

## WHY DO CUSTOMERS PATRONIZE ISLAMIC BANKING IN MALAKAND DIVISION, KHYBER PAKHTUNKHWA

**Adnan Khan**, Department of Commerce & Management Sciences, University of Malakand, Pakistan. Email: [adnan.ilink@gmail.com](mailto:adnan.ilink@gmail.com)

**Arshad Ali**, Department of Commerce & Management Sciences, University of Malakand, Pakistan. Email: [arshaduom@gmail.com](mailto:arshaduom@gmail.com)

**Zahid Ali**, Department of Commerce & Management Sciences, University of Malakand, Pakistan. Email: [zahidzady@yahoo.com](mailto:zahidzady@yahoo.com)

**Arifullah**, Accountant, Pakistan. Email: [Uarif.hmc@gmail.com](mailto:Uarif.hmc@gmail.com)

**Abstract.** *Banks play a vital role in the socio-economic development of a country. Like in other parts of the world, Pakistan has a dual banking environment with intense competition. Knowing the key triggers of patronage factors is of the utmost importance. The study aims to identify the key factors contributing to Islamic banking patronage factors in the Malakand division, Khyber Pakhtunkhwa, Pakistan. 280 customers of full-fledged Islamic banking or conventional banking with Islamic window were selected for the study. Data were collected through a self-administered questionnaire designed based on previous studies. Five points Likert scale range from very important to not important was used. Descriptive statistics and Friedman's test were used to identify the factors associated with Islamic bank selection and their degree of importance. The results of the study revealed both religious and non-religious factors are considered by customers before opting for Islamic banking. Among the variables religiosity was the most important predictor of Islamic banking, followed by friendly and cooperative staff, Shariah-compliant products, ATM facilities, and referral by friends and family. However, banking hours cost of financing, and return on investment were given less preference by customers. Results of the study are expected to benefit the bank officials at large as most of the population lives in rural areas of Pakistan. According to the Pakistan Bureau of Statistics, 67% of the population of Pakistan consists of rural while in KP 83.1% accounts for the rural population. Furthermore, the government authorities could also get more fruitful results by focusing on the factors identified in the study before devising any strategies for rural areas.*

Received 5 November 2020

Accepted 12 December 2020

**Keywords:** Islamic Banking, Non-Religious Factors, Patronage, Religiosity, Riba, Shariah Compliance,

## **1. Introduction**

Bank as a fundamental part of the modern economy, plays a vital role in the lives of the masses by smoothing their routine and business transactions. Keeping in view the role and place of the banks in the economy, investors rush to invest in this segment of the economy. The pace and speed of growth in the banking sector in general and Islamic banking in specific have been reported by various studies. The demand for Muslim customers arose Islamic banking evolved (Yudistira, 2004).

The advent of Islam originated the concept of Islamic finance. Quran is the primary source of guidance, and emphasis its followers to follow its teachings in every field of life. In compliance with the teachings of Islam, and to fulfill the religious obligation and social wellbeing, various attempts were made to replace the interest-based banking system with Islamic banking. Some Islamic countries were successful in the early 70s of the last century (Abdel-Magid, 1981).

Similarly in Pakistan, the government attempted to overcome the hurdles in the way of Islamic banking by amending the banking Company Ordinance 1962 in the early 80s (Mehmood, 2002). BCD circular was issued to eliminate Riba in 1984 by SBP and directing all public, the central and provincial government interest-free to make arrangements for interest free banking by January 1985 (Shamshad, 2007). However, since 2002, rapid growth in IB industry has been seen in Pakistan. Key partners in banking sectors have launched full-fledged Islamic banking or at least Islamic banking window in the country (Mansoor & Bhatti, 2008). Dual banking environment in the world instigated competition among conventional and Islamic banks. The products of both are close-substitutes of each other, thus giving more options to customers' to opt for. Resemblances in the products with slight variation i.e. in cost or benefits of each intensified the competition. Similarly, in Pakistan Islamic banking is in the introduction stage with strong competition in a dual banking environment (A. G. Awan & Azhar, 2014). The aim of the study is to determine the factors behind Islamic banks selection in the Malakand division KP. Furthermore, a detailed investigation is carried out to find why customers' opted Islamic banking. The factors are divided into two major segments of religious items and non-religious items. A self-administered questionnaire was designed to know that Islamic banking is opted by customers for religious purposes only or some other aspects are being considered by customers while selecting Islamic banking in the region. Friedman's test, one-sample t-test,

descriptive statistics, and consumer demographics analysis were used to get the results.

