



Why do Malaysian customers patronise Islamic banks?

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Abstract

Purpose – The purpose of this paper is to examine the main factors that motivate customers to deal with Islamic banks particularly in a dual banking environment, like in the case of Malaysia. A discussion on factors relating to corporate social responsibility initiatives as part of potential customers' banking selection criteria is also included.

Design/methodology/approach – The paper presents primary data collected by self-administered questionnaires involving a sample of 750 respondents from four different regions in Malaysia. The Islamic banking criteria ranking as perceived by the respondents are analysed using Friedman Test. To further explore the customers' understanding of the banking criteria, an exploratory factor analysis is employed.

Findings – This study reveals that the selection of Islamic banks appears to be predominantly a combination of Islamic and financial reputation and quality service offered by the bank. Other factors perceived to be important include good social responsibility practices, convenience and product price.

Practical implications – The empirical evidence of this paper affects two aspects; first, Islamic banks must offer quality services while maintaining its Islamic credential and reputation; second, Islamic banks should also embrace good customers services policies to reap its potential as a strategic tool to achieve competitive advantage, enhance reputation and secure customers allegiance. This research will be of interest to both incumbent and potential entrants into this niche market.

Originality/value – The paper reports findings from the first nationwide study carried out in the area of Islamic banking selection criteria.

Keywords Consumer behaviour, Banks, Banking, Islam, Social responsibility, Malaysia

Paper type Research paper

Introduction

Over the past three decades, Islamic banking has emerged as one of the fastest growing industries. It has spread to all corners of the globe and received wide acceptance by both Muslims and non-Muslims alike (Iqbal and Molyneux, 2005). Islamic banks perform the same essential functions as banks do in the conventional system, except that the need for them to carry out their transactions in accordance with the rules and principles of Islam (Henry and Wilson, 2004; Iqbal and Mirakhor, 2007).

As one of the most important players in service industry today, Islamic banking is no longer regarded as a business entity striving only to fulfil the religious obligations of the Muslim community, but more significantly, as a business that is ineluctably in need for winning over customers whilst retaining the old ones (Wilson, 1995). This necessitates Islamic banks to really understand the perceptions of their customers

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towards them in terms of service quality and other patronage factors to secure customers' allegiance.

In Malaysia, customers' positive perception towards Islamic banking is far more crucial mainly due to the fact that Islamic banks have to compete with the long established conventional banks in a dual-banking system. Since 1983, Malaysia to date has a dual banking system, whereby the Islamic banking system operates in parallel with the conventional system. The former is currently represented by 27 banking institutions, comprising nine Islamic banks and 18 conventional banking institutions (eight commercial banks, four merchant banks and six discount houses) offering Islamic banking products and services under the Islamic Banking Scheme (IBS), also known as Islamic windows (Bank Negara, 2005).

The Islamic banking and finance today has emerged as an important component of the overall Malaysian financial system that contributes to the growth and development of the Malaysian economy. Since 2000, the domestic Islamic banking industry has been growing at an average rate of 18 percent per annum in terms of assets (Aziz, 2006). It is the aspiration of the Malaysian government to have a strong Islamic banking industry capturing 20 percent of market shares of financing and deposits in the Malaysian financial industry by 2010. The latest figure of market shares of Islamic deposits and financing stood at 11.7 and 12.1 percent of the industry's total respectively (Bank Negara, 2005). In this regard, the ability of the Islamic banking industry to capture a significant market share in a rapidly evolving and challenging financial environment particularly in a dual-banking system like Malaysia, is dependent on the strategic positioning of the Islamic banking players to maintain their competitive edge and offer services and products that satisfy the needs of their customers.

Against this backdrop, the present study investigates Islamic banking patronage factors from the customers' perspectives. Specifically, the study sets out to provide answers to the following research questions:

- What are the factors which customers consider important when selecting to bank with an Islamic bank?
- What is the ranking of criteria, which influence the bank patronage decision of customers in a dual-banking environment like Malaysian?

Our analysis is based on a survey conducted among customers (both financing customers and depositors) of two leading full-fledged Islamic banks in Malaysia, namely Bank Islam Malaysia Berhad (BIMB) and Bank Muamalat Malaysia Berhad (BMIMB). To our knowledge, the sample (750 respondents), covering four regions in Malaysia, notably, Kelantan (east), Kuala Lumpur (central), Pulau Pinang (north) and Johore (south) is the largest sample ever employed in the research area of Islamic banking selection criteria. A questionnaire was prepared to solicit information on perception of customers of Islamic banks in Malaysia. An analysis of the collected information has interesting implications for the incumbents and new entrants into this niche market to formulate effective marketing strategies capturing significant market shares of Islamic banking customers.

The remainder of the paper proceeds as follows. The next section highlights the philosophy of Islamic banking, the growing phenomenon of ethical investment in the West and review on past studies on banking selection criteria. Section three and four expounds the research methodology and analysis tools adopted in this study. Research

findings and analysis are enumerated in section five, whilst the final section contains the concluding remarks.

