

Acceptance of Islamic Banking in Muslim Customers

A Comparative Study on Flaws of Interest Based Banking vs Positive Aspects of Islamic Banking

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Abstract

The Islamic banking is one of the most rapidly emerging trends in many different parts of the world. The interest based banking system has now been very evident to the economies regarding their impacts on the economies and the individuals involved. The study analyzed the key determinants of the Islamic banking in the banking customers living in Peshawar KPK using a self-administered questionnaire to collect data from the customers. Using a multiple regression model the study analyzed the data collected from a sample of 45 respondents and the results of the study suggest that the positive aspects of the Islamic banking and the flaws of the interests based has a positive relationship with the acceptance of the Islamic banking in Muslims across Peshawar KPK.

Key Words: *Islamic Banking, Flaws of Interest based banking and Positive aspects of Islamic.*

Introduction

The different economic crisis and the flaws in the many different systems across the world have called for many new trends and many emerging patterns in many different business lines. One of the most emerging trends in the global economies is the concept of Islamic banking and Finance (Ahmad 2000). The Islamic banking system is based on the concept of interest free banking. In the last few decades the Islamic banking has developed very speedy in many different economies and has been established in these economies as one of the most influential alternative to the conventional banking system which is based on the transaction of the interest (Ahmad and Haron 2002).

The conventional or the traditional banking system is based on the pricing of the money in the money markets and these banks accept deposits on a lower interest rates on the people who saves money and then advance these deposits to the borrowers in a higher rates and the margins between these two rates is what is called the profits of these banks (Almossawi 2001). This is what is the conventional or the interest based banking which price the money in the markets and have their profits from these pricing of money in the markets. These banking systems has many different flaws attached with them which have many different disadvantages for the communities which are dependent on the interest based banking system.

The most basic flaw which is attached to the interest based banking is that the crisis is embedded in the conventional banking system and as long as the economies are dependent on the conventional or the interest based banking systems then the economies will goes into crisis at some point of time Almossawi. (2001). The second most important disadvantage which is attached to the conventional banking system is the fast and speedy growth of inflation in the conventional banking system.

The conventional banking system develops inequality in the economies and there is a wider difference in the income levels of the people living in these economies.

On the other hand the Islamic banking system is based on the pricing of goods and services instead of the pricing of money in these economies. The Islamic banking system follows the principal provided by the Islamic Sharia (Umer 1985). This principal provided by the Islamic sharia prohibits interest in the money transaction in the Islamic economies and forbids the pricing of money in these economies.

The Islamic banking system follows the principal of Islamic sharia as provided by the Islamic sunnah and the Quran and implement these principals in their transaction and their transaction to make them free of Riba (Gait and Worthington 2007).

The Islamic economic system prohibits interest and all the transactions which involve interest in order to remove the drawbacks of the interest based banking from the Islamic economic system. With the passage of time the many different communities around the world have realized the fact that the interest based banking has many flaws associated with it and these flaws has very harmful and very serious consequences for the economies in which the banking system operates with the element of interest (Erol and Bdour (1989). These societies have realized the fact that the interest based banking is just in the interest of a very minor portion of the society and the other half of the society specially the poor people in these communities suffer from the flaws of the interest based banking. The Islamic banking system on the other hand promotes and facilitates the flow of funds in the society in such a manner that the distribution of wealth in the society remains just and equitable and all the people living in these societies enjoy equal opportunities and equal status the society (Haron, Ahmad and Planisek 1994). On the other hand the Islamic banking and economic system allow the economy a shield against the different type of crisis and recessions in the economies.

Apart from the relative edge of the Islamic banking and economic system to the conventional banking there are certain other factors which also adds some strong aspects to the Islamic banking system which develops strong preferences to the Islamic banking system. These strong points of the Islamic banking system such as the strong and high quality of the Islamic banking system allows the Islamic banking to have a wider acceptance in the Muslim and the non Muslim communities in different parts of the world.

