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CONSUMER PERCEPTION OF ISLAMIC BANKING IN PAKISTAN

Manzoor A. Khalidi[1] and Amanaullah

College of Management Science,
PAF Karachi Institute of Economics and Technology

Abstract

The paper begins with a brief history of the efforts of the government and the judiciary towards the introduction of Islamic banking in Pakistan. This is followed by a discussion on a survey undertaken to examine the perceptions of the consumers regarding the Islamic banks and the Islamic methods of finance. Based on the responses from the respondents three hypothesis were tested: one, the respondents consider themselves to have adequate knowledge of the Shariah based banking system; two, banking customers are skeptical regarding the truthfulness about Islamic banking; and three, religion is low in priority with regard to the choice of bank. The hypotheses were tested using Z-tests, and all three of them were accepted. The study is important because the results of the survey are contrary to the accepted wisdom among the people involved in the management of the Islamic Banks.

JEL Classification: *G21*
Keywords: *Islamic banking; consumer perception*

1. Introduction

Although Islamic Finance is one of the most rapidly growing segments of global financial services industry, very few attempts have been made to examine the attitudes, perceptions, and knowledge of the current and potential customers vis-à-vis this sector of financial services industry. An excellent literature review of major empirical studies pertaining to the evaluation of consumer attitude towards Islamic banks has been provided by Gait and Worthington (2007). In their review of empirical

[1] Corresponding author: College of Management Science, PAF Karachi Institute of Economics and Technology, PAF Base Korangi Creek, Karachi, Pakistan. Email: khalidi@pafkiet.edu.pk. Fax:+922135091118, Tel: +922135091114.

studies, the two authors have given a summary of 21 empirical surveys undertaken around the world regarding the attitudes, perceptions, and knowledge of Islamic methods of finance. Interestingly enough not one of them pertain to Pakistan, despite the fact that Pakistan ranks among the major markets for Islamic banking, and has also been on the forefront in the implementation of the Islamic banking experiment. This study is a small attempt to fill this gap. Pakistan provides a unique case study in the implementation of Islamic banking, because in Pakistan two attempts were made to prohibit/outlaw the conventional banking system and replace it with the Islamic banking system; the first of these attempts was initiated by the government, and the second by the judiciary through the legal apparatus of Shariat Courts (Mahmood, 2002). Both the attempts proved to be failures. Pakistan is also an interesting case because while the efforts of the government to introduce Islamic banking started in 1981, the actual entry of an Islamic bank providing Islamic financial products and services in direct competition to those being offered by the conventional banks happened about a decade and a half later with the establishment of Al Meezan Investment Bank in 1997. The next section provides a brief overview of these two attempts to impose Islamic banking in Pakistan, and the present state of affairs of the Islamic banking industry in Pakistan; this is followed by a survey undertaken to understand the perceptions of the Pakistani consumers regarding Islamic banking.

2. An Overview of Islamic Banking in Pakistan

A discussion on the two attempts to prohibit/outlaw conventional banking in Pakistan is necessary for interpreting the results of the survey which has been discussed in the latter part of this paper. The first of these two attempts was initiated during the days of General Zia-ul-Haq as a part of government's strategy to convert Pakistan into a model Islamic State. In this attempt the apparatus of Government including the Ministry of Finance, the State Bank of Pakistan (Central Bank), and the nationalized commercial banks were used for launching the Islamic banking experiment. Al-Omer and Abdel-Haq (1996) have provided details of the process. The process began when the government asked the Council of Islamic Ideology (CII) to prepare a blue print for an interest free economic system in light of the Islamic teaching. The CII in turn appointed of a panel of 15 experts to prepare the blue print. The report of the experts was submitted in February 1980. After extensive deliberations on the recommendations of the panel of experts, a modified report was submitted by the CII to the government in June 1980. In this report the CII presented a three year plan for the elimination of interest from the economy. The plan involved three phases: phase one which was envisaged to begin in July 1980, interest was to be eliminated from all specialized financial intuitions. In the second phase effective from July 1981interest was to be eliminated from bank operations, financial institution, and all domestic financial transitions. During this phase banks were to maintain a parallel system of Profit and Loss Sharing Accounts (PLS) in addition to the conventional accounts. The date of the third and final phase was set as July 1985 after which banks were not to accept any accounts based on interest. The actual implementation is discussed in detail by Mahmood (2002) which mentions the start of the process with the introduction of the Profit and Loss Sharing Accounts (PLS) in the nationalized commercial banks in 1981; this was followed by the introduction of markup based lending and the instruments of Participation Term Certificates as a substitute for banks loans in 1984. On 14 June 1984 the finance minister of the country in a speech announced that interest would be eliminated from domestic banking operations of the country effective from 1 July 2005. Consequent to the announcement by the finance minister, State Bank of Pakistan (SBP) issued a directive to the banks on 20 June 2004 in which it outlined the program to be followed by them in the final phase of *"cleansing the banking sector from interest"*. The final phase which began in June 1984 and was to be completed by the end of July 1985 involved the SBP issuing as many as 23 circulars for the elimination of interest from the economy. In reality, however, huge loopholes remained. While PLS accounts were introduced, fixed interest rate long term deposit accounts remained; Government debt continued to be fixed interest based; most of the Islamic lending remained markup based which were based on the interest mechanism. The instrument that for introduced for long term lending 'Participation Term Certificate' provided to be a legal nightmare for dealing with willful defaulters and was replaced with Term Finance Certificates.