Literature review

Philosophy of Islamic banking

Many Islamic banking literature assert that although Islamic banks perform mostly similar functions to that of conventional banks, their approach is distinctly different (Ahmad, 2000; Chapra, 2000; Warde, 2000; Henry and Wilson, 2004; Iqbal and Molyneux, 2005; Iqbal and Mirakhor, 2007). To illustrate, some of the salient features of Islamic banking and finance which making it distinctive and unique from its conventional counterparts include: first, Islamic banking strives for a just, fair and balanced society as envisioned by the Islamic economics (Mirakhor, 2000; Warde, 2000). Accordingly, the many prohibitions (e.g. interest, gambling, excessive risks, etc.) are to provide a level playing field to protect the interests and benefits of all parties involved in market transactions and to promote social harmony (Ahmad, 2000; Chapra, 2000). For example, the prevailing practice of interest in the conventional banking system involves injustice to the borrowers since the interest on their loans have to be paid irrespective of the outcomes of their business. Similarly, interest-bearing contracts can be unjust to the lenders especially when their returns on deposits, which have been channelled by the banks to the entrepreneurs, do not commensurate with the actual performance of the investment (Lewis and Algaud, 2001; Iqbal and Molyneux, 2005).

Second, Islamic banking is constructed upon the principle of brotherhood and cooperation, which stands for a system of equity sharing, risk sharing and stake taking. It promotes such sharing and cooperation between the provider of funds (investor) and the user of funds (entrepreneur) (Ahmad, 2000; Iqbal and Molyneux, 2005). Third, as a system grounded on ethical and moral framework of the Islamic law of Shariah, Islamic banking is also characterised by ethical norms and social commitments (Ahmad, 2000; Mirakhor, 2000; Warde, 2000). There is a moral filter based on the definitions of halal (permissible) and haram (prohibited and undesirable) operating at different levels, carving the conscience of entrepreneur and firm, promoting a positive social climate for society, and providing an expedient legal framework (Chapra, 1992). Accordingly, Islamic banks cannot finance any project which conflict with the moral value system of Islam such as financing a brewery factory, a casino, a night club or any other activity clearly prohibited by Islam or known to be detrimental to society (Ahmad, 2000).

Islamic banking and ethical investment

The philosophy underlying Islamic banking as discussed above is similar to that of socially responsible investment (SRI) and ethical funds that received wide recognition in the West for the last two decades (Wilson, 1997). All these funds are screened to exclude firms involved with products or processes that are considered undesirable in terms of investor's ethical, social, religious or other preferences (Benson *et al.*, 2006). Examples include firms involved in production of armaments, alcohol, and tobacco; possess poor environmental performance record; engage in offensive advertising and practise cruelty to animals. The positive attributes of these funds include firms with desirable products and processes such as firms that are environmental friendly; engage

positively with community; have progressive hiring policies; exercise good corporate citizens, human rights records and labour relations (Benson *et al.*, 2006).

In the UK, the concern for ethical investment and socially responsible financial firm has become increasingly popular since the mid-1970s. Since then, there have been significant developments in the field of corporate social responsibility (CSR) and ethical investment, not least within the financial sector (O'Brien, 2001; Snider *et al.*, 2003). According to a research conducted by EIRIS (Ethical Investment Research Services) more than 50 retail ethical investment funds now exist in the UK. These funds all apply environmental, social and/or other ethical criteria to the selection of their investments. The estimated value of these funds stood at £4 billion in August 2001 (EIRIS, 2003). According to Social Investment Forum, in 2003, 11.3 percent of total assets (representing about US\$2.16 trillion) under professional management in the USA was invested using a socially responsible philosophy (Benson *et al.*, 2006).

The growth of the ethical investment industry is another current indication of the emphasis placed on the social and ethical behaviour of companies. There is a competitive advantage that companies believe they can reap by being ethical and socially responsible (Porter and Kramer, 2002; Snider *et al.*, 2003). They foresee that by communicating effectively about their social, environmental and economic contributions, they can strengthen their brand, enhance their corporate reputation with customers and suppliers, and attract and retain a committed and skilled workforce (Turban and Greening, 1997). Indeed, extant literature asserts that, the commitment towards ethical and social responsibility will in turn lead to better performance in terms of profitability, competitiveness and risk management (Waddock and Graves, 1997; O'Brien, 2001; Porter and Kramer, 2002; Brinkman, 2003; Johnson, 2003; Snider *et al.*, 2003).

The emerging of Islamic banking and finance along with the propagated doctrine of ethical investment and socially responsible financial transactions in the West is really a phenomenon that requires an instructive examination from the customers' perspectives. This growing phenomenon somehow implies that Islamic banks need to balance out their operation between profit-making activities and social responsibility (Wilson, 1997).