The study is beneficial to society at large as the majority of the population lives in rural areas, and the target population also belongs to rural areas. In addition to society, the study is also important for the policymakers to devise the strategies in light of the results of this study and attract more and more customers (Resources). Knowing the intentions and key triggers of the intentions are of utmost importance for the government, before launching any program for rural development. This study is serving as a tool to help the government devising strategies. Moreover, the business community in the region is benefited by know the key elements of the decisions made by the customers who opted for Islamic banks. Besides its practical implications, this study is adding to the existing literature on the area. Previous studies attempted to explore the area from one aspect or another in urban areas of the country, this study is designed to target the rural population of the economy. According to the World Bank report, 35% of the total population lives in urban areas while 65% in rural areas. In Khyber Pakhtunkhwa, 83% of the total population consists of rural while remain 16.90% live in urban areas and big cities (Pakistan Bureau of Statistics). Furthermore, the rural populations of Khyber Pakhtunkhwa are more religious in nature and more inclined to the religion, which further strengthens the need for this study. It was found that customers opted for Islamic banking due to diverse factors i.e. a mixture of religious and non-religious factors. Although religiosity and religious factors were given more importance by the customers, staff cooperation, speed, efficiency, ATM Network, and Bank image and reputations were also considered by customers.

## **2. Literature Review**

Intense competition among the banks gives more choice to customers to opt for one over the other bank. Various studies endured investigating the key factors behind customers' patronage of Islamic banking. Broadly two perspectives have been developed to determine the factors. Some of the authors reported religious belief a key driver among others to attract customers towards Islamic banking (Mansour, Ben Abdelhamid, Masood, & Niazi, 2010; Metawa & Almassawi, 1998; Mukhtar & Butt, 2012; Naser, Jamal, & Al-Khatib, 1999; H. S. Okumus & Genc, 2013). Metawa and Almassawi (1998) reported two important variables enabling customers to opt for Islamic banking in Bahrain were compliance with Islamic teachings and rate of return. Naser et al. (1999) reported that 73% opted for bank reputation, while 70% opted for religious beliefs as Islamic banking section criteria. Another similar study in turkey analyzed the responses of 286 customers and revealed that religious principles,

financial institutions with no interest and availability of various products, efficiency and speed in services, and return were the highest priority of the customers respectively (H. S. Okumus & Genc, 2013). Religion was found as influential patronage factor in customers of Islamic banks (Mukhtar & Butt, 2012). Similarly, other authors also concluded Religious factors to be the most prominent factors in the selection of Islamic banks.

While the other group of authors was of the view that only religious values are not the causes of Islamic banks' choice. Erol and El-Bdour (1989) examined factors behind Islamic bank selection in Jordan, found profit to be the key determinant of Islamic bank selection. Low service charges flowed by nature and the reputation of Islamic banking were key indicators in opting for Islamic banking Mansour et al. (2010). Similarly, another study examined the attitude and selection criteria of Islamic banks. The results revealed that Muslims would prefer for religious and profitability basis, while, non-Muslims would opt for Islamic banks with more branches (Gerrard & Barton Cunningham, 1997). The results of the study on the Islamic home financing section in Malaysia discovered the key factors of quality of service, religious beliefs, advertisement, bank image & reputation, and social influence (Ismail, Azmi, & Thurasamy, 2014). Customers opted for Islamic banks considering product quality and religiosity (Al-Tamimi, Lafi, & Uddin, 2009).

Similarly, another study attempted to examine the relationship among religiosity, religious preferences, and age of the firm and adaptation of Islamic financing intentions in Uganda. The study was based on the fact to identify the core contributors towards Islamic financing patronage. The data was collected from customers of Islamic financing. The sample of the study was 382, selected in the light of the Krejcie and Morgan (1970) Table method. The theoretical base of the study was the Unified theory of acceptance and use of technology (UTAAUT). It was found the religiosity has a more significant association followed by religious preferences and firm age while an insignificant relationship was found with ideology (Bananuka et al., 2020).