While there was not much problem on the deposit side of the balance sheet, on the lending side the introduction of these instruments created a problem of moral hazard among the borrowers leading to the accumulation of substantial amount of bad debts. The gravity of the problem could be understood from the fact that towards the late 1990s all the nationalized commercial banks in Pakistan had become insolvent, and a huge injection of cash from the government was required to bail them out. During this phase of Islamization, a new form of corporate entity called Modaraba Company was also introduced. This step also proved to be a major disaster on account of a major flaw in the covenants of the Modaraba Ordinance, which was tilted in favor of the modari (the user of capital) rather than the provider of capital; this also created the problem of moral hazard in addition to the problem of asymmetric information. The consequence was the misappropriation and mismanagement of funds by the modari, as a result of which the Modaraba sector itself virtually collapsed.

The second attempt to prohibit/outlaw conventional banking was initiated by the judiciary through the legal apparatus of the Shariat Courts. This story begins in 1979 when General Zia-ul-Haq introduced the apparatus of the Shariat Courts. These courts were allowed to review the laws that were repugnant to the injunctions of Islam. Their remit however did not extend to the Constitution and the Muslim Personal Law. Initially these courts were also barred from looking into fiscal and financial laws for a period of three years. Later this period was further extended to ten years. When this period ended on 26 June 1990, a number of petitions were filed at the Federal Shariat Court challenging the legality of interest (and as a consequence, the various laws containing the provisions of interest). These petitions were immediately taken up for review. On 14 November 1991 the Federal Shariat Court delivered its judgment in which it equated Interest with Ribah and declared 23 financial laws as Un-Islamic. The court set 1 July 1992 as the deadline after which these laws would become void. The decision of the Federal Shariat Court was however not implemented as a number of appeals against the decision were filed with the Shariat Appellate Bench of the Supreme Court. For the next seven years nothing happened, as the appeals filed in the Shariat Appellate Bench of the Supreme Court were not heard until 1999. On 23 December 1999 Shariat Appellate Bench of the Supreme Court gave its decision in which it upheld the decision of the Federal Shariat Court of 1991. The bench also fixed two deadlines for the implementation of their judgment: 31 March 2000 was fixed as the deadline for some laws, and 30 June 2001 for the others. The judgment of the court also incorporated an action plan for the transformation of the economy within the given period. This involved the creation of a commission for the transformation of economy, and the constitution of a task force of Ministry of Finance for the implementation of their decision. In view of the past experience of the Islamic banking experiment initiated during the Zia-ul-Haq era, the government as well as the financial sector was extremely reluctant to implement the verdict of the Shariat Appellate Bench of the Supreme Court. Despite the setting up of the commission and the task force, not much progress was achieved towards the implementation of the judgment. When the second deadline of 30th June 2001 set by the Shariat Appellate Bench of the Supreme Court approached, one of the local commercial banks, United Bank of Limited filed a review petition in the Supreme Court of Pakistan against the decision of the Shariat Appellate Bench of the Supreme Court. The judgment of the review petition was rendered on 24 June 2002 in which the Supreme Court of Pakistan set aside the judgment of the Shariat Appellate Bench of 1999 and the judgment of the Federal Shariat Court of 1991, and remitted the case to the Federal Shariat Court for fresh determination in light of the contentions of the parties and the observations of the Supreme Court. Thus ended the twenty-year struggle by the government and the judiciary to annul interest from the economy.

Another interesting facet of the introduction of Islamic banking in Pakistan relates to the actual entry of full fledged Pakistani Islamic banks providing Islamic financial products and services in direct competition to those being offered by the conventional banks. Although Al Barka Islamic Bank entered the Pakistani market as a foreign bank in 1991, the size of its operations remained insignificant to be considered as a major competitor to the conventional banks. The first major Islamic bank to enter the Pakistani market was Al Meezan Investment Bank which was established in 1997 with the mandate to provide Islamic finance services all across Pakistan. Five years later in 2002, the Central bank (State Bank of Pakistan) issued the first Islamic banking license to the Bank which was subsequently renamed Meezan Bank. Four years later in 2006 two more locally incorporated Islamic banks Bank Islami and Dubai Islamic Bank entered the market. At present Pakistan has a dual system of banking like Malaysia where the conventional and the Islamic banks directly compete with each other. In Pakistan Islamic banking services can be provided by: one, full fledged Islamic banks; two, Islamic banking subsidiary of conventional banks; three, designated Islamic branch of conventional banks; and four, Islamic banking counters in the branches of conventional banks. Presently there are five locally incorporated Islamic banks (Meezan, Dubai Islamic, Emirates Global, Dawood Islamic, and Bank Islami) and one foreign Islamic bank (Al Barka). Up till now, none of the conventional banks have set up separate Islamic banking subsidiaries, but quite a few have set up designated Islamic branches, and Islamic banking counters in conventional bank branches. Some time ago, a few of the major conventional banks launched a mass campaign to sell Islamic consumer financing products like Auto Ijara via Islamic counters of their conventional branches. This initiative of the conventional banks to enter the Islamic banking market through the Islamic banking counters of their conventional branches was nipped in the bud by the Central bank which ruled that conventional banks are allowed to sell Islamic banking products only through full-fledged specialists Islamic branches or Islamic subsidiaries. The activities of the Islamic banking counters of conventional bank branches are limited to acceptance of deposits and disbursement of cash to the account holders.