Perhaps, Islamic banks need to play a leading role in social services such as the development of human resources, protection of environment, promotion of human rights and constructive participation in community development programmes. Indeed, Islamic banking system has an in-built dimension that promotes ethics and social responsibility, as it resides within a financial trajectory underpinned by the forces of religious injunctions. These religious injunctions interweave Islamic financial transactions with genuine concern for ethical and socially responsible activities and simultaneously prohibit involvement in illegal activities or those, which are detrimental to social and environmental well-being.

Banking selection criteria

Literature on banking selection criteria contains numerous features by different researchers across the globe. Among the common factors used to measure customers' selection criteria are cost and benefits of products offered, service delivery (fast and efficient), confidentiality, size and reputation of the bank, convenience (location and ample parking space), friends and families influences and friendliness of personnel

(Erol and El-Bdour, 1989; Erol *et al.*, 1990; Omer, 1992; Haron *et al.*, 1994; Gerrard and Cunningham, 1997; Metawa and Almossawi, 1998; Naser *et al.*, 1999; Ahmad and Haron, 2002; Abbas *et al.*, 2003). Additionally, the religious issue is also perceived as one of the important criteria to be considered for the selection of Islamic banking services (Erol *et al.*, 1990; Haron *et al.*, 1994; Metawa and Almossawi, 1998; Naser *et al.*, 1999).

However, despite the most popular claim that Islamic banks are true reflections of Islamic-compatible formulation that the clients themselves respect and believe in, previous empirical studies found that religious motivation is not the sole criterion for the selection of Islamic banking institutions or services. Many of the banking patronage studies identify a number of factors, such as cost and benefits, service delivery (fast and efficient), size and reputation of the bank, convenience (location and ample parking), and friendliness of bank personnel, as either equally if not more important criteria for the customers in selecting a particular Islamic bank. Table I provides a summary of the customers' selection criteria based on the patronage studies on Islamic banking.

Table I depicts, patronage studies on Islamic banking have so far largely focused on the combination of various religious, reputation, commercial, service satisfaction, staff, confidentiality and convenience factors. In one of the earliest banking selection criteria studies on Islamic banking, Erol and El-Bdour (1989) discovered that the most important criteria considered by the customers are provision of fast and efficient services, bank's reputation and image, and confidentiality. Interestingly, they also observe that religious motivation is not a primary criterion for the selection of Islamic banking services in Jordan. Their findings are disputed by later researchers like Metawa and Almossawi (1998) and Naser *et al.* (1999) who assert that adherence to Islamic tenets is the main motivating factor for customers to patronise Islamic banks in Bahrain and Jordan respectively. Nevertheless, these writers also affirm that other factors like bank's name and image, confidentiality, friends and family influences and provision of quality services are equally important for customers when making decision on their choice of bank (Metawa and Almossawi, 1998; Naser *et al.*, 1999).

These studies somehow confirm earlier work, which found that both religious and economic factors are equally important for customers in patronizing Islamic banks (Kader, 1993, 1995; Haron *et al.*, 1994; Gerrard and Cunningham, 1997; Ahmad and Haron, 2002). One of the similarities in these earlier studies is the fact that those investigations were conducted in multi-racial countries. For example, Gerrard and Cunningham (1997) surveyed Singaporean customers, whereas other researchers like Kader (1993, 1995), Haron *et al.* (1994) and Ahmad and Haron (2002) conducted their research based on a sample taken from Malaysian Islamic bank customers.

Nevertheless, studies on banking selection criteria of Islamic banks in Malaysia remain scarce. Previous research is limited in scope either due to limited sample size or restrictive in representation. Research by Ahmad and Haron (2002) for instance, although limited in scope as its sample was only based on 45 corporate users of financial services, reports that the majority emphasize religious as well as other factors like cost/benefit, service delivery, reputation and location in patronizing Islamic banks.

As for Kader (1993, 1995) and Haron *et al.* (1994), their sample was restrictive in a sense that they were collected from one single location or district. For example, in Kader (1993, 1995), the survey was confined to one location in Kuala Lumpur. Similarly

Literature	Religious factor	Cost/benefit (e.g. return on deposits, investments, etc.)	Service delivery (provision of fast and efficient service)	Criteria in banking selection				Confidentiality	Friends' and relatives' Influence	Mass media advertising
				Size and Reputation	Staff factors (competence and courtesy of bank staff)	Convenience (location, ample parking space, interior comfort)	Staff factors (competence and courtesy of bank staff)			
Erol and El-Bdour (1989)	-	+	+	+	+	+	+	+	+	+
Erol <i>et al.</i> (1990)	-	+	+	+	+	+	+	+	+	+
Haron <i>et al.</i> (1994)	-	+	+	+	+	+	+	+	+	+
Kader (1993)	+	-	+	+	n/a	+	n/a	+	+	+
Kader (1995)	+	-	+	+	n/a	+	n/a	+	+	+
Gerrard and Cunningham (1997)	±	+	+	+	+	+	+	+	+	+
Metawa and Almossawi (1998)	+	+	n/a	n/a	n/a	+	n/a	+	+	n/a
Naser <i>et al.</i> (1999)	+	+	+	+	+	+	+	+	+	n/a
Othman and Owen (2001)	-	n/a	n/a	n/a	n/a	n/a	n/a	n/a	n/a	-
Othman and Owen (2002)	+	+	+	+	n/a	+	+	+	n/a	+
Ahmad and Haron (2002)	-	+	+	+	+	+	n/a	n/a	n/a	n/a
Omer (1992)	+	+	n/a	n/a	n/a	n/a	n/a	n/a	+	n/a
Abbas <i>et al.</i> (2003)	±	+	+	n/a	+	+	+	+	+	n/a

