

CONSUMER ATTITUDE TOWARDS ISLAMIC FINANCING

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ABSTRACT

The main objective of this paper is to review current status of knowledge about Islamic ways of financing with focusing on customers' attitude towards Islamic financial products and services. For this purpose, empirical literature related to Islamic financing (particularly Islamic banking products and services) has been reviewed. Review shows that religious conviction is a key variable in the use of Islamic financial products and services. However, along with religious conviction, consumers also give priority to reputation of bank (corporate branding), quality of services and pricing. The knowledge level of customers about Islamic financial services is still low. There is a further need to offer more products and services particularly in Muslim countries and high density Muslim population segments in non-Muslim countries. Research is still limited to few Arab countries, East Asia and Turkey. There is a need to use a variety of samples from different countries. This paper combines existing knowledge about Islamic financing and provides future research directions focusing on customer's perspective.

KEY WORDS: Islamic financing; Islamic banking; Islamic financial services.

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INTRODUCTION

Islamic financing is a rapidly growing segment of global financial industry. It is related to financial institutions, products and services based upon Islamic laws. Islamic financing has been practiced for more than 1400 years but modern financial institutions offered *sharia* (based upon Islamic law) products and services until recently against traditional banking products and services. Modern Islamic finance can be traced back to 1975 when Dubai Islamic bank started its operations from United Arab Emirates and expanded its operations in different countries like Egypt, Lebanon, Bahrain and Pakistan. Initially, it was started from Middle East (e.g. UAE, Bahrain, Saudi Arabia etc) and East Asia (e.g. Malaysia, Indonesia etc.). Today, number of Islamic financial institutions exceeds over 300 and operations have been expanded to more than 75 countries in the world including USA, Europe and Australia (El-Qorchi, 2005). Islamic mode of financing is now even popular in giant conventional multinational banks like Citi, HSBC, Barclays and ABN Amro. Although many banks are offering these types of products and services but still literature related to Islamic financing is not abundant. As Islamic financial products have been entered into the financial services industry, it is important to know about consumers' attitude, perception and knowledge about this new emerging mode of financing. At this level of accomplishment, all academic research fields need an assessment of existing research. The main objective of this paper is to review the existing literature related to consumer's attitude towards Islamic mode of financing. Main focus is on banking sector.

Review will provide current status of knowledge about Islamic ways of financing and how consumers are viewing it. Review can not only useful for finance researchers but also for marketing researchers. First, we have briefly defined the Islamic financing; its commonly used methods, principles and sources; and its products and services. Second, existing literature related to consumer's attitude towards Islamic financing has been discussed. Finally, we have presented the conclusion along with the future research direction.

ISLAMIC FINANCING: AN OVERVIEW

Main principles and characteristics

Scholars have provided suitable introductions to Islamic financing (e.g. Warde, 2000; El-Gamal, 2000; Lewis & Algaoud, 2001; Iqbal & Llewellyn, 2002; Abdul-Gafoor, 2003; Iqbal & Molyneux, 2005; Obaidullah, 2005). Islamic financing can be defined as any financial product which has compliance with the Islamic law and principles (*Shariat*). The main sources of *shariat* are Holy

Quran, Hadith, Sunnah, Ijma, Qiyas and Ijtihad (Gait & Worthington, 2008). The Holy Quran is the book from God been provided to Prophet Muhammad; Hadith can be defined as narratives of prophet Muhammad; Sunnah is the practice and actions of prophet Muhammad during his life; Ijma refers as consensus of Muslim religious scholars on some specific issue which has not been clearly defined in Quran, Sunnah and Hadith; Qiyas is an opinion which is not defined in Quran or Sunnah but some relevant issue has been defined in Quran and Sunnah; and Ijtihad refers to as independent reasoning of Islamic jurists which is based upon Shariat principles. In the light of main sources of Shariat, Muslim religious scholars define main characteristics of Islamic way of financing given in the table 1.

Name	Characteristics
Riba	Usually defined as “Interest” and is prohibited removal of debt based finance
Gharar	Gharar is Prohibited Fully disclose information Free from asymmetric information in agreement/ contract Avoidance from taking risk
Sinful and socially irresponsible products & activities	Not allowed to finance and any type of dealing with prohibited activities and products. Common examples are pork, gambling and alcohol.
Sharing risk	Much emphasis is given on risk sharing Finance provider share business risk in return for profit and loss
Materiality	Financial transaction should have some material finality Direct / indirect link to economic transaction
Exploitation	No exploitation for any party in financial transaction

Table 1: Common characteristics of Islamic financing

Main products and services of modern Islamic financing

In the light of above mentioned characteristics of Islamic financing, Islamic and non-Islamic financial institutions are offering different products and services which are aligned with Shariat principles. Table 2 is showing a brief overview of main Islamic financing products and services offered by different banks all across the world.

Name	Characteristics
Mudarbah	Partial equity partnership in return for providing funds Share in profit Loss on funds lent bear by the lender

Musharkah	Full equity partnership Funds provider and entrepreneur directly and fully share the business
Murabaha	Used to finance the purchase of goods and services Financial institution purchase goods & services on behalf of customer
Bai- Salam	prepaid sale contract of products or services
Bai- muajal	deferred payments on products or services under Murabaha
Ijarah	Lease financing Only in form of operating lease
Istisna	Used for manufacturing contracts under process Finance provided by financial institution on behalf of customers
QarzeHasna	Interest free loans without any time duration to return Benevolent in nature. No legal responsibility to return loan
Takaful	Cooperative/ self-help type of Islamic insurance