Pakistan is an Islamic country with a very speedy and fast growth and development in their economy. The Islamic banking is getting a very wider acceptance in the Islamic countries and especially in economies and countries like Pakistan. This study analyze the acceptance of the Islamic banking in Peshawar and will analyze the impacts of the flaws of interest based banking and the positive aspects of the Islamic banking on the acceptance level of Islamic banking in the Muslim society in Peshawar. A self administered questioner is used to analyze the relationship of these factors with the acceptance of Islamic banking in these respondents.

Literature Review

Islam is a not only religion but it is a complete way of line and provide guidelines to its followers in every field of life. The economic and business transaction is also an important part of individual and social lives of all the peoples following the teaching of Islam. Islam provides very proper and brief teaching and guidelines on the business and monetary transaction in the Islamic society.

The basic principal of the Islamic banking and finance is that the Islamic banking system is that in accordance with the Islamic banking is that the Islam never treats money as a commodity whereas the conventional banking system or the interest based banking system treats money as commodity (Haroon, and Azim 2005). This treatment of money as a commodity is the basic reason which allows the conventional banking system to price money in their system. The Islamic banking and economic system on the other hand do not allow their followers to treat money as a commodity for this reason there is no room in the Islamic banking and economic system to price money in their banking and economic system and for the same reason the system forbids its followers to not charge anything extra over and above the principal money (Haroon, Norafifah, and Sandra1994).

According to the study of Haron, Ahmad and Planisek (1994) the Islamic sharia any business or banking transaction which includes any element of uncertainty, speculation or interest is forbidden or Harm. All these elements are prohibited by the Islamic sharaia to be included in any type of business transaction as all these elements makes some genuine transaction void.

There are many different reasons for which the Islamic Sharia has prohibited interest in the different transaction Iqbal, and Molyneux (2005). The first and the most basic reason for which the Islamic Sharia has prohibited interest in the different business transaction is that the factor of interest in the monetary transaction creates injustice in the society and creates a very wide difference between the different classes in the society. According to Iqbal, Zubair and Mirakhor (1987) the interest is the basic factor which gives rise to social classes in the society. It is interest which supports the national policy of making social classes in the society. This suggests that that interest is the basic factor which creates injustice and inequality in the society.

The second most important factor which is often regarded as the most basic reason for the prohibition of interest in the Islamic economic system is that Interest creates undue inflation in the society and at times the poor in the society are at disadvantage with the use of interest based transaction in the society (Karsten 1982). The savers are often the poor or the middle class people in the society who saves small amount from their incomes for their futures and deposit them in the banks for profits form the banks and the banks pay small amount of interest to them to compensate for their opportunity cost on the other hand the investors who borrow money form the bank and invest them in some profitable investments and earn a higher rate of returns form theses investments. This situation creates and helps the viscous circle of poverty to continue and the inequality among the different classes in the society continues.

According to *Monzer (1987)* the interest based banking system provides returns to the customers without taking any risks and thus provides risk free rate to the investors and people who have money can earn returns without taking any due risks for their returns. The approach in the interest based banking which allows the investors to earn profits from their investments without talking any risks has some disadvantage related to it. According to study of Khir and Shanmugam (2008) the most basic disadvantage related to this approach is that often this type of treatment has disadvantage on side of the investors or the people who deposits money in the banks. The reason for this disadvantage is that a person who saves the money in banks can earn a higher rate of return for their investments if they invest theses funds in some profitable business and can earn a higher rate of return from their investments as compared to the risk free returns which they earn from the deposits in the banks.

For the reason that the funds can be more efficiently used if they are used in some profitable but risky investments is another basic reason for which the Islamic banking do not allow their followers to invest their funds in non risky business. According to study of Almosawi (2001) this rule of the Islamic banking system ensures the fact that the funds in the society are used more efficiently and effectively and the economy can have higher benefits from the use of theses funds in the society.