Notes: + indicates a positive and important result, ± indicates an equivocal result, - indicates negative or no significant result and n/a indicates variable was not investigated/examined in the study

Table I.
Patronage studies on Islamic banking

in Haron *et al.* (1994), the sample was drawn from three Northern towns namely: Alor Setar, Sungai Petani and Kangar. Hence the results of these studies should be treated with caution particularly with regards to the limited number of sample responses used and restrictive location where the sample was drawn in respective studies.

In summary, previous results suggest that Islamic banks must not rely solely on religious factors as a strategy to secure customers' allegiances but they should also emphasize providing quality and efficient product and services. However, past studies on banking selection criteria exclude factors like social responsibility despite the claim that investors are now more attracted to socially responsible funds because they possess personal values that are consistent with the underlying philosophy of these ethical funds (Benson *et al.*, 2006). This study attempts to fill this gap by providing insights into customers' perceptions toward social responsibility factors together with other Islamic banking selection criteria in Malaysia. This is done by eliciting customers' perceptions towards banking patronage factors which include social responsibility factors. On this basis, the study will be potentially relevant to Islamic banks that wish to know the ranking of criteria, which influence the bank selection decision of customers in Malaysia. Therefore, the study aims to investigate the following main hypothesis:

Ho. There is no significant difference in the ranking of banking selection criteria as perceived by customers of Islamic banks in Malaysia.

Research methodology

Instrument

The data were collected by self-administered questionnaires distributed to respondents at 52 different branches of Islamic banks namely Bank Islam Malaysia Berhad (BIMB) and Bank Muamalat Malaysia Berhad (BMMB) in four different states of Malaysia, Kelantan, Penang, Kuala Lumpur and Johore, representing four main regions namely Eastern, Northern, Central and Southern respectively.

There are two main reasons for choosing Malaysian customers as the sample. First, the aspiration of the Malaysian government to become a key Islamic financial hub in the region requires Islamic banks to intensify their market shares of financing and deposits in the Malaysian financial industry and this inevitably necessitates them to understand their customers' perceptions and attitudes in terms of banking selection criteria used to patronise banks. Second, the liberalisation of the Islamic banking sector in Malaysia since 2004 signals opportunities for new entrants especially among foreign banks to enter into this market. This would in turn require banks to have in-depth comprehension about factors that may affect the demand for Islamic banking in Malaysia.

The questionnaire contains two sections: the first section was designed to gather information about the sample's personal, demographic and economic characteristics. In the second section, the respondents were asked to indicate, on a five-point Likert-type scale, ranging from "not important at all" to "very important", the factors they perceive when selecting an Islamic bank. Most of these factors have been adapted from previous banking patronage studies with some additional items to represent issues like religious and social responsibility (Erol and El-Bdour, 1989; Erol *et al.*, 1990; Omer, 1992; Haron *et al.*, 1994; Gerrard and Cunningham, 1997; Metawa and Almosawi, 1998; Naser *et al.*, 1999; Ahmad and Haron, 2002; Abbas *et al.*, 2003).

Initially, a list of 18 selection criteria was gathered from past studies. Before the final questionnaire was sent out, a pilot study was conducted to determine the appropriateness and relevance of these factors in the instrument. A total of 41 respondents were invited and participated in this trial run. Based on the respondents' feedback, the list of banking selection criteria was reduced to 12 factors due to their unfamiliarity with six of the chosen factors.

The final 12 variables included for this study are: financial product price, customer service quality (fast and efficient service), convenience (e.g. available parking space, interior comfort), location being near home or work, friendly personnel, knowledgeable and competent personnel, Islamic working environment, economic and financial reputation, respect for human rights, Islamic reputation and image, involvement in the community and environmental practice and impact.

It is important to note that the three social responsibility-related factors, namely, involvement in the community, respect for human rights and environmental practice and impact have been taken from some identified initiatives suggested by the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) to be implemented and practised by Islamic banks as stipulated in its Accounting, Auditing and Governance Standards for Islamic Financial Institutions 2004-2005 (AAOIFI, 2004).

The questionnaire was originally prepared in English and then translated into Malay by using backward translation method with an assistant from an expert in both languages to reduce translation bias and error. Only minor discrepancies were observed between the original instrument and its back translated version, which was resolved by the translator.

