TESTING THE RELATIONSHIP BETWEEN CUSTOMER'S SATISFACTION, PRODUCTS (MODES) AND SERVICES OF ISLAMIC BANKS

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ABSTRACT

The study aims at finding out the relationship between the satisfaction of customers, products and services of Islamic Banks operating in Peshawar. Retrospective/descriptive study has been performed to include past research work by the scholars on the same area of interest. This study consists of 100 respondents (male 75 and female 25) were taken from three Islamic banks in Peshawar. The primary data collect through developing close ended questionnaire and data analyzed through SPSS. The data analysis shows significant positive relationship between services and products and customers’ satisfaction. The results of this study have provided some useful information for common investors and customers as well as policy makers of Islamic banks.

Keywords: Islamic Banking, Satisfaction of Customers, quality of Products

Paper Type: Research Paper


Introduction

The banking system (Conventional) has its roots in capitalism where interest is considered as the cornerstone of the economy. Under this system of banking, Banks are not more than a mediator in channeling fund from lender to the borrower. Due to exploitative rates of interest charges, this kind of financial system is failed to uplift the lives of its customers. Islam on the other hand provides a financial system which is free of interest and provides for the development of the society.

The first milestone achieved by Muslim countries was the establishment of Islamic development bank (IDB) in 1973. Since then tremendous growth has been noticed in Islamic Financial Industry. By the end of December, 2017 the number of Islamic financial institutions in world were more than three hundred. One of the successful attempts in terms of Islamic banks was the Grameen bank of Bangladesh. Since then Islamic banks are gaining the confidence of customers in South Asia with a tremendous pace.

Owing to the rapid growth of Islamic Financial Industry, customers are now switching from conventional to Islamic banks. The current study is therefore an attempt to test whether or not there
is a relationship between customers’ satisfaction quality of products and services of Islamic banks in Peshawar. The purpose of this paper is to find out the relationship between satisfaction of customers, products and services of Islamic Banks operating in Peshawar.

The study has an extraordinary significance on the grounds that Islamic banks are a rising and quickly developing industry. The results of this study have provided some useful information for common investors and customers as well as policy makers of Islamic banks.

The research is focused on testing the following hypotheses.

H01: There is no significant relationship between quality of products and Customer’s satisfaction of Islamic banks.

H02: There is significant relationship between quality of services and Customer’s satisfaction of Islamic banks.

Literature Review

Islamic Banking: Origin, Scope & Growth

Islamic banks are established to reorganize the Muslims financial contracts and activities which complement the principles of Shariah (the Islamic Law) and enable them to conduct it without interest, usury, or ‘riba’. Zaher and Hassan (2001) mentioned that Islamic finance was practiced predominantly in the Muslim world. As a matter of fact, the term “Islamic Financial system” started to appear only in the mid-1980s, where it is not limited to banking, but covers financial instruments, financial markets, and all types of financial intermediation. The main factor which is supporting the dramatic growth of Islamic finance for the last couple of years is the spread of the Islamic religion globally.

Siddiqui (2008) mentioned that International banks around the globe considered it as a profit opportunity to cater the increasing demand for Sharia compliant products, which changed from a normal deposit to creating new products in hedging, investments, and derivatives. Brooks (1999) concludes that some non-Muslims are participating in Islamic banking because they consider it to be commercially sound. On the other hand, Zaher and Hassan (2001) rationalized that the growth of Islamic finance and banking is influenced by factors including the introduction of broad macroeconomic and structural reforms in financial systems, the liberalization of capital movements, privatization, the global integration of financial markets, and the introduction of innovative and new Islamic products.

Islamic Banks have recorded high growth rates both in size and number around the world even in non-Muslim countries such as Western Europe, North America, and Asia. Islamic banks operate in over a hundred countries worldwide, most of them in the Middle East and Asia, with over three hundred Islamic financial institutions in operation which manage assets worth $500 billion. Islamic banking industry has increased its share of total bank assets from 8.8% in 2002 to 13.4% in 2008 (Islamicbanker.com).

Olson and Zoubi (2008) observed that there were Multinational banks which have introduced Islamic windows and divisions to offer Islamic products and services within their Conventional banking or have substantial dealings in the field, such as HSBC, BNP Paribus,

As per Asian Banker’s annual report, the world’s largest Islamic banks by assets are concentrated in only five markets: Iran, Kuwait, Malaysia, Saudi Arabia and the UAE. In three countries, Iran, Pakistan and Sudan, the entire banking system has been converted to Islamic Banking, and they are considered as the pioneers of full Islamization. In other countries, the banking systems are still dominated by Conventional banking institutions operating alongside Islamic banks. Molyneux and Iqbal (2005) estimated that Islamic banks in the GCC Region held about 74% of Islamic Banking system assets in 2002.

