Islamic banks is due to religion and ethical part only or not. The studies by Metawa and Almossawi [8] and Okumkus [9] have suggested that customers choose Islamic banks mainly on religious grounds. These were Arabic countries like Kuwait, Saudi Arabia and Egypt. In contrast, Wilson [10] and many others [5, 6, 10, 11] suggested that, Islamic banks cannot expand by only fulfilling the religious obligations of the Muslim community. Thompson, Strickland and Gamble [12] suggested that 'sustainable competitive advantage requires any firm to have a large pool of customer base who has an enduring preference for the firm'. Thus, it appears that the Islamic banks may not be able to retain or catch new customers only by ensuring Islamic principles in banking system; rather they need to fulfill other criteria of customer satisfaction. In this scenario, it is an appropriate study to investigate the factors behind patronizing Islamic banks by the customers in the context of Pakistan.

## II. HYPOTHESES DEVELOPMENT

The null hypothesis to be tested was as follows:

Null hypothesis ( $H_0$ ): Islamic bank customers are 'neither satisfied nor dissatisfied' with the standard of services i.e. the customer satisfaction is not important.

Alternative hypothesis ( $H_1$ ): Islamic bank customers are at least 'satisfied' with the standard of services i.e. the customer satisfaction is important.

To analyze the above null and alternate hypothesis, the customers of Islamic banks were interviewed to know whether they were satisfied with the basic elements of service delivery system such as employees, physical facilities of the bank, location and banking hours etc or not.

The respondents were also asked if they were satisfied with the overall customer services. If null hypothesis is established, it means that the existing clients are not much worried about the services; they are patronizing Islamic banks because of following Islamic rules. On the other hand, if alternative hypothesis is established, then the customer service is also important for holding existing clients and attracting new clients along with following the Islamic rules.

### III. DEFINITION OF THE TERMS

Although Islamic banks offer a number of products, only a few (Al-Wadia Current Account, Mudaraba Savings Account, Musharaka, Ijara and Bai-Salam) were used in this study. To better understand, it is justified to put a short review on these products of Islamic banks.

#### A. Al-Wadia Current Account

Islamic banks receive deposits from customers on current accounts like the conventional banks; however they operate these current accounts under a principle named 'Al-Wadia'. Under the Al-Wadia principle, the customers authorize the bank to use their money at the bank's own risk. The bank guarantees its customer that full deposit with any voluntary profit will be repaid to the depositor, which is the only difference from current account.

#### B. Mudaraba Savings Account

Under Mudaraba savings accounts, the banks possess the rights to manage the deposits exclusively. The banks and the depositors share the profit or loss from the use of the money of these accounts. The profit or loss is divided between the depositor and the bank at a pre agreed-upon ratio.

#### C. Musharaka

Musharaka means partnership. Under Musharaka, the bank and the customer share the required capital at agreed ratios. Subsequently, profit or loss is shared as per the contract.

#### D. Ijara

Ijara refers to leasing, which is quite similar to that of conventional banks. In Ijara, the bank purchases the property and then leases it to one of its clients for a limited period of time on an agreed sum. The agreed sum is usually paid in installments and these installments are invested in Mudaraba investment for the customer's account. Under such Islamic banking leasing, the risk related to leasing is shared between both lessee and lessor.

#### E. Bai-Salam

Bai-Salam refers to a sale in which the payment is made in advance and the delivery is made later. Here the buyer is usually the bank. Thus bank locks in the price at which the commodities will be purchased. Upon delivery, the bank sells those commodities and makes profit. Thus the bank is benefitted. On the contrary, the individual or business receives money before selling the product and can use this money for other purposes such as meeting the working capital requirements. Thus the person/business is also benefitted.

### IV. SAMPLE AND METHODOLOGY

Questionnaire based survey was used to collect data from the field. This mode is economic and the data becomes reasonably representative of the population. Data was collected from the sample population of 200 customers of Islamic banks in Islamabad. The questionnaire included demographic information and history of banking relationship. The main part included feedback of the customer on Islamic bank products and services. The final part asked the customer to provide information on the four main aspects of product delivery system. The main questions were based on 5-point Likert scale. The clients mentioned their satisfaction on a scale ranging from 1 (highly dissatisfied) to 5 (highly satisfied). The questionnaire asking feedback on satisfaction / dissatisfaction had 5 parts. Each part was about a specific product offered by the Bank. Out of many products offered by Islamic banks, the most frequently used ones (explained in the previous section) were selected for the questionnaire. The next portion of the questionnaire included feedback on four main product delivery elements namely, employees, physical facilities of the bank, location and banking hours. In this part also, the client was told to express his/her feedback on a scale of 1 to 5. The last part included three more questions on the bank selection criteria. These three questions would provide information whether the clients prefer Islamic banks only for religious factors or for other factors. The scales here were 1 (strongly agree) to 5 (strongly disagree).