Data collection

Respondents were randomly selected from Islamic banks' customers who visited the sampling locations during the chosen time intervals, in order to eliminate the sampling frame errors and to ensure the representation of the population under study in the sample units. Following the data collection procedures outlined by similar banking studies the questionnaires were distributed during various working hours of the same day (morning and evenings), as well as various days of the week, to reduce any potential bias owing to high concentration of bank customers during certain hours of the day, or certain days of the week or month (Creyer and Ross, 1997; Gerrard and Cunningham, 1997; Metawa and Almosawi, 1998; Naser *et al.*, 1999; Owusu-Frimpong, 1999; Jamal and Naser, 2002; Abbas *et al.*, 2003; Sureshchandar *et al.*, 2003).

About 20 to 40 respondents were approached at each Islamic bank's branch. The researcher counted every seventh bank customer who had completed a transaction. They were politely approached, and the purpose of the study was explained. Then they were asked if they would be prepared to fill in the questionnaire. Once they had agreed to participate, the researcher then handed over the designated questionnaire to the participating respondents to be answered either in English or in Malay according to their preferences. The researcher then left the respondent alone to answer the questionnaire and did not interfere in any way, so as to avoid any potential bias such as the respondents feeling intimidated, threatened or being influenced by the

researcher. Once completed, the respondent either returned the questionnaire to the researcher or to any of the bank staff.

Sample

From a total of 1,000 questionnaires distributed, 800 were returned, out of which 750 were usable (valid and completed), thereby yielding a response rate of about 75 percent, a response rate considered sufficiently large for statistical reliability and generalisability (Tabachnick and Fidell, 1996; Stevens, 2002). This relatively high response rate was attributed to the self-administered approach undertaken in distributing questionnaires and approaching respondents at the various branches.

Many previous studies received comparatively high response rate when surveying customers' perceptions on various banking issues using similar data collection techniques. For example Gerrard and Cunningham (1997) yielded 55 percent; Creyer and Ross (1997) yielded 62 percent; Metawa and Almossawi (1998) yielded 75 percent; Naser *et al.* (1999) yielded 69 percent; Owusu-Frimpong (1999) yielded 56 percent; Jamal and Naser (2002) yielded 85 percent; Sureshchandar *et al.* (2003) yielded 60 percent; and Abbas *et al.* (2003) yielded 54 percent response rate. An analysis of the respondents' demographic characteristics is presented in Table II.

Table II summarises the basic statistics on gender, age, marital status, educational level and monthly income of the respondents. The respondents are predominantly male, constituting 65 percent of the respondents. Almost 90 percent of Islamic bank customers fall in the range of 20-50 years of age. This percentage appears to be in line with the findings of previous banking studies (see, for example, Erol and El-Bdour, 1989; and Metawa and Almossawi, 1998). According to Metawa and Almossawi (1998), "investigating the perception and behaviour of customers and depositors within this

		Valid percent (%)
<i>Gender</i>	Male	64.5
	Female	35.5
<i>Age group</i>	Below 20	4.5
	20-30	39.9
	31-40	33.1
	41-50	16.8
	Above 50	5.7
<i>Marital status</i>	Single	33.0
	Married	67.0
<i>Educational level</i>	Primary/secondary school	30.8
	College diploma/matriculation/a-level/	24.4
	Bachelor	23.9
	Professional qualification	7.7
	Postgraduate (Master or PhD)	11.5
	Others	1.6
<i>Monthly income</i>	Less than RM1,000	24.7
	RM1,000-RM3,000	47.0
	RM3,001-RM5,000	16.5
	RM5,001-RM10,000	9.4
	RM10,001-RM20,000	1.4
	More than RM20,000	1.0

Table II.
Distribution of
respondents (*n* = 750)

age group is likely to have far-reaching influence on the Islamic banking policies". This may be plausible since banks normally regard clients within this age category as relatively less risky age groups, especially in advancing loans and other financing transactions (Greuning and Bratanovic, 1999). Thus, with this sample, the study may provide useful insights on how these promising respondent groups perceive the patronage factor of Islamic banks.

The results reported in Table II also indicate that the majority of respondents are well educated, with more than 24 percent holding college diploma, matriculation or a-level certificates and about 45 percent holding a bachelor degree or above. As depicted in Table II, majority (47 percent) of the respondents are in the RM1000-RM3000 monthly income group. A total of 17 percent of the surveyed respondents earn between RM3001-RM5000 per month. Combined together, the respondents in those two income groups represent approximately 64 percent of the total sample. This result indicates that most of the respondents can be classified as middle-class income earners since majority have monthly incomes within the range of RM1000 to RM5000[1]. This finding captures closely the pattern of income distribution of Malaysian households consisting mainly of those with earnings between RM1000 to RM5000 or middle-class households.