Islamic Law and Concepts (Sharia Law)

Many of the legally recognized business arrangements and contracts in Islamic Finance and Banking have been derived from the four main sources of Islamic Law (or Sharia), which are: The Quran, the Sunnah, the Ijma, and the Qiyas. Islamic law prohibits the payment and receipt of interest or usury (riba). Legally, riba is defined as a “contractual increase arising from a loan (qard), whether in money or barter” (Rosly & Bakar, 2003).

The Holy Quran indicates that interest is an unfair business transaction as profits realized from loans are risk-free with no evidence of value-addition by lenders, which is considered as an ethical concern. The rationale behind the prohibition of interest or usury (riba) is based upon values of justice (‘adl), cooperation (ta’awun), efficiency, stability and growth. Also, it is Islam’s response to resolve social imbalances arising from inequitable distribution of income created by the credit system. Even though the interest (riba) system has its benefits which are confined and restricted only to the lenders, the borrowers stand to bear the costs which is unethical.

Zaher and Hassan (2001) have included in their research that Islam is against making money or demands that Muslims revert to an all-cash or barter economy; however it means that all parties to a financial transaction share the risk and profit or loss of a venture, and that no one party to a financial contract gets predetermined return. Such a system or framework will cut down the credit transactions and expand genuine trade and commercial activities in finance and banking.

Regarding the efficiency of capital allocation, interest based lending with adjustments for risk capital tends to result in serving the more creditworthy borrowers and not necessarily the most productive projects. On the other hand, the Islamic profit and loss sharing (PLS) system allocates financing to the most productive business ventures, as the share in returns is more promising.

Banning of interest and activating the (PLS) system in Islamic finance is supported by economic rationales which are described by the International association of Islamic banks (1995, pp3-4), as per the points listed below:

1. Based on (PLS) banking system, the allocations of funds will be primarily based on the soundness of the project, and the return on capital will depend on productivity. This will results in improving the capital allocation efficiency.
2. The (PLS) system will ensure more equitable distribution of wealth and the creation of additional wealth to its owners more than the credit system which depends on interest. As a result, this would definitely lead to reduction of unjust distribution of wealth under the interest system.

3. The (PLS) system may increase the volume of investments and hence create more jobs. On the other hand, the interest system would make feasible and acceptable only to those projects whose expected returns are higher than the cost of debt, and therefore filter out projects which would have been accepted under the (PLS) system.

4. Islamic finance and banking reduces the size of speculation in financial markets, but will allow for a secondary market for trading stocks and investment certificates based on profit sharing principles. This will bring sanity back to the financial markets and promote liquidity to equity holders.

In the (PLS) system, the supply of money is not allowed to overstep the supply of goods and would reduce inflationary pressures it has in the economy.

Islamic Financial Contracts

There are basic financing contracts which are Sharia compliant and have been developed for the usage of Islamic Banks. The Islamic modes of financing are divided into two groups, which affect both the assets and liabilities sides of the Bank’s balance sheets (Al-Jarhi, 2009; Siddiqui, 2008; Zaher & Hassan, 2001).

- Core modes which are based on the profit-and-loss-sharing (PLS) principle and include: Mudaraba (trustee finance), Musharaka (equity participation).
- Marginal modes which are based on mark-up principle and are (non-PLS) based, such as, Qard Al Hasanah (beneficence loans), Bai’ Mua’jjal (credit sales or deferred payments sales), Bai’ Salam or Bai’ Salaf (purchase with deferred delivery), Ijara and Ijara wa iqtina’ (leasing and lease-purchase), Murabaha (mark-up), Istisna’a (forward contract), and Jo’alah (service charge).

The literature below will provide a brief overview of some widely used Islamic banking contracts which are commonly used to provide sharia compliant products covering savings, trade, real estate, investment and many more, as Islamic banks offer a range of financial services and products:

*Murabaha* *(trade with markup or cost plus sale)*

A Murabaha transaction is a cost plus profit financing contract in which the asset is purchased by the Islamic Bank at the request of its customer from a supplier. The Islamic Bank then sells the asset to its customer on a deferred sale basis with a mark-up, which reflects the bank’s profit, which cannot be changed during the life of the contract.

*Musharaka* *(partnership or joint venture)*
It is considered as a form of equity participation contract where it is usually employed to finance long-term investment projects. If the customer (debtor) does not seek full bank financing of the project (100%) but contributes some of his own equity capital, then such a contract is referred to as a Musharaka. The bank is not the sole provider of the funds in order to finance the project, as the customer, who's considered as a partner, contributes to the joint capital of an investment. The two parties are involved in a (PLS) agreement where the profits are shared in accordance with pre-determined ratios while the losses are borne in proportion to equity participation.