Like in the rest of the world, various authors examined why customers opted for Islamic banks in Pakistan. H. M. Awan and Shahzad Bukhari (2011) assessed the customers in the big cities of Pakistan. The results revealed that similarities exist between the customers of Islamic banks and Islamic banking windows in conventional banks. Furthermore, differences were reported in different geographical locations. Religious thoughts were the primarily driven force followed by secrecy, expertise, competence, and frankness of staff as key factors in customers from Karachi. Similarly, the customers in Lahore preferred Islamic banks based on the profitability, low service charges, more financing options, and lowest priority to the image of the bank. Another study on the

motivational factors to opt for an Islamic bank in Pakistan conclude that Shariah compliance to be on the top priority followed by, ease, technological advancement, and capital protection (Lee & Ullah, 2011). Another research in Peshawar reported Cost efficiency, ease and facilitation, and self-motivation were preferred by banks over the other factors like religion and family and friends influence (Asif, Shah, Afeef, & Ahmed, 2016). A study on bank accounts opening with Islamic banks in Pakistan reported branches network, products range, efficiency, and easy approach to banks were key determinants in Pakistan (Israr, Qureshi, & Butt, 2018). Similarly, Hussain, Aslam, and Bugti (2020) conducted a study in Pakistan to examine the degree of customers' satisfaction and selection mechanism towards Islamic banking. 350 customers of Islamic banks were selected for the study through a convenient sampling method. Competence, convenience, commitment bank image, Shariah compliance, and compassion were the independent variables. Their impact was examined on satisfaction. It was found the convenience and commitment were more influential in opting for Islamic banking while compassion and Shariah compliance were more significant in the degree of satisfaction.

Based on the above literature it could be summarized that the results of various studies on the topic under consideration given different results based on social class, financial position, and working environment in the different parts of the world. Specifically, in Pakistan, all studies targeted the urban and sub-urban areas in research. Providing basis to this study to examine the factors behind Islamic banks selection in customers in rural/suburban areas of the Malakand division.

**H1:** Religious and Non-religious factors are the main contributors to the selection of Islamic Banks in the Malakand Division.

### 3. Conceptual Framework

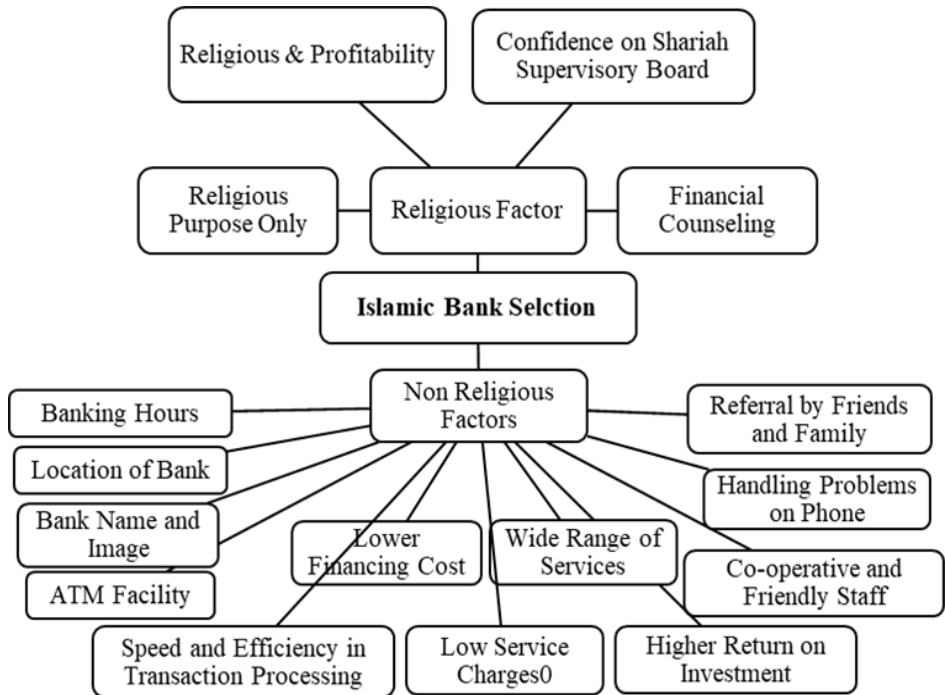


Figure 1 Conceptual Framework

### 4. Methodology

#### 4.1 Population of the study

The objective of the study is to identify factors contributing to Islamic banking selection in the Malakand division. To achieve the objective the target population of the study is customers of full-fledged Islamic banks and conventional banks with Islamic windows in the Malakand division, Khyber Pakhtunkhwa province.

#### 4.2 Sampling

The total population was divided into strata based on the geographic location of the division into districts. A stratified random sampling technique is used to determine the sample size out of the targeted population. Three districts of the Dir. Lower, Swat, and Malakand were selected for the study. Then a total of 280 customers of Islamic banks or conventional banks with Islamic windows were randomly selected with the help of the customer's lists provided by the bank officials situated in the study region.