### V. RESULTS AND DISCUSSION

#### A. Demography

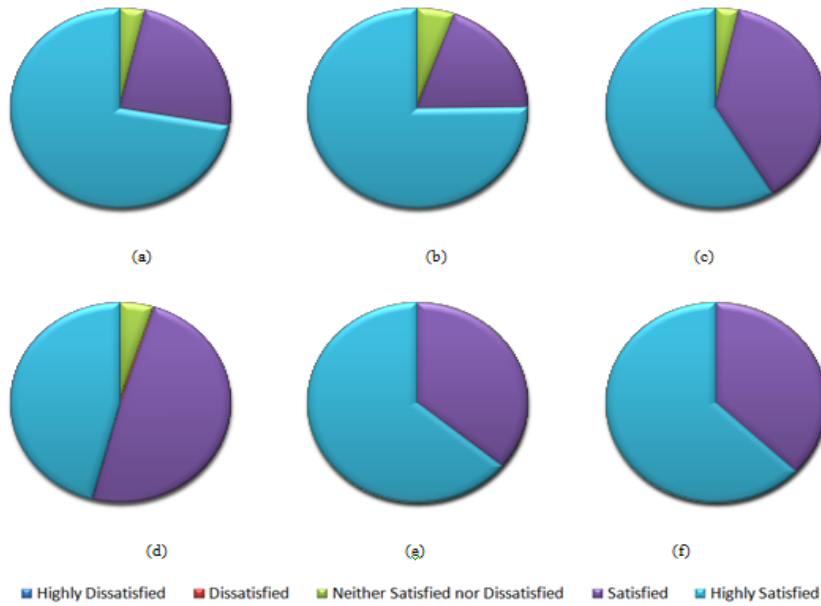
The demographic factors included age, sex, educational background, monthly income and occupation. Majority (68%) of the respondents were male, which might be due to the social structure of Pakistan. There were wide varieties in the profession. Similarly there were wide varieties in monthly income and educational background.

#### B. Banking History

It was found that majority of them (87.5%) had previously been using traditional i.e. non-Islamic banks and only 12.5% did not have experience with conventional banks. This shows that those who were earlier using traditional banks gradually became interested in Islamic banks and now they are using Islamic banks. The number of years they are using Islamic bank was also varying from 1-2 years to more than 6 years.

#### C. Satisfaction with Selected Islamic Bank Products

Clients were asked to express their satisfaction level on five Islamic products (Al-Wadia Current Account, Mudaraba Savings Account, Musharaka, Ijara and Bai-Salam) and ATM service. It was found that many of the clients did not have experience with Musharaka, Ijara, and Bai-Salam. Some had experience with either one or two of these three and only few had experience with all. But almost everyone had experience with Al-Wadia Current Account, Mudaraba Savings Account and ATM services. Important fact evident from Fig. 1 is that, if someone was using a product of Islamic bank, in majority cases, he or she was either 'satisfied' or 'highly satisfied'. This means that the products are popular among the customers once they come to know about it or use it.



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Fig. 1 Frequency distribution of the respondents with respect to their satisfaction with (a) AI-Wadia Current Account, (b) Mudaraba Savings Account (c) Musharaka, (d) Ijara, (e) Bai-Salam and (f) ATM services

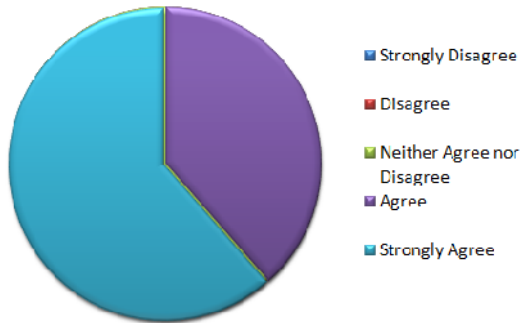


Fig. 2 Frequency distribution of the respondents with respect to the opinion that they prefer Islamic banks because of following Islamic rules of finance

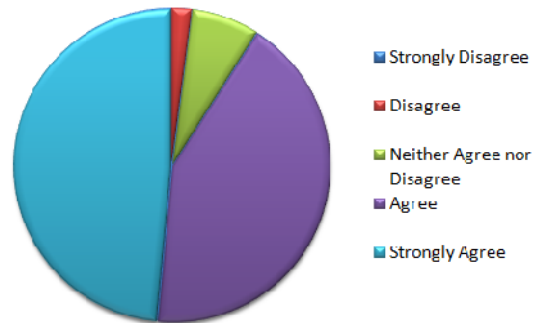


Fig. 3 Frequency distribution of the respondents with respect to the opinion that they prefer Islamic banks because of excellent customer service

TABLE I  
 CUSTOMERS' SATISFACTION ON ASPECTS OF SERVICE

	Percentage				
	Highly Dissatisfied	Dissatisfied	Neither Satisfied nor Dissatisfied	Satisfied	Highly Satisfied
Employees	-	3.0	2.0	51.5	43.5
Facilities	-	1.5	1.5	55.5	41.5
Branch Location	-	-	6.5	52.0	41.5
Banking Hours	-	-	1.0	25.0	74.0

TABLE II  
 ONE SAMPLE T-TEST RESULTS FOR THE ELEMENTS OF CUSTOMER SATISFACTION

	t	df	Mean	95% Confidence Interval	
				Lower Limit	Upper Limit
				Employees	91.69
Facilities	103.74	199	4.370	4.29	4.45
Branch Location	102.63	199	4.350	4.27	4.43
Banking Hours	143.20	199	4.730	4.66	4.80
Customer Service	87.78	199	4.375	4.28	4.47

#### D. Satisfaction with Aspects of Service

The customers were checked for four important aspects of service, namely employees of Islamic banks, physical facilities, location of branches and banking hours. From Table I it is seen that around 43% are highly satisfied with the employee and around 51% are just satisfied. This is a major finding that, to increase the popularity of Islamic banks, they should try to make more customers 'very happy' through their employees.