Compared to the pricing of the money in the conventional banking system the Islamic banking system uses the pricing of goods and services in their society in order to have true growth and prosperity in the society (Metawa and Almosawi 1998). The Islamic banking system uses alternatives modes of business transaction such as the partnership (Musharika), and the agency agreement (Mudarabha). Both theses modes of transaction are based on the guidelines and principals of Islamic Sharaia. Theses modes of transaction are based on the partnership agreement between the banks and the depositors of the banks and the banks uses the funds of the savers in some profitable business and then distribute the profits form theses business with their depositors (Umer 1985). This suggest that the banks and the customers of the banks uses the funds in a profitable business which is either operated by both the bank and the customers or only by the bank on behalf of their customers and then uses the profits from theses investments.

The Islamic banking system also uses some alternatives investments modes to finance the different needs of their customers in a way which is Sharia compliant. Theses modes of transaction involves Ijarah which is used as an alternative for the conventional banking car finance transactions and also the Diminishing Musharaka is used for financing the homes of their customers (Gait and Worthington 2007). The Islamic banking system also use Murabah transaction to full fill the different needs of their customers regarding the working capital required for their business purposes.

Theses differences in the conventional and the Islamic banking system are quite visible to the banking customers and they can easily understand the differences and the advantages of the Islamic banking system and the disadvantages of the conventional banking system. In a study by Iqbal and Molyneux, (2005)

investigated the role of the negative sentiments regarding the conventional banking system in the acceptance of the Islamic banking in the banking customers in Malaysia. In his results he found that the negative sentiments regarding the conventional banking system is a strong determinant of the acceptance level of the Islamic banking in the Muslim customers in Malaysia and people who understand and perceive the flaws of the interest based banking are often very much attracted towards the Islamic banking system. In another study in Indonesia Jamal and Khatib (1999) also investigated the impacts of the flaws of the interest based banking on the Muslim customers in the online banking customers of the Indonesian banks in their results stayed found that the awareness level of the customers about the conventional and the Islamic banking industry play a very important role in setting the attitudes of the customers towards the Islamic banking and play a very important role in the acceptance of the Islamic banking in these customers.

Apart from the flaws of the interest based banking which have affected the attitudes of the banking customers in the Muslim societies, the positive and the strong aspects of the Islamic banking is another important factor which has a very important role in the acceptance of the Islamic banking in the Muslims and the non Muslim Societies (Zaher and Hassan 2001).

The strong aspects of the Islamic banking include more customer attention and more customer satisfaction on part of the customers. The Islamic banking system in order to fulfill the principals and the Guidelines of the Islamic Sharia provide more accurate and more reliable and high quality customer services to the banking customers. The modes of transactions which are offered by the Islamic banking system are also more reliable and are more trust worthy for the banking customers and they have more trust on these transactions (Zaman and Movassaghi 2004). The process followed by the Islamic banks for many different transactions is also important aspects of the strong points of the Islamic banking as it allow the banking customers to have more trust and reliability regarding the sharia compliances of these transactions for the banking customers.

Apart from these aspects the most influential aspect of the Islamic banking is the resilience of the Islamic banking to the crisis and the downturns in the economies. It has been quite visible in the different crisis that the Islamic banking system is comparatively less struck by the crisis and the downturns in the economies as compared to the conventional banking system (Monzer 1987). This aspect of the Islamic banking system also provides their customers a sense of security regarding their different business transactions and they can feel secure about their funds in their banks in case of any such situation. The literature presented above suggests that the Islamic banking system provide a more secure and more reliable banking alternative to the banking customers and specially the Muslim banking customers. The literature also suggest that the flaws in the interest based banking such as the inequality, poverty and inflations are some of the key determinants which are setting the attitudes of the Islamic banking customers towards the acceptance of the Islamic banking. Apart from the flaws of the interest based banking the strong aspects of the Islamic banking also plays a major role in determining the attitudes of the banking customers.