### 4.3 Data collection

Data was collected through a self-administered questionnaire adapted from the previous studies. A questionnaire was further divided into two sections. Questions regarding customer's demographics were asked in the first part of the questionnaire. Socio-economic information of the customers like age, address, education, income level, and experience in years with banks was asked in its part. The second part consists of questions regarding why they opted for Islamic banks collected from previous literature. Five points Likert scale was used from very important to not important.

### 4.4 Data analysis

Descriptive statistics were used to measure the demographic profile of the respondents. Wajdi Dusuki and Irwani Abdullah (2007) assessed the Islamic bank selection criteria in Malaysia. The data was analyzed through Freemans's test to determine means rank and mean values and assigned the importance rank to the attributes studied. Furthermore, to assess the factors associated with Islamic banks selection Freedman's test and factor analysis were used. Following the previous studies, we have used Friedman's test, descriptive and one-sample t-test to examine key contributors towards Islamic bank selection in the study region (Abdul Rehman & Masood, 2012; Hasan, Subhani, & Osman, 2012; Shabbir, 2019; Wajdi Dusuki & Irwani Abdullah, 2007).

## 5. Analysis and Results

### 5.1 Customers demographics

Details regarding population characteristics are shown in this section. Details regarding age, education level, income level, and total experience with the banks are analyzed in the given table and followed by charts:

Table 1. *Descriptive Analysis*

<b>Variable</b>	<b>Frequency</b>	<b>Percentage</b>	<b>Cumulative Percentage</b>
<b>Customers Age in Years</b>			
Below 20	8	3.4	3.4
21-35	116	49.6	53.0
36-50	84	35.9	88.9
Above 50	26	11.1	100.0
	234	100.0	
<b>Level of Education</b>			
Under Matric	30	12.8	s
Matric	41	17.5	30.3

Intermediate	66	28.2	58.5
Bachelor	97	41.5	100.0
Total	234	100.0	
<b>District</b>			
Dir. Lower	80	34.2	34.2
Malakand	91	38.9	73.1
Swat	63	26.9	100.0
Total	234	100.0	
<b>Monthly Income Level of Customers</b>			
Below 20000	49	20.9	20.9
20000-39999	107	45.7	66.7
40000-59999	52	22.2	88.9
60000-79999	15	6.4	95.3
Above 80000	11	4.7	100.0
Total	234	100.0	
<b>Experience with Bank</b>			
Below 2 years	85	36.3	36.3
2-5 Years	104	44.4	80.8
6-10 Years	39	16.7	97.4
Above 10 Years	6	2.6	100.0
Total	234	100.0	

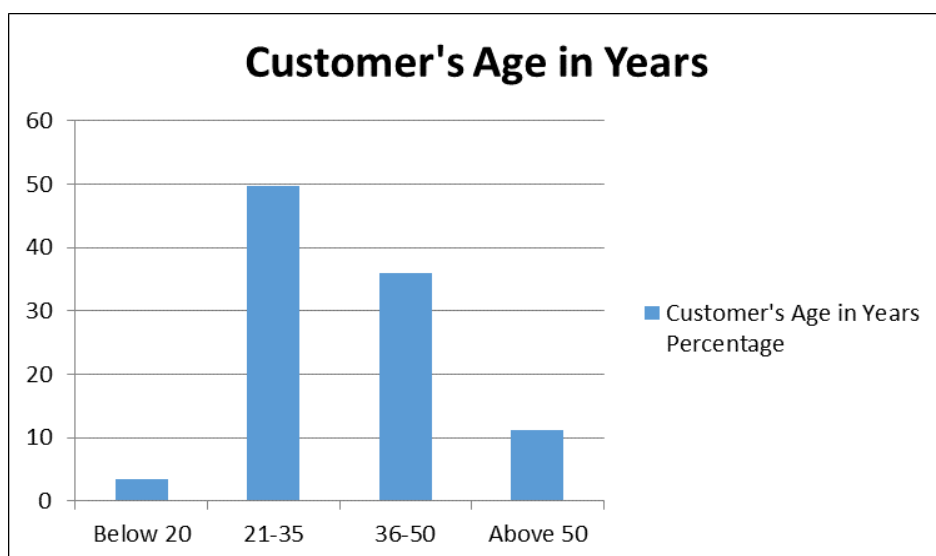


Figure 2 Customers Age in Years



Results revealed that the majority of the customers (49.6%) of Islamic banks consists of youngsters i.e. age group of 21-35 (35.9%) followed by 36 to 50years.