Table 2: Main products of modern Islamic financing

ISLAMIC FINANCING: CUSTOMERS ATTITUDE

Substantial literature related to consumer's attitude towards conventional banking exists. However, little work is done in Islamic banking segment. Erol and El-Bdour (1989) survey can be considered as the first peer reviewed study in this segment. They used self-generated questionnaire to ascertain the attitudes of customers towards Islamic and traditional banks in Jordan. Quick service, credibility of bank, and confidentiality were the main criteria for customers to select the bank irrespective of Islamic or conventional banks or their products. This study shows that there is no significant relationship between Islamic banking and customer's selection of bank. However, this survey clearly shows that customers are fully aware about Islamic banking and products through bank advertising and word of mouth from relatives and friends. Erol and his colleagues (1990) survey examined the patronage behavior of banking customers in Jordan. Conventional and Islamic banking customers' viewpoints are significantly different from each other about the pricing policies of their respective banks. However, study finds no relationship between religious motivation and use of Islamic banking services. Omer (1992) survey of 300 Muslims in U.K reveals that Islamic financing products were available even in conventional banks. However, study revealed that most of the Muslims had lack of knowledge about Islamic financing. This is consistent with existing research which shows that Muslims living in Islamic countries have more knowledge than immigrants Muslims in non-Muslim countries. Metwally (1996) study in Saudi Arabia, Kuwait and Egypt shows that Islamic

banks are not too much different from traditional banks in their services and cost of their offered products and services. No significant relationship was found in staff competency and customer services of traditional vs Islamic banks. However, this study concluded that religion was the main factor in choosing Islamic banking which was also been concluded by Omer (1992).

Hegazy (1995) compared demographic factors of customers belonging to Faisal Islamic bank and Bank of Commerce Development (conventional bank) in Egypt. He revealed that more than 98 % customers of Faisal Islamic bank were Muslim. In contrast, 54% customers were Muslim and 32% were Christian in the conventional bank. This shows that choice of religion affects the customer's choice of bank. Similar to existing researchers (Erol & El-Bdour, 1989; Erol et al., 1990; Haron et al., 1994), his results also show that speedy and efficient services were the main priority for Islamic bank's customers. Customers of Islamic bank were also partly agreed from bank's philanthropic activities for society even at the cost of profitability. In comparison, traditional bank's customers were mainly concerned about better rate of return on their investments. Haron and his colleagues (1994) surveyed the Muslim and non-Muslim banking customers in Malaysia. They could not find any strong relationship between religious beliefs and bank selection. They also revealed that Islamic financing knowledge among Muslims and non-Muslim in Malaysia is also low. This is surprising because Malaysia is considered as second largest market for Islamic financial products after Middle East. Study of Hamid and Nordin (2001) focused on awareness about Islamic banking among Malaysian customers. They revealed that majority of the customers can not differentiate between Islamic and traditional banking products and services. However, they know about different Islamic financing products offered by different banks. Although half of the customers were from Islamic banks but they still need extra knowledge about Islamic ways of financing. Zainuddin and his colleagues (2004) surveyed the users and non-users of Islamic banking services in Malaysia. Their results show that majority of Islamic banking customers were more than 30 years old and have stable income. In contrast, most of the non-users of Islamic banking services were less than 30 years of age having low income. They also concluded that decision making process of Islamic banking services users is greatly affected by their family, relatives, and friends and religious beliefs.

Metawa and Almosawi (1998) study show that most important factor for choosing Islamic financial services was religion rather than profitability in Bahrain. Most of the customers were satisfied from the quality of Islamic banking services (particularly investment accounts).

However customers were not satisfied from complex and vague investment schemes of Islamic banks. The high cost was the main reason of customers' dissatisfaction. Nasir and his colleagues (1999) study show that bank credibility and religious beliefs were the two main reasons for customers to use Islamic financial products and services in Kuwait. Al-Sultan (1999) study shows that customers prefer Islamic banking products and services. However, if Islamic banks fail to provide the better quality of services, customers may easily switched to conventional banks. This shows that religious beliefs to prefer Islamic banking may be subsumed by concerns about better quality of services. Gerrard and Cunningham (1997) surveyed the customers' attitude towards Islamic banking services in Singapore. As expected, non-Muslim customers were mostly unaware about these services and Muslim customers were slightly aware. Metwally (2002) focused on demographic and socioeconomic factors' effect on bank selection in Qatar. They revealed that elder, female and public services customers were more motivated towards Islamic banking services. Most of the Islamic banking services customers were low income and comparatively less educated. On the other hand, conventional banking services customers were mostly young, better educated and high income level. Bley and Kuehn (2004) study focused on students' knowledge about Islamic financial services and products in United Arab Emirates. Muslims students prefer Islamic banking services due to religious beliefs. Arab students had better knowledge about Islamic financing as compared to non- Arab Muslims. Okumus (2005) focused on customers' satisfaction towards interest free banking and selection of banks in Turkey. Most of the customers agreed that religion is the primary source of motivation in using Islamic banking services.

CONCLUSION

Islamic financial service is an emerging segment which is growing rapidly. However, research is still limited to conventional financial products and services. To date evidence from the existing literature suggests that religious belief is logical factor in choosing Islamic financial services. However, it is not the only factor. Other factors such as bank credibility, quality of service and cost also play important role in selecting Islamic financial services, products and institutions. The knowledge level of customers about Islamic financial services is still low. This may be improved by putting more funds into advertising programs. Moreover, there is a further need to offer more products and services particularly in Muslim countries and high density Muslim population segments in non-Muslim countries. Research is still limited to few Arab countries,

East Asia and Turkey. There is a need to use a variety of samples from different countries. All studies are quantitative in nature and qualitative approach might also be used effectively. A comparison of predominated Islamic banking system country (e.g. Saudi Arabia, Malaysia) with a conventional banking system country can provide valuable insights.

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