Flaws of interest based banking

It is one of the independent variable of the study and presents the different disadvantages which are caused by the use of the interest based banking to the individuals and the economy as a whole. Some of the flaws of the interest based banking consist of the increases in the poverty in the society. Also the interest based banking has impacts on the inflation and the resilience of the economy to the different crisis situation in the economy. The factors of discrimination and the creation of the social classes in the society are some of the basic factor which makes a negative image of the interest based banking in the society.

Positive aspects of Islamic banking

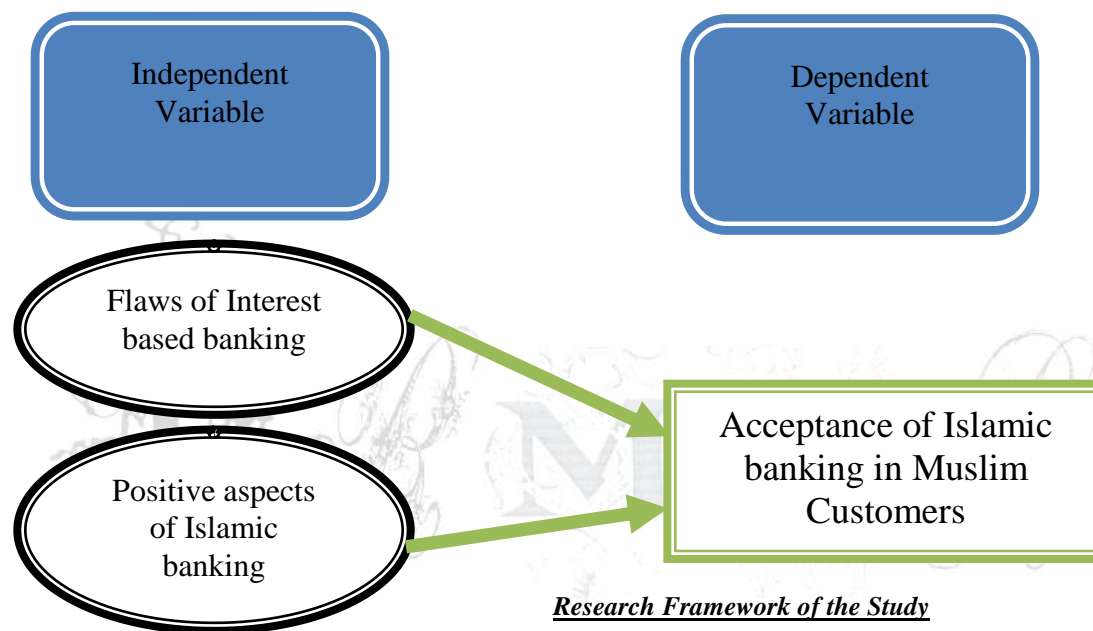
The positive aspects of the Islamic banking consist of the different products and the services of the Islamic banking which provides a competitive edge to the Islamic banking. These positive aspects of the Islamic banking are another independent variable of the study and are used in the study to analyze its impacts on the acceptance of the Islamic banking in Peshawar KPK. The service quality and the different products of the Islamic banks which have a competitive edge in the market as compared to the conventional banking products is another important aspect of the Islamic banking which may have some influence over the acceptance of the Islamic banking in the Muslims across Peshawar.

Acceptance of Islamic banking

It is the dependent variable of the study and presents the mind set of the people toward the Islamic banking in Peshawar. The acceptance level of the Islamic banking represents the attitudes and the mind set of the individuals and the society as a whole to the Islamic banking.

Theoretical Frame work

The theoretical frame of the study presents the dependent and independent variables of the study. The following Figure presents the relationship between the dependent and independent variables of the study.