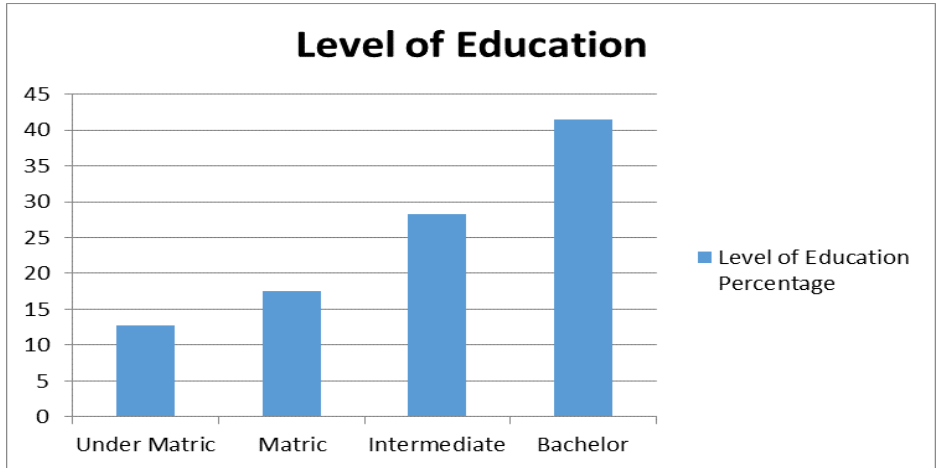


Figure 3 Level of Education

It was found that more educated people opted for Islamic banking. As shown in the above chart majority of the population opted for graduation as their level of education followed by inter and matric. The least opted were under matric.

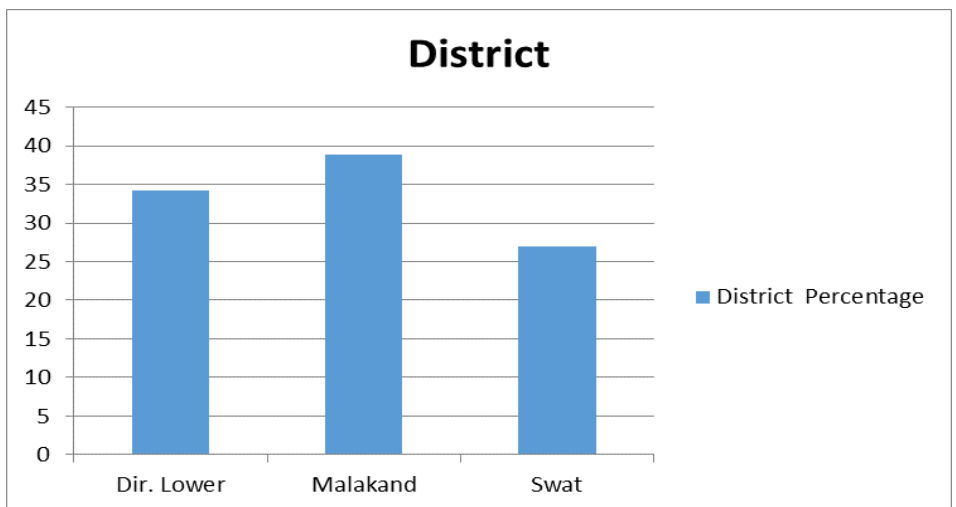


Figure 4 Districts included in the Malakand Division

Three districts of the Malakand Division were selected as sample for the study. The above chart shows that more participants were from district Malakand being easily accessible, followed by Dir. lower and Swat.