3. Consumer Perception of Islamic Banking

3.1. Literature Review

The emergence of Islamic banks as a separate entity with an alternate portfolio of products and services competing directly with those of conventional banks is a relatively new phenomenon. The Mit Ghamar experiment in Egypt in 1963 is generally considered as the point of emergence of Islamic banking. It was however the establishment of Dubai Islamic Bank in 1975 which may be deemed to be the point of emergence of modern Islamic banks as an alternate entity competing directly with the conventional banks. El-Qorchi (2005) has estimated the size of Islamic banking industry as being in excess of $250 Billion with over 300 banks operating in 75 countries around the world. He estimates the growth rate of the Islamic banking industry at 15% which makes the present estimate of the size of Islamic banking industry in the region of $400 Billion. Despite the size and growth of this industry, there are very few research studies examining the attitudes, perceptions, and knowledge of Islamic modes of finance (primarily those offered by Islamic banks). Gait and Worthington (2007) have provided an excellent empirical literature review of these comparatively few studies of customer attitudes, perceptions, and knowledge of Islamic modes of finance. Unfortunately none of these studies pertain to Pakistan, implying a gap in research that needs to be filled.

Knowing the factors that reflect the attitudes, perceptions, and knowledge of the customers of Islamic banks are important because these factors determine how and the extent to which the individual consumers and business firms chose to patronize the alternative products and services of the Islamic banks. Gait and Worthington (2007) have organized the literature on the attitudes of customers towards Islamic finance into three categories: one, individual customer's attitude towards Islamic finance; two, business firm's attitude towards Islamic finance; and three, financial institution's attitude towards Islamic finance; The crux of their conclusions is that while religious conviction is a logical key determination of the use of Islamic finance, it is not the only concern; most customers also give due regard to the reputation, service quality, and pricing as important considerations in determining their patronage of a particular financial institution. While in the case of individual customers, religious convictions also seems to play a role, the evidence from the studies related to business firm's suggests that the selection criteria of the majority of the business firms is the same as that used for the selection of conventional banks. This has important implications for the Islamic banks vis-à-vis their ability to complete with the conventional banks for the business accounts.

In the context of the Pakistani market, two points need to be noted: one, the review of literature by Gait and Worthington (2007) did not have reference to any study on the attitudes of Pakistani customers regarding Islamic banking which points to a knowledge gap that needs to be filled; two, the Pakistani customers are a bit different from those in the other Muslim countries. The reason for the difference primarily relates to the two attempts by the government and judiciary to terminate/outlaw the conventional banking system and replace it with its conception of an Islamic banking system, as a consequence of which the debate on the pros and cons of Islamic banking has been, and still remains a hot topic in the media. People in Pakistan are therefore generally more aware of Islamic banking. They are also not afraid to question the de-jure difference but the de-facto similarity between the Shariah compliant Islamic banking products and services and their conventional banking counterparts. When subjected to criticism, the interest groups representing the Islamic banks tend to take refuge by passing on the criticism to the Islamic banking products that were introduced in Pakistan during the days of Zia-ul-Haq as being flawed, and their own services and products do not have those flaws which reflected by the fact that they have been authenticated by their Shariah advisors as being halal. But when their own products and services are subjected to the criticism that although their products and services may be de-jure different from their conventional banking counterparts, de-facto they are the same because they are based on the same time value pricing formula and the same benchmark interest rates, the standard reply that the Shariah advisors of these banks tend to give is that the McDonald Burger sold in Pakistan is halal while the same burger sold in New York is haram. Such senseless rationalization has created a certain degree of skepticism or should one say agnosticism about Islamic banking. The question that need to be examined is do the customers of Islamic bank believe in the truthfulness of the Islamic bank, because it appears that the choice of patronizing Islamic banking seems to have become a matter of one's faith rather than the outcome of one's rational decision making process. The following excerpt from Al-Omer and Abdel-Haq (1996, p.58) illustrate the point:

> *as to the question whether, in their opinion, the JIB was working under Islamic Law, some answered positively, while others equivocated, saying 'Even if it does not exist, Allah will punish them. We trust them to make halal profit and this is what they say that they will give us. But if they do something else it is they who will be punished by Allah, not us, because we have the good intentions to work with Shariah '*

Two studies examining the perceptions of Pakistani customers regarding Islamic banks are worth discussing. The first study is by Jalees and Kamal (2007) who used Akers five determinants in their study to measure the brand image of Islamic banks. The results of the study indicate that the brand image of Islamic banks is not high, implying that the Islamic banks may be progressing because of the patronage provided by the government, and that their current high growth rate may be an aberration because of their relatively small size compared to the total size of the Pakistani banking market. The implication of the study, being that Islamic banks need to think on developing their brand image if they want to succeed in the long run.

The second study worth discussing is that by Azeemi et.al. (2004) which was aimed at examining the awareness of the customers towards Shariah-based financial system. The study was based on a questionnaire survey of 100 respondents conducted in Karachi. The ‘overall awareness’ was measured in the context of four sub-dimensions: awareness, differentiation, obstacles, and acceptability. The first of these sub-dimensions ‘awareness’ covered statements for assessing the self perception of respondent’s regarding their knowledge of Shariah based financial system (SBFS) and their perception regarding the reasons for the lack of awareness among the general public regarding the Shariah based financial system . A five point scale was used for evaluating the responses. The second sub-dimension ‘differentiation’ covered statements involving the respondent’s perception regarding the product differentiation between conventional and Islamic banking products. The third sub-dimension ‘obstacle’ covered statements regarding the possible reasons hampering the growth of Shariah based financial system. The final sub-dimension ‘acceptability’ covered possible steps that could be taken for improving the acceptability of Islamic finance. The study is useful in terms of the measurement of respondent’s perception regarding each of the individual sub-dimensions of awareness. The combining the four sub-dimensions into a single measure of ‘overall awareness’ is however problematic. Moreover, each of the individual statements were aimed at soliciting the respondent’s opinion (agreement or disagreement using a 5 point scale) on the statements, and not aimed at evaluating the respondent’s level of knowledge/awareness regarding the Shariah based financial system. The conclusion of the study that the overall awareness level of our society members towards Shariah based financial system is not high is therefore debatable. The descriptive statistics of the study however have value in terms of providing us an insight into the perceptions of Pakistani people regarding the four sub-dimensions of awareness outlined above. The study is also important because some of the questions of the survey discussed in this paper were adopted from this study. Having delved into some of the literature on consumer perception, the next section proceeds with the actual survey undertaken for the study on the consumer perception of Islamic Banking in Pakistan.