Analysis

The responses obtained were analysed using SPSS. To ascertain which of the banking selection criteria are perceived as more or less important, the Friedman test was performed to rank all the 12 factors. This test was adopted to test the hypothesis mentioned earlier. Friedman Test is a non-parametric alternative to the one-way repeated measures analysis of variance. It is more suitable when measurement of the variables is in an ordinal scale and is obtained from the same person (Norusis, 2004). Although it is not as powerful as a parametric test, increasing the sample size can increase its power to that approaching its parametric equivalents (Sekaran, 1992).

SPSS was also used to carry out factor analysis on the responses to the bank selection criteria. Factor analysis is a technique which is used to "reduce a large number of variables to some smaller number by telling us which belong together and which seem to say the same thing" (Emory and Cooper, 1991). This technique was deemed to be appropriate for this particular analysis because banking selection factors have many connotations. As noted by De Vaus (2002), such factors are not single measurable entities but are constructs of a number of other directly observable variables. By factor analysis, these observable variables can be clustered into factors, each reflecting an underlying property, which is commonly shared by a certain group of variables (De Vaus, 2002). It also helps to validate that respondents are able to distinguish between the various variables despite the similarity of the items questioned (Hair *et al.*, 1998). The responses within various factor groups were tested for internal consistency and reliability using Cronbach alpha tests.

Research findings and implications

Islamic banking criteria ranking

The results are summarised in Table III. The chi-square value ($\chi^2 = 1200.298$) is higher than the tabulated chi-square value ($\chi^2 = 19.68$) at 0.05 confidence interval; 11 degrees of freedom. The observed significance level $p = 0.000$, is lower than the 0.05

Table III.
Ranking of banking
criteria

	Arithmetic mean*	Std. dev.	Mean rank	Importance rank
Knowledgeable and competent personnel	4.54	0.621	7.57	1
Friendly personnel	4.54	0.599	7.54	2
Customer service quality (e.g. fast and efficient services)	4.54	0.592	7.49	3
Islamic reputation and image	4.51	0.669	7.47	4
Economic reputation	4.41	0.654	6.90	5
Respect for human rights	4.45	1.664	6.76	6
Islamic working environment	4.31	0.802	6.55	7
Convenience (e.g. available parking space, interior comfort)	4.33	0.732	6.54	8
Involve in community (e.g. giving donation, scholarship)	4.41	2.069	6.53	9
Environmental practice and impact	4.08	0.801	5.43	10
Product price factor	3.92	0.797	4.74	11
Location being near home or work	3.69	1.078	4.49	12
<i>N</i>				750
Chi-square				1200.398
Degree of freedom (df)				11
Asymp. sig.				0.000

Notes: *Mean values – scoring: 1= not important at all; 5= very important

confidence level, which implies that variations between the 12 variables are likely to hold in the population. Thus we may infer that the ranking of importance among the banking selection criteria is statistically significant, thus the null hypothesis can be rejected.

The results in Table III reveal that customers highly regard knowledgeable and competent personnel coupled with friendly and courteous values to be the most important criteria in patronising Islamic banks. The finding corresponds to the study of Abbas *et al.* (2003), who found that the staff factor is one of the most important factors that customers use to select an Islamic bank. According to their findings incompetence and lack of courtesy of the bank's personnel, was the major reason why customers turn away from Islamic finance.

Accordingly Islamic banks ought to adequately train and develop their staffs especially with respect to the distinctive characteristics of Islamic banking products and services. Indeed, sufficient knowledge in various Islamic banking instruments compounded with other relevant aspects such as ethics, professionalism, duties and responsibilities towards customers and organisations will enhance efficiency and smooth-running of Islamic banking. Adequate personnel training also boosts the quality of Islamic banking staff, which eventually may influence and attract more customers into choosing Islamic financing as their preferred choice.

It has always been recognised that Islamic financial institutions face a challenging task in building customers' allegiance and attracting newcomers, particularly in a dual-banking system country like Malaysia, where competition is fierce with many other conventional financial institutions (Ahmad and Haron, 2002). Therefore highly qualified and skilled Islamic banking staffs are indispensable for smooth-running and effectiveness of Islamic banks. Banks must ensure their staff is adequately trained to handle customers' enquiries and to subsequently provide adequate explanation about the facility. This is particularly important to avoid confusion amongst customers especially with regards to the distinctive features of Islamic banking products and facilities.

On the other hand, factors like close proximity to home and work, and price of the product are perceived to be the least important criteria by the respondents. Having mentioned the above result, one should not conclude that Islamic banks do not need to address the issue of price, instead, the result of the analysis indicates that customers attach more importance to service quality factors. Among the factors included are the competence and courtesy of employees and their ability to convey trust and confidence onto their customers, for example friendliness of staff, efficiency and effectiveness in handling transactions; knowledgeable and experience of the bank personnel; convenience; and positive appearance of physical facilities, equipment, personnel and communication materials. Thus Islamic banks should not take for granted the expectation of their clients by assuming that they are prompted to deal with Islamic banks solely based on their religious consciousness, rather they should also promote quality services that can satisfy their clients.