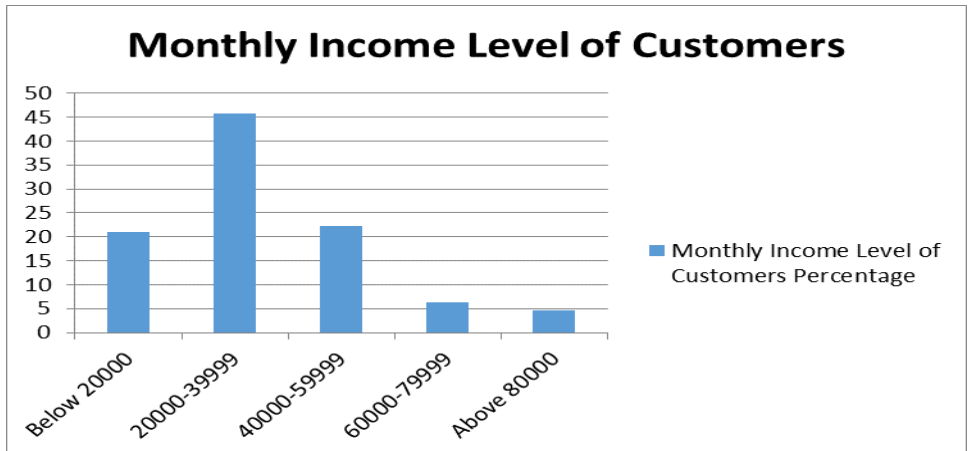


Figure 5 Monthly Income Levels of Customers

It was found in the study that lower-income or middle-income people opted for Islamic banking as compared to the upper class of the economy. The majority of the respondents fell in the income group of 20,000 to 39,999 followed by the Income group of 40,000 to 59,999 and below 20,000 respectively.

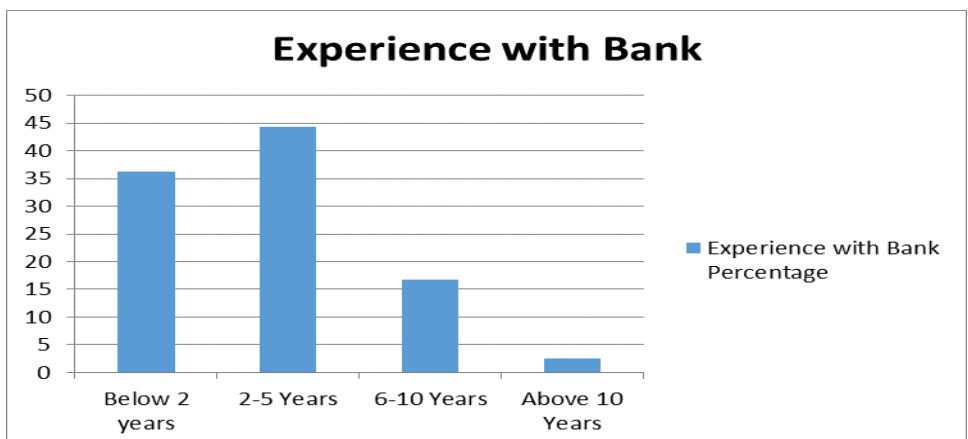


Figure 6 Experiences with Bank

Islamic banking is an emerging field, being new; a majority of their customers have less than 5 years of banking relationship with their banks. It was found that most of the customers of Islamic banking were having

experience in the range of 2-5 years followed by less than 2 years and 6-10 years. The least group was having more than 10 years' experience.

**Friedman's Test**

To determine the key variable contributing to the decision of customers to opt for Islamic banking Friedman's test was used. Results obtained are shown in the below tables:

Table 2 *Friedman Test (N=234)*

<b>Variables</b>	<b>Mean Rank (MR)</b>	<b>Mean</b>	<b>Std. Deviation</b>	<b>Importance Rank</b>
Religious Purpose only	12.54	4.21	0.952	1
Co-operative and Friendly Staff	12.14	4.17	1.022	2
Shariah Compliant products	12	4.12	1.016	3
Speed and Efficiency in Transaction Processing	10.81	3.89	0.004	4
ATM Facility	10.26	3.87	0.931	5
Religious & Profitability	10.07	3.82	0.979	6
Confidence on Shariah Supervisory Board	9.87	3.73	0.972	7
Bank Name and Image	9.54	3.61	1.092	8
Low Service Charges	9.52	3.62	1.005	9
Handling Problems on Phone	9.41	3.57	1.245	10
Financial Counseling	9.4	3.58	1.114	11
Wide Range of Services	9.21	3.57	1.005	12
Referral by Friends and Family	9.04	3.52	1.194	13
Location of Bank	8.35	3.40	1.323	14
Staff Qualification	8.26	3.32	1.261	15
Lower Financing Cost	7.75	3.24	1.008	16
Banking Hours	6.9	3.06	1.101	17
Higher Return on Investment	5.94	2.85	1.138	18