3.2. The Survey

3.2.1. Introduction to the Customer Survey

This section covers the consumer survey undertaken to examine the customer perception of Islamic Banks in Pakistan. The study is based on a questionnaire survey undertaken in the last quarter of 2007. The respondents were banking customers, half of whom were customers of Islamic Banks. The sample size was 100; half of the forms were filled at the branches of conventional banks, and half at the branches of Islamic banks. The survey was restricted to Karachi only. The basis of the choice of sample was convenience sampling. The relatively small sample size and the choice of convenience rather than random sampling were on account of the constraints of resources and time. It was a broad based survey covering a number of questions soliciting the views of the banking customers regarding Islamic Banking.

The questionnaire comprised of three sections. Section one consisted of ten questions related to the demographic data of the respondents. Section two also consisting of ten questions that examined the banking practices of the respondents. Some of the responses of this section have been discussed in the next section on the background information of the respondents banking practices. The third section was on the perception of the respondents towards Islamic banking. This section consisted of 15 statements regarding Islamic banking, some of which were quite provocative. A five point rating scale was used to evaluate the respondent's perceptions regarding the statements with 1 being strongly disagree and 5 being strongly agree. It was the third section that was used for formulating the three hypotheses which are noted below:

1. The respondents consider themselves to have adequate knowledge of the Shariah based system;
2. Banking customers are skeptical regarding the truthfulness about Islamic banking;
3. Religion is low in priority with regard to the choice of bank.

In view of the sample size of 100 respondents and the normal distribution of data, the hypotheses were tested using Z-tests. In all the three cases the Z-calculated values were greater than the Z-critical values; all three of the hypotheses were therefore accepted.

3.2.2. Background Information of the Respondents Banking Practices

Choice of Bank for Maintaining Account

The respondents were asked (1) whether they bank with conventional bank or Islamic bank, and (2) their preference between the two types. The reason for asking these two questions was to ascertain the gap between the respondents' actual practice and their preference. The summarized results are presented below:

Table 1
Types of Banks for Maintaining Account

Islamic Banking	Conventional Banking	Both
30%	50%	20%

Table 2
Preference Regarding the Choice of Banks

Islamic Banking	Conventional Banking	Both
30%	60%	10%

The survey involved 100 questionnaires half of which were administered at the premises of Islamic banks and half at the premises of conventional banks. The results indicate that questionnaires administered to the clients of the conventional banks did not have accounts in Islamic banks, which implied that they preferred conventional banks to Islamic banks. But of the 50 questionnaires administered to the clients of Islamic banks, 20 of them also had accounts at conventional banks; half of these preferred the services of conventional banks to Islamic banks, while the other half were indifferent between the two. People who maintained accounts only at Islamic Banks did so because of their preference of Islamic modes of finance over the conventional modes.

Rationale for the Choice of Banks for Saving/Deposits

The respondents' opinions were obtained on: (1) the factors they consider important for their choice of bank for savings; and (2) the type of deposit/saving account maintained by the respondents. The summarized results are presented below:

Table 3
Type of Deposit/Saving Account Maintained

Checking Account	Short term Investment	Long term Investment
50%	37.5%	12.5%

Table 4
Rationale for the Choice of Bank for Savings/Deposits

High Return	Low Risk	Religion	Better Service
33.33%	40%	13.33%	46.67%

This is a very interesting finding, priority of religion as the basis for the choice of bank is quite low. Only 13.33% of the respondents noted religion as the basis for the choice of bank. Considering that 30% of the respondents stated their preference for Islamic Banks, this amounts to an equivalent of 45% of these consumers, which means that the remaining 55% of the respondents who stated their preference for Islamic banks prefer them for the other reason. Among the reasons, the most important was the quality of service, followed by low risk; high return is also lower in priority (33%) because 50% of the respondents use the banks for maintaining checking account in which the primary aim is generally convenience, liquidity, and quality of service rather than investment for maximizing their returns.

Rationale for the Choice of Bank for Borrowing

Respondents' opinions were obtained regarding: (1) borrowing from banks; (2) reasons for borrowing; and (3) the factors that that influence their choice of banks for borrowing decisions. The summarized results of their responses are presented below:

Table 5
Consumer use banks for borrowing

Yes	No
60%	40%

Table 6
Reasons for borrowing

Personal Loans	House Finance	Car Finance
17%	13%	50%

Table 7
Factors influencing the choice of bank for borrowing

Low Cost	Better Service	Religion	Easier Documentation	Publicity
33%	25%	8.33%	17%	16.67%

From the viewpoint of borrowing from the banks, automobile loans (Auto Ijarah in case of Islamic banks) have substantially higher demand compared to personal loans, and housing finance. In terms of the factors influencing the choice of banks for borrowing, cost or interest rates (profit rates in case of Islamic banks) is by far the most important consideration for the choice of bank. This is followed by the quality of service, documentation procedure, and publicity in that order. The least important criteria for the choice of bank for borrowing is religion. The implication of this finding for the Islamic banks is that if they want to succeed then they need to think in terms of providing their clients with a better quality of service and lower servicing cost, rather than directly or indirectly censuring conventional banking by constantly referring to ribah or using the term halal profits as their unique selling proposition. They need to stress on the quality of their services and the value addition that their products and services provide.