It is seen that around 41% are highly satisfied with the physical facilities whereas around 55% are just satisfied. This gives the message that Islamic banks should also try to increase their physical facilities to retain and increase the number of customers. The location of the branches was good enough for good feedback and the strongest aspect of Islamic banks was found its late banking hours.

#### E. Bank Selection Criteria

The clients were asked whether they have chosen Islamic bank for following Islamic way of financing, whether they started dealing with Islamic banks due to recommendation from their families and friends and whether they will continue to deal with Islamic banks due to their excellent customer services. From Fig. 2 it is seen that 61.5% of the respondents 'strongly agree' that they prefer Islamic banks because they follow Islamic rules of banking. Remaining 38.5% 'agree' to this reason and there is no percentage in the category of 'neither agree nor disagree', 'disagree' and 'strongly disagree'. So, majority are in the opinion that they like Islamic Banks because of Islamic rules. The factor of recommendation from friends and families was not so strong.

On the other hand from Fig. 3 it is found that 48.5% of the respondents 'strongly agree' that they choose Islamic banks because of their excellent customer service. 42.5% 'agree' to this reason. Only 7% 'neither agree nor disagree' and 2% 'disagree' to this reason. Thus, as high as 91% customers either 'strongly supports' or 'supports' the fact that customer services of Islamic banks are excellent.

#### F. Hypothesis Testing

For establishing the null hypothesis/alternate hypothesis, five questions of the questionnaire were used, which were directly related to the customer satisfaction. These were the responses on employee, physical facilities of bank, bank location, working hours and customer satisfaction. To test the hypothesis, t-test was used along with mean of these five variables. The results are shown in Table II.

From the above table it is found that the mean of the responses of the customers to all these five questions are above 3.0. The highest average of 4.73 was found for the banking hour criteria and the lowest average of 4.35 was observed for branch location criteria. The t-test was carried out with 95% confidence interval. With this confidence level the customers of Islamic banks have a satisfaction of 4.26 – 4.45 regarding employees, 4.29 – 4.45 regarding physical facilities, 4.27 – 4.43 regarding branch location, 4.66 – 4.80 regarding banking hours and 4.28 – 4.47 regarding customer services.

Thus, all the factors showed that the customers are at least 'satisfied' with the elements of customer service. Thus, the null hypothesis was not established. Rather, the alternative hypothesis that the customers of Islamic banks are at least 'satisfied' with the customer services was established. This means that the Islamic banks' customer service is good enough and this is a factor for which the clients prefer Islamic banks in addition to following the Islamic principle.

Thus, it can be concluded that both the factors, following Islamic rules in business and excellent customer services, are important in retaining old customers and catching new customers. This deduction is in agreement with many researches discussed earlier, who said that the customer services are as important as following Islamic rules for retaining and increasing customers of Islamic banks.

## VI. CONCLUSION

This survey based study has focused on the responses of the customers of Islamic banks in Pakistan and tried to find out the factors that work for choosing Islamic way of banking. Majority of the respondents were male but there were wide varieties in the profession, monthly income and educational background. Majority of them (87.5%) had previously been using traditional i.e. non-Islamic banks and only 12.5% did not have experience with conventional banks. This testifies that those who were earlier using traditional banks gradually became interested in Islamic banks. Mostly they were using Islamic banks from 1-2 years to more than 6 years.

Five products of Islamic banks (Al-Wadia Current Account, Mudaraba Savings Account, Musharaka, Ijara and Bai-Salam) were checked for their satisfaction level. Customers were more familiar with and using the first two products. If someone was using a product of Islamic bank, in majority cases, he or she was either 'satisfied' or 'highly satisfied'. This means that the products are popular among the customers once they come to know about it or use it.

On the question of following Islamic rules of finance, 61.5% of the respondents 'strongly agreed' that they prefer Islamic banks due to this reason. On the other hand, the study on four important aspects of service (employees of Islamic banks, physical facilities, location of branches and banking hours) revealed that with 95% confidence level the brute majority of customers were either 'satisfied' or 'highly satisfied' with the customer services of Islamic banks. So, it is concluded that the Islamic banks' customer service is good enough and this is a factor for which the clients prefer Islamic banks in addition to following the Islamic principle. Thus, both the factors, namely following Islamic rules in business and excellent customer services are important in retaining old customers and catching new customers.

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