Hypothesis of the study

Based on the assumptions of the study from the literature presented above the study has outlined the following main assumptions regarding the results of the study

Hypothesis: 1: There is a positive relationship between the flaws of the interest based banking on the acceptance of the Islamic banking in Muslims across KPK

Hypothesis: 2: The positive aspects of the Islamic banking are positively related with the level of acceptance of the Islamic banking in the Muslim across KPK

Methodology

The study is conducted in Peshawar KPK and the Islamic banking customers are studied in this regard to have answer to the outstanding questions of the study. For the reason the population of the study consist of the entire Islamic banking customer in Peshawar during the period of the study which is in the year 2012.

As mentioned above the population of the study consists of the entire Islamic banking customer in Peshawar during the period of the study. As it is very hard to investigate the attitudes and the preferences of all the banking customers in Peshawar, therefore the study will select a sample from the population of the

study in order to make some meaningful results from the respondents of the study. There are six different banks with 21 different branches which operate in Peshawar. For the purposes of the study two of the major Islamic banks namely Meezan bank limited and Bank AL Falah are selected for the purposes of the study and their customer are investigated for the purposes of the study.

The instrument of the study which is used by the study to collect data from the respondents of the study has been arranged as a self administered questioner. The first part of the study consist of 20 attributes regarding the Islamic banking and theses attributes are rated at a scale of five point liker scale. The respondents are asked to rate theses attributes on the five point scale. The next part of the questioner also consist of 20 questions which are arranged in the form of different statements and the respondents are asked to rate the different positive aspects of the Islamic banking. The last part of the study consists of fifteen questions which are rated at a scale of five point liker scale.

Data Discussion and Analysis

The following section of the study presents the results of the study. Questioners were distributed in 50 participants of the study. Out of theses 50 participants of the study 45 of the questioner were returned by the respondents which were properly filled by the respondents and the remaining five questioners of the study were either not properly filled or were not returned back by the respondents of the study. The following table presents the descriptive statistics of the study.

Table: 1: Descriptive Statistics

	N	Minimum	Maximum	Mean	Std. Deviation
Acceptance of Islamic banking	45	2.7	5	4.23	.71
Positive aspects of Islamic banking	45	2.8	5	4.22	.71
Flaws of interest based banking	45	3.0	4.5	4.21	.76
Valid N (list wise)	45				

The first columns of the above table present the number of observations for each of the variable of the study and suggest that for each of the variable of the study there were 45 respondents. The second column of the study presents the minimum values of the study and the third column presents the maximum values for each variable of the study. Column five presents the mean value for each observation of the study and the last column is the standard deviation for each of the variable of the study.

The results which were generated based upon the data from the 45 respondents using the multiple regression models are as follow,

Table two of the study presents the model summary for the regression model of the study. In the table presented below the value for the R is .91 thus suggesting that the dependent variable of the study varies .91 times with the independent variable of the study.

Table 1 Model Summary

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.91 ^a	.89	.906	.21305

a. Predictors: (Constant), Flaws of Interest based Banking, Positive Aspects of Islamic banking

The value presented by the table for the R square is .89 suggesting that 89% of the variation in the acceptance of the Islamic banking in the Muslim customers in Peshawar is explained by the flaws of the interest based banking and the positive aspects of the Islamic banking. The value for the adjusted R square

is .9 suggesting that 90% of the variation in the acceptance of the Islamic banking is being explained by the independent variables of the study.

The next table is the ANOVAs table of the study presented by table 3 of the study. The ANOVAs table of the study presents the fitness of model of the study and provides evidences of the accuracy of the model used in the study for the analysis of the relationship between the dependent and independent variable of the study. The ANOVAs table provides the goodness of fitness of the regression model used by the study. If the model is fit then the study is confident in the calculations which are made by the study.

Table 2 ANOVA

ANOVA^b

Model	Sum of Squares	Df	Mean Square	F	Sig.
1 Regression	19.49	2	9.74	13.74	.000 ^a
Residual	1.96	42	.05		
Total	21.35	44			

a. Predictors: (Constant), Flaws of Interest based Banking, Positive Aspects of Islamic banking

b. Dependent Variable: Acceptance Of Islamic banking

In the table above the value for the F statistics is 13.74 suggesting that the value is more then the critical F value at the 5% level of significance and suggest that the value is greater then the required F value at the required 5% level of significance. The probability for this value is .000 suggesting that there is very low probability for that the predictions of the study may have occurred by chance and all the calculations of the study are due to accurate. The significance of the F value of the table suggests that model is very accurately predicting the relationship between the dependent and independent variable of the study.