3.2.3. Hypothesis Testing

Hypothesis One: Respondent's self perception regarding the adequacy of knowledge of Shariah based financial system

Adequate knowledge of Shariah based financial system refers to the respondent's self assessment of their understanding of the fundamental principles of a Shariah based financial system, and the difference between Shariah based and conventional financial system. Some bankers representing Islamic banks lament that the lack of awareness of Shariah based financial system among the banking customers was a major drawback hampering the growth of Islamic banking in Pakistan. This hypothesis not only tests this claim of these bankers vis-à-vis self perception of the customers, but is also aimed at evaluating the competency of the respondents to evaluate the truthfulness of Islamic banking which is the focus of hypothesis two. To evaluate the respondent's self perception of their competency, the following hypothesis was formulated:

H1: The respondents consider themselves to have adequate knowledge of Shariah based financial system.

Ho: $\mu 1 \geq 2$ (those who do not disagree consider themselves to have adequate knowledge of the Shariah-based financial system)

The hypothesis was tested through Z-test one sample and the summarized results are presented below:

Table 8

	Overall
Mean	2.93
Observations	100
Hypothesized Mean (μ)	2.0
Standard deviation	1.32
z-cal	7.05
z Critical one-tail	-1.67

The hypothesis that the respondents consider themselves to have adequate knowledge about Islamic banking was accepted. At 95% confidence level the Z critical value was -1.67, whereas the Z-calculated value was 7.05 which fall in the non-critical region.

The results of the above hypothesis are based on the combined effect of two questions: one, familiarity with the fundamental principles of Shariah based financial system; and two, the respondent's awareness/ knowledge of the difference between the conventional and Shariah based financial system. The summarized results of these two questions and their analysis are separately presented below:

Figure 1
Familiarity with the fundamental principles of Shariah based financial system

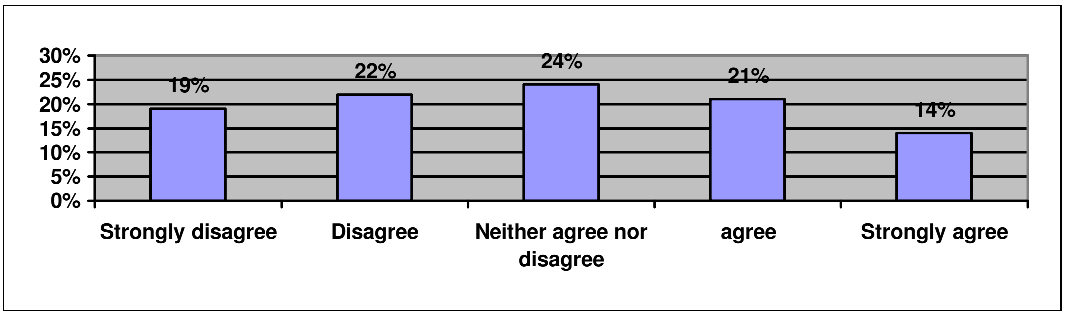
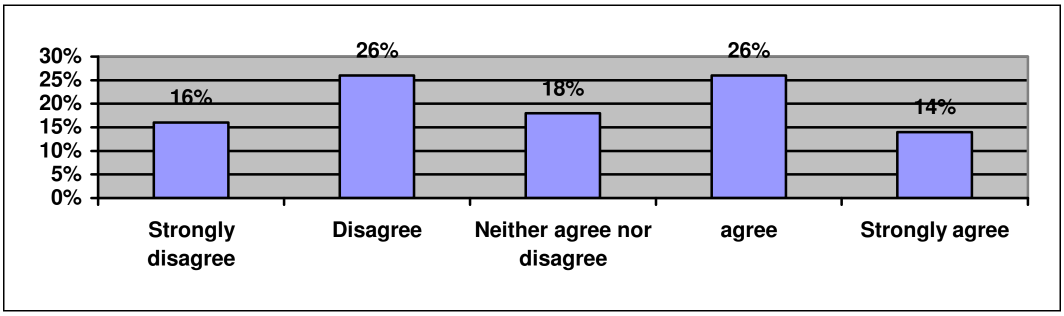


Figure 2
Awareness/knowledge of the difference between conventional & Shariah based financial system

