

Consumer Perceptions of Islamic Banks: The Case of Saudi Arabia

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Abstract:

There is no clear line and distinction between Islamic and conventional banks in Saudi Arabia. Banks which are perceived as non-Islamic banks do offer various types of Islamic banking products beside their conventional products. Some of the banks are full-fledged Islamic banks. However, the Saudi Arabian banks do not carry the word "Islamic" in their names, as it pertains in U.A.E, Malaysia, Pakistan etc. So, it is hypothesized that the general public might not attach significance to the distinction between Islamic and conventional banks. This paper is conducted to assess the perceptions of Saudi Arabian people of Islamic banking in Saudi Arabia, and to draw conclusions from their views about the degree of the Shariah compliance of the Islamic banking practice. The results of this paper imply that the customers are generally satisfied with the Islamic banking practice, but they want them to do more than current level because they perceive that their banking operations are just marginally Shariah compliant. The customers also generally disapprove of the window Islamic banking by the conventional banks.

Key Words: Islamic banking, Perceptions, Shariah Compliance, Customers, Conventional banks

Introduction

Islamic Banking is the banking system that operates under the law of *Sharia* (Islamic jurisprudence). According to *Sharia*, any type of usury, interest or getting fixed

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money on loans is *Haram* (forbidden). In addition, *Sharia* prohibits investing in businesses that are considered *Haram* in Islam (i.e. selling or making of alcohol, pornography etc...). Islamic banks perform the same essential functions as other banks do in the conventional system, except that they should carry out their transactions in accordance with the rules and principles of Islam (Henry and Wilson, 2004; Iqbal and Mirakhor, 2007). Islamic banking has been launched during 1970's when the world first full-fledged Islamic commercial bank (Dubai Islamic Bank) started operation in Dubai, U.A.E in 1975. Since then the Islamic banking industry started growing rapidly not only in the Muslim countries but also in some non-Muslim countries. Islamic banks have more than three hundreds institutions over 51 countries, and its assets reached about \$400 billion in 2009. According to World Islamic Banking Competitiveness Report 2013–14 Islamic banking assets with commercial banks globally are set to cross \$ 1.7t in 2013 suggesting an annual growth of 17.6% over last four years. It is predicted that Islamic banks will control around 40-50 per cent of Muslims' savings by 2009/10, (Zaher and Hassan, 2001). The popularity of the Islamic banking system is not limited to the Islamic banks only. Large international conventional banks are showing increasing interest in the Islamic banking system as well, (Kamal Naser et al., 1999). The conventional banks, such as HSBC and Citibank, have established Islamic banking branches in some countries to meet their Muslim customers' needs. This is evidently clear in Saudi Arabia, where the distinction between conventional and Islamic banks in terms of offering Islamic financial services is increasingly blurred. Saudi Arabia has a profitable and stable banking industry. Its banking industry is regulated by the Saudi Arabian Monetary Agency (SAMA). It has the largest assets of both Islamic and conventional banks among Gulf Cooperation Council Countries (GCCs), (Alkassim2005). According to SAMA's 49th annual report; the number of commercial banks operating in the Kingdom of Saudi Arabia stood at 23 at the end of 2012, including branches of some foreign banks. Saudi Arabia is the largest market for Islamic finance in terms of size. The largest Islamic bank in the world, Al-Rajhi Banking and Investment Corporation, is based in Saudi Arabia. The bank had 267,383(SAR million) in assets at the end of 2012. The country hosts the Islamic Development Bank, which is an equivalent of Muslim countries' World Bank. Saudi Islamic banks have a clear competitive advantage over their conventional competitors. The deposit growth of Islamic banks have been higher than that of the Saudi banking sector as seen by the CAGR (Compound Annual Growth Rate) growth of 17.4% in the period 2002-05 as compared to 12.9% recorded by the Saudi banking sector for the same period. Islamic banking industry is growing rapidly in Saudi Arabia forcing some conventional banks to convert wholly to Islamic banking practices, such as the case of Bank Al-Ahli. This phenomenon has encouraged the authors to investigate the performance of this industry through the perceptions of its customers. Since there is no banking regulation in the country forbidding the banks to offer conventional products, the paper attempts to explore whether or not the perceptions and attitudes of the customers have any role in forcing the banks to Islamize. We conduct a questionnaire survey to collect the required data from the customers to examine the hypotheses of the paper. Specifically the paper examines the factors that inspire customers to choose Islamic banking services. This includes determining the level of knowledge of the customers about the Islamic banking practice and their perceptions on the reliability of its products and service quality. The rest of this paper is organized as follows: section 2 summarizes and discusses some relevant literature, section 3 discusses the method, hypotheses and results, and section 4 presents the conclusions and implications.