The results in Table III indicate some variation in the ranking of banking patronage factors, which suggests that customers of Islamic banks are able to differentiate between various banking selections criteria. To shed more light whether which criteria are consistent with each other and form dimensions or components, a factor analysis, with varimax rotation was carried out and reported in Table IV.

Table IV.
Factor analysis for
perceived banking
selection criteria

Variable	Factor			Communality of each variable
	1	2	3	
Knowledgeable and competent personnel	Reputation/service delivery	Convenience/product price	Social responsibility of Islamic bank	0.689
Islamic reputation and image	0.789			0.644
Islamic working environment	0.765			0.571
Friendly personnel	0.738			0.638
Economic reputation	0.711			0.524
Customer service quality (e.g. fast and efficient services)	0.652			0.547
Location being near home or work	0.596			0.621
Convenience (e.g. available parking space, interior comfort)		0.766		0.581
Product price factor		0.681		0.288
Involve in community (e.g. giving donation, scholarship)		0.487	0.778	0.607
Environmental practice and impact			0.556	0.457
Respect for human rights			0.465	0.287
Eigenvalue	4.33	1.10	1.03	
Percent of variance	27.65	15.18	10.94	
Cumulative %	27.65	42.83	53.77	

Factor analysis

This part of the findings reports the outcome of factor analysis used to define customers' selection criteria of Islamic banks in Malaysia. In line with the analytical style used by Haron *et al.* (1994), Gerrard and Cunningham (1997, 2001); and Almosawi (2001), exploratory factor analysis with varimax rotation, was conducted to delineate patterns of patronage factors based on customers' perceptions more clearly. The Kaiser-Meyer-Olkin (KMO) measure for Islamic banking objectives combined items shows a value of 0.86 and the Bartlett's Test of sphericity also reaches statistical significance (0.000), supporting the factorability of the correlation matrix. Based on these results, factor analysis proceeds to conduct principal component analysis (PCA) and varimax rotation with Kaiser Normalisation.

To aid interpretation of these two factors, two methods are available for rotation of factors, orthogonal and oblique rotation. The former ensures the factors produced will be unrelated to each other, while the latter produces factors, which are correlated (Hair *et al.*, 1998). However, no specific rule has been developed to guide the researcher in selecting a particular orthogonal or oblique rotational technique. In this study, Varimax orthogonal rotation is used because the study seeks to ensure that the factors produced will be independent or unrelated to each other. Variables which most highly loaded (correlate) with the first factor are clustered together and arranged in descending order according to the size of their correlations. Then, variables, which load strongly with the second factor, will form the second factor, and so on.

It is worth noting that orthogonal rotation has a disadvantage of forcing factors to be unrelated when they may be related in real life. In this regard, oblique rotation may be applied to check this (Hair *et al.*, 1998). The study realises that the variables loading are exactly the same as found with this Varimax orthogonal rotation, hence similar interpretation could be used for the factor analysis. The rotated solution (presented in Table IV) reveals the presence of three factors with a number of strong loadings. No instance of obvious cross-loading over factors can be observed; in addition, eigenvalue indicators falls within recommended guidelines (Hair *et al.*, 1998). The communality indices are acceptable: they range from 0.29 to 0.69.

The results in Table IV reveal the presence of three factors with all 12 items of the banking selection criteria exhibit large factor loadings (above 0.4 significant levels). The eigenvalues for the three factors are above 1. These three factors explain a total of 54 percent of the variance. Factor 1 has six significant loadings while both factor 2 and 3 have three respectively.

Turning to an interpretation of independent dimensions based on the varimax rotated matrix as given in Table III, one can see that the first factor delineates a cluster of relationships among the following attributes; "knowledgeable and competent personnel", "Islamic reputation and image", "friendly personnel", "Islamic working environment", "service quality (fast and efficient service)" and "economic and financial reputation". The nature of the highly loaded variables on this factor suggests that it can be named "reputation and service delivery". This "reputation and service delivery" factor contributes around 27 percent of the reasons for selecting Islamic banking. Since factor 1 has the highest eigenvalue and variance, it necessarily represents the most important factor that has influenced stakeholders to patronise Islamic banking.

This result indicates that the selection of Islamic banks appears to be predominantly a combination of Islamic and financial reputation and quality service

offered by the bank. Therefore, Islamic banks must have good public relations in order to boost their reputation simultaneously to foster good customer and employee relations in order to attract customers. This finding is consistent with many earlier Islamic banking patronage studies like Erol and El-Bdour (1989), Erol *et al.* (1990), Haron *et al.* (1994), Gerrard and Cunningham (1997) and Abbas *et al.* (2003), in which reputation and the quality of service delivery including staff friendliness and competency and efficient and speedy service to be pertinent factors in influencing customers' banking selection.