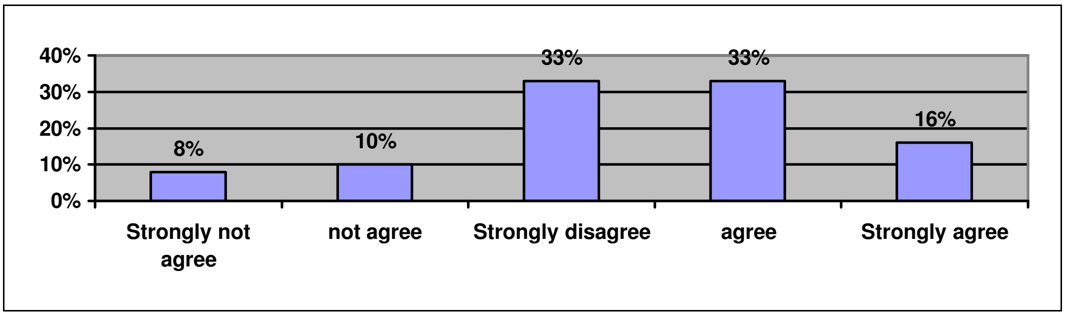


About 41% of the respondents consider themselves uninformed regarding their understanding of the fundamentals of Shariah-based financial system. The proportion is almost the same (42%) when compared with the respondents who consider themselves inadequate in terms of their understanding of the difference between conventional and Shariah-based financial system. The respondents who are in the neutral zone (neither agree nor disagree) have not been included the category of the inadequately knowledgeable respondents because they consider themselves sufficiently knowledgeable not to disagree with the statement.

This hypothesis is also important because the potency of the subsequent hypothesis (hypothesis two) regarding the truthfulness of Islamic Banking is very much dependent on the conviction of the respondents regarding their opinion as being that of a knowledgeable respondent as against that of a layperson.

While most people seem to have a broad insight into the basic principles of Shariah based financial system which are generally described as prohibition of Ribah, and sharing of returns based on profit and loss, there is a bit of a confusion in the mind of general public regarding the structure the instruments of financing used by the Islamic banks. This is primarily on account of the use of Arabic terminology which is used as a label for Islamic banking products. A supplementary question was therefore added to get the insights of the respondents regarding the predisposition of the Islamic banks towards the use Arabic labels for the financial products being marketed by them. The respondents were asked whether replacing Arabic terminology, i.e. 'Ijarah' with 'leasing' or 'Musharakah' with 'equity participation', would lead to a greater understanding of the Shariah-based Financial System. The summarized results of their answers are presented below:

Figure 3



The results point to one of the problematical areas of Islamic banking which is the predisposition of Islamic banks to use Arabic labels for their financial products that makes them incomprehensible for the consumers. Financial products are not divine revelations for which Arabic labels are necessary. Use of Arabic labels may give these products a mystique and convey a religious feel to it, but it makes the instruments non-transparent which is contrary to the tenants of fairness. Almost half (49%) of the respondents showed their preference for changing the names of the instruments to what the users of banking channels can understand. A small minority (18%) preferred the Arabic terminology. A surprising 33% had no opinion on the issue.

Hypothesis Two: Respondents skepticism regarding the truthfulness of Islamic banking

The focus group discussions undertaken for the development of the questionnaire revealed that that the consumers are skeptical regarding the truthfulness about the Islamic banking. The hypothesis formulated in this context is presented below:

H2: The respondents are skeptical about the truthfulness of the Islamic system.

> Ho: $\mu 1 \geq 2$ (those who disagree believe that the products and services of Islamic Bank are truly Shariah compliant)

This hypothesis was also tested through Z-test one sample; the summarized results are presented below:

Table 9

	Overall
Mean	3.82
Standard deviation	1.20
Observations	100
Hypothesized Mean	2.0
z-cal	15.04
z Critical one-tail	(1.67)

The hypothesis relating to the respondent's skepticism regarding the truthfulness of Islamic banks was substantiated. At 95% confidence level, the Z- critical value is -1.67, whereas the Z-calculated value was 15.04 which fall in the non-critical region.

The results of the above hypothesis were based on the combined effect of two statements on which the respondents' were asked to give their opinions in terms of their degree of agreement or disagreement. The first statement was "Shariah-based banking and the conventional banking system are basically the same the only difference being the profit 'Shariah' label", and the second statement was "Service charges & profit margin etc. charged against Shariah based financial products are a form of interest". The response of the respondents and the interpretation of results are discussed below:

Figure 4
Shariah-based banking and the conventional banking system are basically the same the only difference being the profit 'Shariah' label

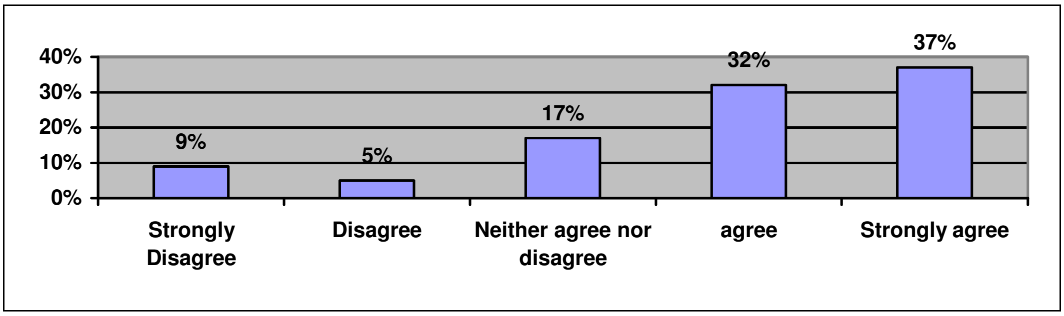
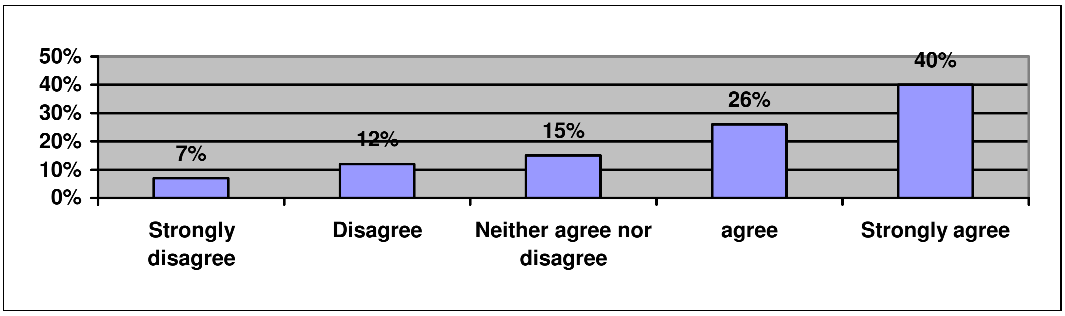