Some relevant literature

In reviewing some relevant literature, we have identified five areas of interest that some previous papers have investigated with respect to the customer-bank relations of the Islamic banks. They are customer satisfaction about the Islamic bank operations in general and factors that enhance the customer satisfaction, customer awareness, bank selection criteria, perception about the degree of Islamization of Islamic bank products, and customer perception about the Islamic banks. Badara et al (2013) find the customer satisfaction among prospective customers depend on the bank staff responsiveness and the bank assurance. The higher the staff responsiveness is the higher the customer satisfaction. Another area of interest is the bank selection and the reason for selecting or doing business with an Islamic bank. A good number of papers have found that religion has been a key factor for most customers for selecting or doing business with Islamic banks. This could be a biased result given the fact that most of these studies were conducted in Muslim-dominated countries, and hence the samples were skewed in favor of Muslim respondents. These respondents might not have a choice from a religious perspective but to do business with Islamic banks. Subhani et al (2012) conducted their study in Malaysia and Bley and Kuehn (2004) conducted their study in United Arab Emirates and these studies find the respondents to select Islamic banks on the basis of religious principle. Non-Muslim respondents select Islamic banks on the basis of lower transaction costs, Hadayat and Al-Buwardi (2012), Saini et al (2011). Other Non-Muslim respondents choose Islamic banks on the basis of high profit and high earnings paid on the deposits, Haque (2010) and Gerrard and Cunningham (1997). Another area of interest the literature has examined is the level of awareness and knowledge of the customers about the various Islamic finance modes. In Pakistan, Khan and Asghar (2012) find that customers in general are aware of Islamic banking models, but when Karim (2012) examines awareness of customers of one bank out of the bank population in Pakistan, the customers were found not fully aware of what financing products their bank offered. In Malaysia, Thambiah et al (2011) find that urban customers have higher level of awareness than the rural customers about the Islamic bank financing modes. In Bosnia and Herzegovina, the customers have little knowledge and awareness, Ergun and Djedovic (2011) and similar findings were arrived at in Australia by Rammal and Zurbruegg(2007). In Bangladesh, customers are aware of the deposit mobilization instruments, but they have little knowledge of the financing instruments. In United Arab Emirates and Jordan, the customers are generally aware of the financing modes, Bley and Kuehn (2004) and Naser et al (1999) respectively. Interestingly Naser et al (1999) finds that customers know Mudarabah and Musharakah modes but do not use them, and they are found to hold both Islamic bank accounts and interest-based accounts. This situation could change by now, as the study was conducted fourteen years ago with growing Islamic banking practices in the Middle East in recent years, customers' awareness might have changed. This is reflected in the summary table below; as the literature gets older the level of awareness and knowledge of Islamic banking modes is low. In the 1990's, both Muslims and Non-Muslims, were generally unaware of Islamic banking practices. The other area of interest the literature has treated is the general perception and attitude of the customers about the Islamic bank and their performance. Khan and Asghar (2012) find that in Pakistan customers generally hold positive attitude about the Islamic banks, and they are always found ready to do business with the Islamic banks. In contrast, Akbar et al (2012) find the Muslims in UK do not fully approve of the Islamic banks, because they find them to be not fully aligned with the Islamic teaching. In Qatar, the customers' perceptions are highly influenced by the premises and tangible assets of the banks and not by the competence areas, Hossain and Leo (2009). This will give the bank observers

distorted picture and view about the banks. Thus, the Islamic bank observers should not take the positive perception of customers on the face value. They should endeavor to know the factors that influence the perception. Similarly, the bank observers should know whether or not positive customer perceptions translate into actions. For example do customers who hold positive attitude about the Islamic banks increasingly do business with the Islamic banks?