Moreover, being a religious-based institutions, Islamic banks ought to provide quality services which are deemed satisfactory by their customers, particularly when they often ascribe themselves as being providers of ethical financial services (Wilson, 2003). In this regard, Wilson (2003) aptly states that Islamic banks should not emphasise competing on price, but instead stress the unique quality of products and services provided. Hence, regular consultations on a highly organised basis (e.g. customer surveys, handling complaints, etc.) to ascertain the views of their clients on ethical issues are paramount for the enhancement of reputation and long-standing of Islamic banking.

The second factor defining stakeholder banking selection criteria relates to "location is near home or office", "convenience (e.g. available parking space and interior comfort)" and "financial product price". For this, the proposed name for it is "convenience and product price" factor. The results of the factor analysis ranked "convenience and product price" as the second important factor behind the "reputation and service delivery" factor, since it explains 15.2 percent of the total variance for the variables in the data set. This result is somehow inconsistent with the previous conventional banking studies since convenience and product price factors have often emerged as most common and important factors among the banking selection criteria. For example, Almossawi (2001); Gerrard and Cunningham (2001) found that convenience factors were of paramount importance in banking selection criteria as compared to other factors based on their survey conducted on conventional banking customers in Bahrain and Singapore respectively (Almossawi, 2001; Gerrard and Cunningham, 2001).

Interestingly, the results of the factor analysis in Table IV also reveal that the variables which have loadings on the second factor are "environmental practice", "involvement in community" and "respect for human rights". The combination of these variables can be compositely grouped together under the proposed heading of "Social Responsibility of Islamic banks". The reasons are quite apparent when these variables are normally associated to dimensions under social responsibility in many previous studies (CSR Europe, 2001; EIRIS, 2001; Greenwood, 2001; Al-Khater and Naser, 2003; EIRIS, 2003). As shown in Table II, Factor 2 – "CSR of Islamic banks" accounts for 10.9 percent of the total variance. All three variables are moderately correlated with Factor 2 with factor loadings ranging from 0.465 to 0.778.

These findings imply that all the customers of Islamic banking place equal emphasis on social responsibility of Islamic banking. The fact that customers are also concerned with social responsibility issues suggests that Islamic banking institutions should promote it as one of its strategic marketing tools. This emphasis is by no means limited to Islamic banking. All forms of business enterprises in Malaysia, which are based on religious doctrine and ethical principles, should demonstrate their

commitment to social responsibilities if they want to be perceived as ethical businesses. Otherwise, they will be seen as vehicles for capital accumulation bearing no relevance to welfare of millions of those who live in relatively less favourable conditions.

In the final analysis, banks cannot depend only on financial performance to survive in this ever-changing scenario of global competition, but owes a social responsibility to the various stakeholders in which they exist. Based on the positive results on perceptions of customers towards the practice of good social responsibility, as evidenced in this study, managers need to be convinced that social responsibility and profit maximisation need not be conflicting goals. Instead, ethics and social responsibility could be used as a strategic tool to enhance the reputation and public image of a business institution, while simultaneously prove to be profitable for an institution in the long run.

Indeed, Islamic banking should endeavour to be the epicentre in the financial galaxy of promoting good social responsibility practices. In this respect, an assimilation of social responsibility and other Islamic ideals in fulfilling customers' expectations deserves utmost consideration as it represents a unique and fundamental difference between Islamic and conventional banking, and potentially able to propel Islamic banking to greater heights in securing customers' recognition and acceptance. An additional important aspect is to strategically market such an initiative through rigorous publicity, not only to attract potential customers, but also to serve as an effective tool for educating public about Islamic banking.

Conclusion

It is the main objective of this study to determine the pertinent factors, which customers of Islamic banks perceive as influential to their selection and patronage of banks. The most important fact revealed by this study is that customer satisfaction often depends on the quality of services provided by Islamic banks. The quality of services includes factors like treating customers with courtesy and respect; staff ability to convey trust and confidence; efficiency and effectiveness in handling any transaction; and knowledgeable and preparedness in providing solutions and answers concerning Islamic bank's products and services.

Consequently, Islamic bankers can no longer depend on marketing strategy of attracting pious and religious customers who might only concern about Islamicity of financial product. The important insights identified on the ranking of various banking selection criteria implies the need for Islamic bank to enhance its service quality which is now considered a critical success factor that affects an organisation's competitiveness.

In addition, another substantial issue, which requires attention, is the need to intensify public education and awareness towards the distinctive characteristics of Islamic banks and how it may profitably suit the interest of customers in their financial dealings. Islamic banks have the potential of being marketed to various segments of customers extending beyond those who are concerned with the legitimacy of the facility from Islamic point of view and those who seek for service quality, convenience and efficient transactions. Consumer education programmes are therefore crucial if they are to increase the level of consumer awareness about the unique characteristics of Islamic banking and its wide-range of financial products offered.

Note

1. According to the definition given in the Eight Malaysian Plan (2001-2005), lower-income households were defined as those earnings less than RM1500 per month. The middle-income households, defined as those earnings between RM1500 and RM5000. While higher-income households, defined as those earnings between RM5000 and above.

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