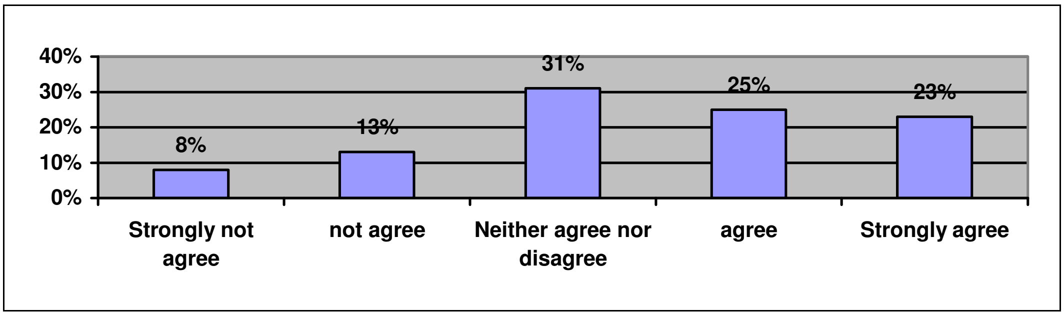
Figure 5
Service charges & profit margin etc. charged against Shariah based financial products is a form of interest



This is perhaps the most significant finding of the survey. The two questions asked were very similar. In the first question a certain amount was ambiguity was allowed in the interpretation of the question by the respondents, but the second question was very clear and bang on target that the profit charged by the Islamic banks was a form of interest, implying that if interest was ribah, the same could be said of the profit connected with the products of the Islamic banks. Putting it another way, these two questions were aimed at soliciting the customer's perception regarding the very validity of the whole edifice of Islamic banking. The respondent's opinion in this regard was very clear. Only 14% disagreed with the first question. In the case of the second question in which the profit of the Islamic banks was equated to interest, only 19% disagreed compared to 66% who were in agreement with the notion.

To corroborate the general skepticism of the respondents towards Islamic banking two more supplementary questions were asked, one related to the extent of Shariah compliance by the existing products of Islamic banks, and the other was on the futility of converting the existing banking system to Shariah based banking. Again the modus operandi of the questions was the use value judgmental statements to solicit the response of the respondents in terms of their agreement or disagreement to the statements. The response of the respondents and the interpretation of their response are summarized below:

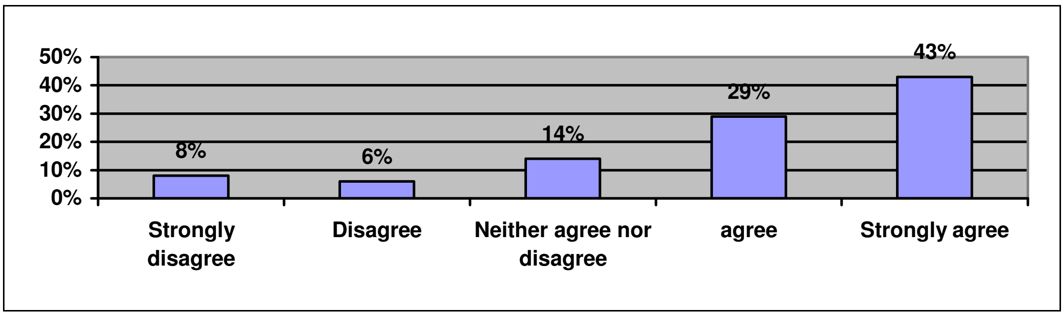
Figure 6
The existing Shariah-based financial services/products are not yet fully Shariah compliant



This question perhaps allows us to understand the reason for the consumer's skepticism regarding the truthfulness of Islamic Banking (Hypothesis 2). Although the Shariah Advisors of the Islamic Banks have validated the products of Islamic banks as being Shariah compliant, the general public (48%) has its doubts. This implies the existence of credibility deficit in the authority of the Shariah advisors of the Islamic banks.

This is in comparison to 21% who affirm their faith in the word of the Shariah Advisors. Another interesting aspect of the response was the very high number of respondents (31%) who are unsure about their response, which is markedly different from their response in the case of skepticism regarding the truthfulness of Islamic banking. Perhaps it is a reflection of the general attitude of the Muslim consumers who tend not to speculate on religious interpretations even when they have doubts regarding the reliability of those interpretations by the religious scholars.