Our study attempts to further enrich the literature by not only revisiting the aforementioned five interest areas, but also constructing and testing a set of hypotheses about the customer-bank relations of the Islamic banks. These hypotheses are stated and explained in the section of research methods.

Methods, Results and Analysis

Methods & Hypotheses

The paper attempts to explore the customer bank relations of the Islamic banks. We constructed a questionnaire consists of five categories namely demography, religious commitment, product quality, customer satisfaction and customer suggestion. Each category has a set of hypotheses or issues to investigate, as explained below:

A. Demography

Under this category the paper profiles the bank customers in accordance to their sex, nationality, education level, age, employment, social status and incomes. This profiling is expected to produce for us a typical/average bank customer in the sample and the level of the relation of this average customer with the Islamic bank.

B. Religious Commitment and knowledge

This section investigates the degree of religious devotion and dedication of the customers, and whether or not the level of religious devotion is predictor of selecting an Islamic bank. The customer's knowledge of Islamic banking practices is assessed and their knowledge is employed in the analysis to ascertain their approval and disapproval of Islamic banking services. The hypotheses to test are:

1. Islamic banking practice and religious commitment

H_O: Customers' religious commitment is not associated with Islamic banking practice

H_A: Customers' religious commitment is associated with Islamic banking practice

The respondents are allowed to choose their religious commitment on the labels of highly committed, moderately committed and not committed.

2. Islamic banking practice and Knowledge of Islam

H_O: Customers, who are knowledgeable of Islam, are not associated with Islamic banking practice

H_A: Customers, who are knowledgeable of Islam, are associated with Islamic banking practice.

The respondents are allowed to choose their level of knowledge of Islam on the scale of excellent knowledge, moderate knowledge, and poor knowledge. The

Islamic banking practice concerns the degree of Islamization of the Islamic banking operations. The respondents are asked to answer YES, if they believe that the banking operation conforms to the Shariah teachings, and NO, otherwise. The respondents are also asked to answer YES, if they believe that the Islamic banks are different from the conventional banks and NO, otherwise.

3. Approval of Islamic banking services and knowledge of Islamic banking

H_O: Customers, who are knowledgeable of Islamic banking, are not associated with Islamic banking products

H_A: Customers, who are knowledgeable of Islamic banking, are associated with Islamic banking products

The respondents are allowed to choose their level of knowledge of Islamic banking on the scale of excellent knowledge, moderate knowledge, and poor knowledge.

C. Products Quality

This section explores the customers' perceptions about the quality of the Islamic bank products in terms of conformity with *Sharia*, meeting the customer needs and the awareness level of the customers about the various Islamic financing models. The section solicits the perception of the customers on the degree of Islamization of the Islamic banking services. The hypothesis to test is:

4. Hypothesis: customer awareness and the Islamic banking practice

H_O: Customers who are aware and use the Islamic banking products are not associated with the degree of Islamization of the Islamic banking services

H_A: Customers who are aware and use the Islamic banking products are associated with the degree of Islamization of the Islamic banking services

The respondents are asked to rate their own awareness about the Islamic banking products on the scale of "aware of, aware of it and used it, and not aware of it", and then they are given a number of Islamic banking products to rate on the degree of their Shariah compliance on the scale of highly Shariah compliant, controversially Shariah compliant, and not Shariah compliant.

D. Customer satisfaction

This section gauges the level of satisfaction of the Islamic bank customers in respect to 23 different banking customer care services. The customers are asked to rate their satisfaction on a scale of 1 to 7. Where 1 denotes highly unsatisfied and 7 denotes highly satisfied.

E. Customer suggestion

This section presents three open ended questions for the customers. The first question wants customers to suggest things that the Islamic banks should do, given that they currently do not do those things. The second question asks the customers to suggest things that the banks stop doing, given that they currently do those things. Finally, the customers are asked to suggest further rooms for improving the practices of Islamic banks in Saudi Arabia.