Chi-Square = 572.062; df = 17, *p* = 0.000

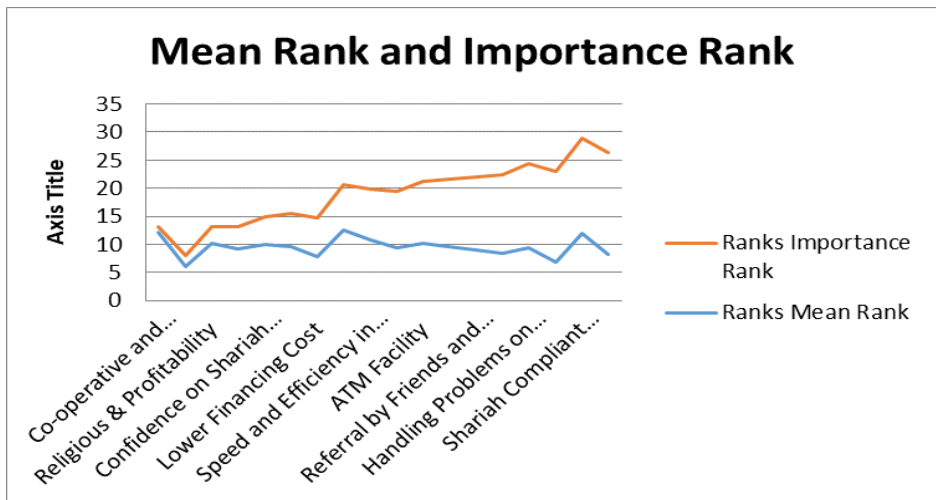


Figure 7 Mean Ranks and Importance Rank

As shown in the above table and chart the customers considered religiosity as the topmost criterion for considering Islamic banking with the highest MR of 12.54 and placed on the top in the list of importance rank followed by co-operative and friendly staff and Shariah-compliant products by the score of 12.14 and 12 respectively and placed 2<sup>nd</sup> and 3<sup>rd</sup> in the order of importance. While opting for Islamic banking. Similarly, speed and efficiency, ATM facility, and religious plus profitability variable came in the MR range group of 10.81 to 10.07, considered an important predictor of the customer's choice. These results are consistent with the findings of the studies of (Abdul Rehman & Masood, 2012; H. Okumus, 2005; Wajdi Dusuki & Irwani Abdullah, 2007). It was found that confidence on Shariah board (MR 9.87), Bank name and Image (MR 9.54), Low Service Charges (MR 9.52), Handling problems on Phone (MR 9.41), followed by financial Counseling (MR 9.4), a wide range of services (MR 9.21), and Referral by Friends and Family (MR 9.04) considered moderate score in order of preferences. Location of the bank, staff qualification, lower financing cost, banking hours, and higher rate of return on investment were given less preferences by the customers in the stud region. The results of the study confirm the findings of the previous studies (Bisharat, 2014; Hussain et al., 2020; Sayani & Miniaoui, 2013).

## 6. Conclusion & Recommendations

The main objective of the study was to determine the Islamic banking patronage factors in the Malakand division. It was found that the majority of the customers of Islamic banks consist of the young generation. Being new, the experience of more customers was less than five years. Total variables selected

from the literature in the topic are 18, sub-divided into two major groups of religious factors and non-religious factors. It was found in the study that the respondents opted for mixed variables i.e. religious and non-religious as a key determinant of the decision to opt for Islamic banking. However, being a religious conscious region, the element of religiosity was on the top followed by cooperative and friendly staff and Shariah-compliant products. The least favored among the variables was the higher rate of return, banking hours. Staff qualification and cost of financing. It was revealed in the research that customers opted for Islamic banking due to diverse reasons; therefore, only focusing on the religious aspect of Islamic banking wouldn't work for a longer time. As the Islamic banks are facing intense competition from their conventional counterparts, therefore, more efforts must be made to attract and educate more and more customers. By focusing on the results of the study policies must be devised to target the key factors like staff cooperation, efficiency, ATM facility, and bank image in addition to the religious factors of religiosity, Shariah compliance, religiosity, and profitability to get maximum market share, more awareness campaigns must be launched regarding investment and financing facilities being offered by the Islamic banks as the customers are given least priority to these factors. The government authorities must consider the choice of customers and devise strategies to get maximum socio-economic welfare out of the Islamic banking sector.

## **References**

- Abdel-Magid, M. F. (1981). The theory of Islamic banking: accounting implications. *International Journal of Accounting*, 17(1), 79-102.
- Abdul Rehman, A., & Masood, O. (2012). Why do customers patronize Islamic banks? A case study of Pakistan. *Qualitative Research in Financial Markets*, 4(2/3), 130-141.
- Al-Tamimi, H. A. H., Lafi, A. S., & Uddin, M. H. (2009). Bank image in the UAE: Comparing Islamic and conventional banks. *Journal of Financial Services Marketing*, 14(3), 232-244.
- Asif, M., Shah, F. A., Afeef, M., & Ahmed, Z. (2016). Factors Determining the Attitude of Customers towards Islamic Banking: A Study of Peshawar, Pakistan. *Abasyn University Journal of Social Sciences*, 9(1).
- Awan, A. G., & Azhar, M. (2014). Consumer behavior towards Islamic banking in Pakistan. *European Journal of Accounting Auditing and Finance Research*, 2(9), 42-65.