The last table of the regression model is the coefficient table which represents the different co efficient of the study as calculated by the study. Table four of the study presents the different coefficients of the study.

Table 3 Coefficients

Coefficients

Model	Un standardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	.30	.16		1.61	.031
Positive Aspects of Islamic banking	.41	.17	.42	2.62	.011
Flaws of Interest based Banking	.50	.14	.54	3.41	.001

a. Dependent Variable: Acceptance Of Islamic banking

The first coefficient as persisted by the study is the intercept term also known as the constant term in the regression model or the alpha of the regression model. The constant term in the regression model is .30 which implies that on average without the influence of the different independent variables of the study the average acceptance among the sample of the study for the acceptance of the Islamic banking is .3. This is point on the y axis from where the relationship of the acceptance of the Islamic banking with other variables of the study starts. The T vale is 1.61 which is higher at the 5% level of significance then the critical T value for significance.

The second coefficient presented by the table four of the study is the slope coefficient or the beta for the positive aspects of the Islamic banking. The value for this coefficient is .41 this implies that the acceptance of the Islamic banking varies .41 times with the changes in the positive aspects of the Islamic banking in a

appositive direction. The T value for this statistic is 2.62 which suggest that the value is grater then the critical T value for significance at the five percent level of significance.

The probability for this value is only 1% suggesting that the value is highly significant. This suggests that there is a positive relationship between the acceptance of the Islamic banking and the positive aspects of the Islamic banking.

The last coefficient in the table presents the relationship between the flaws of the interests based banking with the acceptance of the Islamic banking. The value for this beta is .5 suggesting that both the variables move positively with each other in the same direction and there is a positive relationship between theses variables of the study. The T value for this co efficient is 3.41 which is very high then the critical T value at the 5% level of significance and suggest that the positive relationship between theses two variables is significant and has not occurred by chance.

Conclusion

The literature presented in the study suggests that the Islamic banking phenomenon is one of the most emerging and the most rapidly growing concept in the global economies. Some of the studies suggest that the Islamic banking is gaining a wider acceptance in the different parts of the world especially in the areas where there are large Muslim population.

The literature also suggest that the flaws of interests based banking and the positive aspects of the Islamic banking are some of the most important factors which are having significant impacts on the acceptance of the Islamic banking in the different parts of the world.

The study analyzed the impacts of the positive aspects of the Islamic banking and the flaws of the interest based banking on the acceptance of the Islamic banking in the Muslims living in Peshawar KPK. The results of the study suggest that the slope coefficient for the relationship between the flaws of the interest based banking and the acceptance of the Islamic banking is positive and significant. This leads to the acceptance of the alternate hypothesis of the study that there is a positive relationship between the acceptances of the Islamic banking in Peshawar KPK and the null hypothesis of the study is rejected.

The slope coefficient for the relationship between the acceptance of the Islamic banking and the positive aspects of the Islamic banking is positive and is significant thus suggesting that there is a positive relationship between the acceptance of the Islamic banking the positive aspects of Islamic banking in the perception of the banking customers in Peshawar KPK. Thus the null hypothesis of the study is rejected and the alternate hypothesis of the study is accepted that there is a positive relationship between theses two variables.

The results of the study suggest that the awareness of the customers regarding the Islamic banking is an important factor in setting the attitudes of the Muslim customers regarding their acceptance of the Islamic banking. By properly making the customers aware of the positive aspects of the Islamic banking and making them realizing the flaws which are associated with the use of the interest based banking in the economy is an important determinant of the acceptance of the Islamic banking in Peshawar KPK.

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