Results and Analysis

One hundred and seven questionnaire forms were distributed randomly, and 90% of the respondents have responded to all the questions in the survey. The respondents are 56% male and 44% female; they are mostly Saudis, accounting for 94% of the respondents. Married respondents constitute 53% and the single respondents account for 44%. 72% of respondents are aged between 20 to 40 years; 58% of them are government employees, and 22% of them students. 36% of them have a high school certificate and 56% has an undergraduate degree. They generally come from four major income groups. One group earn less than SR 3000 a month and it constitutes 31% of the respondents. This group could come mostly from the student population. Another group earns between SR 5000 and SR 10000 and it accounts for 25% of the sample. The fourth group earns between SR 10000 and SR 20000 a month.

In terms of Knowledge of Islam, most respondents describe themselves as moderate devout Muslims accounting for 69% of the respondents, and those who describe themselves as highly devout constitute 25%. Those, who claim to have good understanding of Islam accounts for 75%, and those who claim to have excellent understanding of Islam account for 21%. 57% of the respondents say they have good knowledge of Islamic banking. 15% has an excellent knowledge and 14% has poor knowledge. Most of them know that interest is forbidden in Islam and they perceive Islamic banks to be different from the conventional banks; they do banking with the Islamic banks, and they believe that the Islamic banks are alternative to the conventional banks. But their selection of Islamic banks is influenced by religion, they use Islamic banks mainly for salary account services, and only 40% of them think that the Islamic banks in Saudi Arabia are not truly Islamic. They do not know how competent the Shariah board members are, and 62% of them do not approve or do not know the Shariah competence of the window Islamic banking by conventional banks.

70% of the respondents do not know or have limited knowledge about the Shariah competence of the Islamic banking products. The contract theories of Islamic banking, finance and investment, of which the respondents are widely aware of, are MUDARBAH, MURABBAH, WAKALA, TUWARRUQ, and IJARRAH. The respondents are of limited or have no awareness about MUSHARAKAH, SALAM, ISTISNA and ISTIJRAR. Out of these contract theories, of which the respondents are aware of, it is only TUWARRUQ contract that 10% of them claim to use, and the usage of the rest accounts for 6% and below by the respondents.

The customers were asked to rate on a Likert scale their satisfaction about the Islamic banking services. The aggregate percentage of customers, who are dissatisfied, mostly dissatisfied and highly dissatisfied accounts for 44% of the respondents. 38% of them are satisfied, mostly satisfied and highly satisfied, and the rest are neutral. On average, 18% of the respondents were highly dissatisfied compared with 14% of them who were highly satisfied. Whereas on average 17% of the respondents were neutral, and they could not rate their satisfaction about the bank services. The table below gives the bank services that score above the average 18% high dissatisfaction among the customers, services that score above the 14% high satisfaction among the customers and services that score above the average 17% neutral satisfaction among the customers.

Table 2: Customer satisfaction about the Islamic banking services		
Above average 18% high dissatisfaction	Above average 14% high satisfaction	Above average 17% high neutral satisfaction
<ul style="list-style-type: none"> - Branch Customer service counter - Bank personal understanding of customer business - Staff politeness with customers - Degree of adherence to islamic principles - Lower service charges - Complaint and suggestion system - Convenience to access 	<ul style="list-style-type: none"> - ATM services - Phone banking services - Confidentially - Cash & cheque deposit ATM - Confidence in bank management - Internet banking - Secure transaction 	<ul style="list-style-type: none"> - Staff knowledge about the islamic banking products - Uniform services across the branches - Availability of financial advice - Awareness programs on bank service - Competitive product offerings service charge - Convenient access