- Awan, H. M., & Shahzad Bukhari, K. (2011). Customer's criteria for selecting an Islamic bank: evidence from Pakistan. *Journal of Islamic Marketing*, 2(1), 14-27.
- Bananuka, J., Mukyala, V., Tumwebaze, Z., Ssekakubo, J., Kasera, M., & Najjuma, M. S. (2020). The intention to adopt Islamic financing in emerging economies: evidence from Uganda. *Journal of Islamic Accounting and Business Research*.
- Bisharat, R. M. N. (2014). Patronage factors in Islamic banks in Pakistan. *Journal of Business and Management*, 16(6), 108-114.
- Erol, C., & El-Bdour, R. (1989). Attitudes, behaviour, and patronage factors of bank customers towards Islamic banks. *International Journal of Bank Marketing*, 7(6), 31-37.
- Gerrard, P., & Barton Cunningham, J. (1997). Islamic banking: a study in Singapore. *International Journal of Bank Marketing*, 15(6), 204-216.
- Hasan, S. A., Subhani, M. I., & Osman, M. (2012). Consumer criteria for the selection of an Islamic Bank: Evidence from Pakistan.
- Hussain, A., Aslam, H. D., & Bugti, F. (2020). A study on bank selection criteria and retail customer satisfaction across Islamic Banks in Pakistan. *Al-Qalam*, 25(1).
- Ismail, S., Azmi, F., & Thurasamy, R. (2014). Selection criteria for Islamic home financing in Malaysia. *International Journal of Business and Society*, 15(1), 97.
- Israr, A., Qureshi, F. A., & Butt, M. (2018). Selection Criteria of Public for Account Opening: A Case Study of Islamic Banks in Pakistan. *Al-Iqtishad Journal of Islamic Economics*, 10(1), 153-170.
- Lee, K.-h., & Ullah, S. (2011). Customers' attitude toward Islamic banking in Pakistan. *International Journal of Islamic and Middle Eastern Finance and Management*, 4(2), 131-145.
- Mansoor, K., & Bhatti, I. (2008). Islamic banking and finance: on its way to globalization. *Managerial finance*, 34(10), 708-725.
- Mansour, W., Ben Abdelhamid, M., Masood, O., & Niazi, G. (2010). Islamic banking and customers' preferences: the case of the UK. *Qualitative Research in Financial Markets*, 2(3), 185-199.
- Mehmood, A. (2002). Islamisation of the economy in Pakistan: past, present, and future. *Islamic studies*, 41(4), 675-704.
- Metawa, S. A., & Almoosawi, M. (1998). Banking behavior of Islamic bank customers: perspectives and implications. *International Journal of Bank Marketing*, 16(7), 299-313.

- Mukhtar, A., & Butt, M., Muhammad. (2012). Intention to choose Halal products: the role of religiosity. *Journal of Islamic Marketing*, 3(2), 108-120.
- Naser, K., Jamal, A., & Al-Khatib, K. (1999). Islamic banking: a study of customer satisfaction and preferences in Jordan. *International Journal of Bank Marketing*, 17(3), 135-151.
- Okumus, H. (2005). Interest-free banking in Turkey: a study of customer satisfaction and bank selection criteria. *Journal of Economic Cooperation*, 26(4), 51-86.
- Okumus, H. S., & Genc, E. G. (2013). Interest-free banking in Turkey: a study of customer satisfaction and bank selection. *European Scientific Journal, ESJ*, 9(16).
- Sayani, H., & Miniaoui, H. (2013). Determinants of bank selection in the United Arab Emirates. *International Journal of Bank Marketing*.
- Shabbir, M. S. (2019). Nexus between customer preference and operation of conventional banks Islamic windows in Pakistan. *Journal of Islamic marketing*.
- Shamshad, A. (2007). Pakistan Islamic banking—past, present, and future outlook. *SBP, Karachi, Pakistan*.
- Wajdi Dusuki, A., & Irwani Abdullah, N. (2007). Why do Malaysian customers patronise Islamic banks? *International Journal of Bank Marketing*, 25(3), 142-160.
- Yudistira, D. (2004). Efficiency in Islamic banking: An empirical analysis of eighteen banks.