Figure 7
The existing banking system cannot be replaced with Shariah-based financial system



This question was important because of the constant pressure from the religious lobbies which includes the political parties based on Islamic ideology, Islamic banks especially their Shariah advisors, and religious scholars. This lobby has been very vociferous in its demand for the replacement of the current interest based banking system with a non-interest based Islamic banking system. It has primarily been the pressure of this lobby that has been at the back of the two futile attempts to transform the present banking system into a Shariah based financial system. This question was aimed at soliciting the response of the general public regarding the non-feasibility of such an endeavor. Only 14% disagree with the statement, which is a reflection of the extent of disagreement between the general public and the religious lobby. Although we did not investigate into the reason for the response of the overwhelming majority of 72% who agreed with the statement that the existing banking system cannot be replaced with Shariah-based financial, but it is apparent that this skepticism is directly connected with their skepticism regarding their perception of the Islamic banks and the banking products being marketed as being Shariah compliant.

Hypothesis Three: The importance of religion as the basis for the choice of bank

Literature on attitudes of consumers towards Islamic banking reveals that religious conviction although a key logical reason is often not the only basis for the selection of banks; other considerations include banks reputation, service quality, pricing, convenience, etc. (Giat and Worthington, 2007). Brand image is also a very important feature of the selection criteria of consumers. Jalees and Kamal (2007) in their study on the brand image of Islamic banks found that the brand image of Islamic banks was not high, implying that they may be progressing because of the patronage provided by the government. The hypothesis developed in this context is presented below:

H3: Religion is low priority for with regard to the choice bank.

Ho: $\mu 1 \geq 2$ (respondents who do not agree with the statement are those for whom religious motivations are the key to the determination of bank for saving)

The hypothesis was tested through Z-test one sample, and the summarized results are presented below:

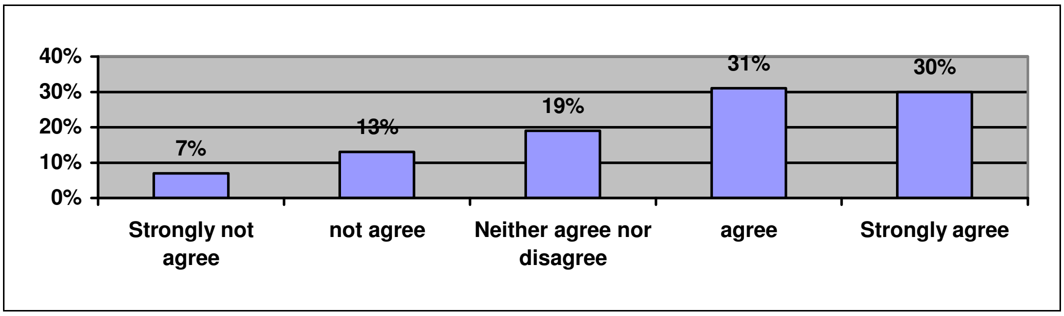
Table 10

	Overall
Mean	3.64
Observations	100
Hypothesized Mean	2.0
Standard deviation	1.20
z-cal	13.67
z Critical one-tail	-1.67

The hypothesis relating to religion being low priority for selecting the bank was accepted. At 95% confidence level the Z-critical value is -1.67 whereas the Z-calculated value was 13.67 which fall in the non-critical region.

The qualitative analysis of the respondents' opinion on the importance of religion for selecting the banks is presented below:

Figure 11
I would prefer the one that has a brand name than Islamic only bank, without the brand name



This question should be interpreted in conjunction with the following tables which pertain to (1) Ranking of the factors influencing the choice of banks for saving/investing; (2) Ranking of factors influencing the choice of banks for borrowing. Respondent opinions on these two issues are presented below:

Table 11
Factors influencing choice of bank for saving/investing

High Return	Low Risk	Religion	Better Service
33.33%	40%	13.33%	46.67%

Table 12
Factors influencing choice of bank for borrowing

Low Cost	Better Service	Religion	Easier Documentation	Publicity
33%	25%	8.33%	17%	16.67%

These two questions which were based on ranking scale not only substantiate hypothesis three, but also provide an explanation of the other important influences behind the choice of bank like returns, risk, quality of service, publicity, etc.

4. CONCLUSIONS

In drawing conclusions from the results of the study one has to consider the limitations of the research, which includes the relatively small sample size, and the use of convenience rather than stratified random sampling. Also important is the fact that the research was limited to Karachi only where the population is generally more educated and well informed compared to that in the rest of the country. Instead of generalizing the results, the study it should be viewed as a direction flag for focus of future studies in the area of Islamic banking. Previous studies that examined consumer perceptions regarding Islamic banking were aimed at understanding the factors that determine how and the extent to which the individual consumers and business firms chose to patronize the alternative products and services of the Islamic banks. The significance of the study is that it is perhaps the first study, which takes a critical analysis of Islamic banking by examining the perceptions of the banking consumers. Academicians who generally write on the subject are those who have vested interest in maintaining the existing version of truth. Anything that has a religious label attached to it becomes hallowed and gains its legitimacy because of the reluctance of the scholars and academicians to question the legitimacy of those truths. Despite the legitimacy provided to Islamic banking by the Shariah advisors, the reality is that the general public in Pakistan has doubts about the legitimacy vis-à-vis Shariah compliance of Islamic banking products and services. De-jure they may be Shariah compliant, but de-facto they are no different from their conventional banking counterparts. It is therefore imperative that the Islamic banks instead of focusing their advertizing and promotional blitz on the negativities of conventional banking through the use of terminology like ribah, gharar, halal profits, Shariah compliant, etc., need to direct their attention towards developing their brand image by concentrating their efforts towards developing their core competencies in the areas that influence the customer's decision to patronize a bank (factors like service quality, lower cost, customer friendly staff, efficiency, etc.). Otherwise the Islamic banks will remain a niche rather than a mainstream player even in Muslim majority countries.

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