These results in the table above indicate three important things. One thing is that the average scores on dissatisfaction and neutrality are higher than the average score on satisfaction, and this implies that in general customers are not satisfied with the banking services. Another indication is that services involving interaction with the bank personnel feature prominently in the areas of customer dissatisfaction and neutrality. Whereas, services involving no or low interaction with the bank personnel, appear in areas of customer satisfaction. This implies that more automation of banking services increases the customer satisfaction, and where the services are less or not automated, the banks should employ high professional bankers in order to increase its customer satisfaction. The final indication from the above table is that there are still a good number of customers who cannot decide or judge their interaction with the banks. This implies either lack of knowledge or lack of interest in the relationships with the banks. This sizeable number of customers, who are neutral, can swing either towards dissatisfied customers or satisfied customers; and in either way the bank customer satisfaction will be sustainability affected. Thus, the banks should increase their efforts in improving their customer relation by positioning themselves distinctly as Islamic banks contrasting clearly with the conventional banks. For example, the TUWWARUQ loan transaction and the IJJARAH MUNTAHIYA BITAMLIK (lease purchase agreement) have been highly diluted, and the bank customers seem not able or convinced that it is different from an Islamic bank to a conventional bank. To make these products more Islamic, the Islamic banks can offer the customers, under the TUWARRUQ contract, the option to complete sale contract directly with a third party, instead of contracting the bank as a customer agent to execute the customer's sale contract, obscuring the Shariah principle that the bank and the third party should be different entities. Similarly, the IJJARAH MUNTAHIYA BITAMLIK should now be used less frequently and replaced with MUSHARAKAH MUTANAGISA (diminishing MUSHARAKH). In MUSHARAKAH MUTANAGISA the customer and the bank share the ownership of the underlying asset, and the income generated by the asset is shared proportionate to the ownership in the underlying asset. Then, the sale contract is entered into whereby the customer undertakes to buy gradually the ownership proportion of the bank in the underlying asset. In this way, the principle of profit/loss sharing will be observed, whereas the IJJARAH MUNTAHIYA BITAMLIK tilts towards the spirit of the conventional finance lease. Tables 3 and 4 present the test results of the hypotheses 1 to 4, which are described under

the section of methods and hypothesis. The paper makes use of the likelihood ratio test for the row-column independence, and it follows chi-squared distribution.

Respondents' interaction with and views on Islamic banking	Given that the respondents have		
	Religious Commitment	Knowledge of Islam	Knowledge of Islamic Banking
Having an account with Islamic bank	3.058 (0.217)	0.977 (0.807)	0.238 (0.971)
Belief that Islamic banks are different from Conventional Banks	2.219 (0.529)	6.304 *** (0.098) *	18.969 * (0.001)
Degree of Shariah compliance of the Islamic banking practice	6.652 (0.673)	3.536 (0.936)	19.488 *** (0.077) *

From the table above, the first hypothesis that says that there is no relationship between religious commitments and having an Islamic bank account cannot be rejected using likelihood ratio test at 1% significance level. Nevertheless, the cross tabulation shows that 74% and 64% respectively of those who say they have high religious committed and those who say have moderate religious commitment, have accounts with Islamic banks. The non-rejection of this hypothesis does seem to confirm the previous result. When the respondents were asked why did they open an account with Islamic bank? Majority of the respondents indicated the salary account as the most important factor for opening an account. Similarly the Islamic understanding of the respondents is insignificantly related to their holding of Islamic bank accounts. We test the hypothesis that Islamic knowledge is independent of the belief that Islamic banks are different from the conventional banks. The result is found significant at 1% level. This means the Islamic knowledge of the respondents is highly associated with the belief that Islamic banks are different from the conventional banks; around 80% of those who have excellent and good Islamic knowledge believe that the Islamic banks are different from conventional banks. The likelihood ratio test also shows there is a significant association between Islamic knowledge and the belief or disbelief in the Islamicity of the Islamic banks. 56% of those who have excellent knowledge of Islam believe the current Islamic banking practice is in compliance with Shariah, and 43% of those who have moderate Islamic knowledge believe the current Islamic banking practice is in compliance with Shariah. These percentages are in contrast to 31% and 18% respectively of those who have excellent and Moderate Islamic knowledge and believe that the current Islamic banking practice is not in compliance with the Shariah. They're still 12.5% and 39% respectively of those who have excellent and moderate Islamic knowledge and they cannot decide on the compliance of the current Islamic banking practice with the Shariah. These cross percentages imply that the current Islamic banking practice as far as the respondents are concerned is marginally compliant with Shariah. Taking the knowledge of Islamic banking of the respondents and degree of awareness of the respondents about

the Islamic banking products as independent variables, we test whether or not they are associated with their responses on the degrees of Shariah compliance of 8 Islamic banking products as illustrated in the table below:

Table4: Islamic banking products vis a vis Awareness of Islamic banking and knowledge of Islamic banking (hypotheses 3 and 4)		
Respondents views on the Shariah compliance of the product	Given that the respondents are	
	Aware of Islamic banking practice	Knowledgeable of Islamic banking
Personal Finance	10.734 (0.097)***	5.118 (0.745)
Real estate finance	13.947** (0.030)	5.214 (0.735)
Car finance	16.326 (0.012)	8.847 (0.387)
Education finance	9.025 (0.172)	8.805 (0.359)
Trade finance	13.895** (0.031)	10.558 (0.228)
Current account services	4.504 (0.609)	7.968 (0.4371)
Saving account services	12.081*** (0.060)	4.794 (0.779)
Investment account services	8.323 (0.215)	7.071 (0.529)

We find that the knowledge of Islam is not associated with the products' Shariah compliance; whereas, the knowledge of Islamic banking is significantly associated with four products' Shariah compliance. These products are personal finance, real estate finance, car finance and trade finance. 62% of the respondents who claim to have excellent knowledge of the Islamic banking believe that the Shariah compliance of personal finance is highly trusted, and 58% of those who have moderate Islamic banking knowledge also believe so. 25% of those who have Excellent Islamic banking knowledge believe that personal finance is not Shariah compliant, and 13 % of them say it is controversial. 36% and 45 % of those who have good and moderate Islamic banking knowledge respectively believe that the Shariah compliance of personal finance in controversial. These cross percentages can be generalized for the other Islamic banking products where the row-column association is significant. It implies again that the respondents consistently view the Islamic banking practice as marginally Shariah compliant.

Conclusion and Implications

To study the bank-customer relation of the Islamic banks, the literature offers five areas to investigate in relation to the customer satisfaction and the factors that influence their satisfaction. First, it is found that staff-responsiveness is a key determination of customer satisfaction. We find that in Saudi Arabia, customer satisfaction is high with automated banking services and low with person-to-person banking services. Second, the literature investigates the factors for Islamic banking selection and it found that religion is an important criterion for Muslims to choose Islamic banks over conventional banks, and for non-Muslims high returns have been the key factor. The respondents in our paper are all Muslims, and they too choose Islamic banks on the basis of religion. The third, fourth and fifth areas of study in relation to the bank-customer relation are customer awareness and knowledge of Islamic banking products, customer perception about the Islamic banking practice, and customers' belief about the degree of Shariah compliance of Islamic banking practice. In general, the perception is getting increasingly positive as we move from old literature to the most recent ones (table1). The customers appear to be aware of certain Islamic banking products such as TUWARRUQ, MURABHAH and IJARRAH, and in term of usage it is only TUWARRUQ they claim to have used. The respondents of the current paper generally describe themselves as devout Muslims who have good knowledge of both Islam and Islamic banking. They believe and consider Islamic banks as different, and alternative to the conventional banks. Their selection of Islamic banks is influenced mostly by the religion, and they often do salary account business with the Islamic banks. They generally have no knowledge of the Shariah board members of the Islamic banks, but they do generally disapprove of the Shariah competence of the window Islamic banking. Most customers do not know or have limited knowledge about the Shariah compliance of the Islamic bank products. The customers are aware of MUDARBAH, MURABHAH, WAKALA, TUWARRUQ, and IJARRAH, and they are unaware of MUSHARKAH, SALAM, ISTISNA and ISTIJRAR. The only contract theory they knew and used widely is TUWARRUQ. The customer satisfaction is found to be high with the automated banking services and low with person-to-person banking services. This implies that customers are not satisfied with the personal responsiveness of the banks. The customer religious commitment is found insignificantly related to having an Islamic bank account, or the belief that the Islamic banks are different from the conventional bank, or the degree of Shariah compliance of the Islamic banking practice. Whereas, their knowledge of Islamic banking is significantly related to their belief that the Islamic banks are different from conventional banks, and it is also significantly related to the degree of Shariah compliance of the Islamic banking practice. On the Shariah compliance of eight Islamic banking products, (table 4) around 50% of the customers believe that the products are Shariah compliant. The customers' awareness of these products is significantly associated with the Shariah compliance of the products. The results of this paper imply that the customers are generally satisfied with the Islamic banking practice, but they want them to do more than current level because they perceive that their banking operations are just marginally Shariah compliant. The customers are also generally found to disapprove of the window Islamic banking by the conventional banks.

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