**Mudaraba (trustee finance contract)**

Under this financing contract, the Bank provides the entire capital required for the project, while the customer (or entrepreneur) offers his labor and expertise. Being a PLS mode, the profits from the project are shared between the bank and the customer at a certain fixed ratio. Financial losses are borne exclusively by the bank, where the liability of the customer is only limited to his time and efforts. Only in the event of mismanagement or negligence is the customer held liable for the losses.

The Mudaraba contract is reflected in the balance sheet of the bank on both the asset and liability side. On the liability side, the contract between the bank and the depositors is known as unrestricted Mudaraba in which the depositors agree that their funds to be used by the bank’s discretion, to finance an open-ended list (unrestricted) of profitable investments and expect to share with the bank the overall profits accrued and earned.

**Ijara or ijara wa iqtina’ (leasing contract)**

Ijara is similar to a conventional operating lease, where when an Islamic bank (lessor) leases the asset to a customer (lessee) with an agreement on lease payments for a specified period of time, but with no option of ownership for the customer (lessee). On the contrary, Ijara wa Iqtina’ is similar to the conventional financial or capital lease, where the Islamic bank (lessor) purchases the asset such as a building, equipment or even an entire project and leases it to the customer for an agreed lease rental payment, together with the customer agreement to make lease payments towards the purchase of the asset from the lessor at the end of the leasing period.

Zaher and Hassan (2001) mentioned in their study that many investors, especially Islamic banks, have been attracted to Islamic leasing with the promise of higher yields than Murabaha, which accounts for the bulk of Islamic banks financial contracts. The performance of first Islamic bank in Pakistan i.e. Meezan bank was compared with group of five conventional banks. The study evaluated the performance in terms of profitability, liquidity, risk, and efficiency for the period of 2003-2007.

Twelve financial ratios such as Return on Asset (ROA), Return on Equity (ROE), Loan to Deposit ratio (LDR), Loan to Assets ratio (LAR), Debt to Equity ratio (DER), Asset Utilization (AU), and Income to Expense ratio (IER) were used as variables to assess banking performances. T-test and F-test were used to measure the significance difference of these Performances.

The study found that MBL is less profitable, more solvent (less risky), and also less efficient comparing to the average of the five conventional banks. However, there was no
significant difference in liquidity between the two sets of bank (Moin, 2008). Islamic bank business development framework is not working efficiently as compare to conventional banks (Khan, Farrukh, & Aslam, 2014).

Samad and Hassan (2000) evaluated the intertemporal and interbank performance of Islamic bank Islam Malaysia Berhad (BIMB) for the period 1984-1997 by using same performance measures and found that in inter-temporal comparison Islamic bank BIMB’s made (statistically) significant progress in profitability while the BIMB risk increased. In interbank comparison the study found that BIMB is relatively more liquid and less risky compared to a group of 8 Conventional banks.

A study conducted on five Islamic banks from MENA region analyzed their financial statements over the period 1993 – 2002 found that liquidity risk arises because of pre mature withdrawal by account holders due to a mismatch between investor’s expectations of return and the actual return. Therefore, Islamic banks are required to keep adequate cash or cash equivalents to meet the demand. They identified the other reasons of liquidity risk can be the lack of confidence on the banking system, reliance on few large depositors, reliance on current accounts and restrictions of Islamic banks on sales of debt.

The profitability of Islamic banks is low due to short term investments and low equity base (Badr-El-Din, Ibrahim, & Vijaykumar, 2003). In case of Islamic banks, short term Debt financing includes Murabaha, Salam, and Qard fund and long term debt financing includes Sukuk, leasing and Istisna. In case of Conventional banks short term debt financing include treasury bills, trading bonds, short term loan and advances and deposits at other financial institution that mature within one year. Long term debt financing include non-trading bonds and medium and long term loans (Donsyah, 2004).

Samad (2004) examined the comparative performance of Bahrain’s interest-free Islamic banks and the interest-based conventional commercial banks during 1991-2001. It has been realized that there exists a significant difference in credit performance between the two sets of banks. However, the study finds no major difference in profitability and liquidity performances between Islamic banks and conventional banks. Srairi (2010) evaluated the cost and profit efficiency through stochastic frontier approach of 71 commercial banks of Gulf cooperation council countries from 1999 to 2007.

The efficiency comparison between Islamic and conventional banks is evaluated across the world and especially the gulf countries. The calculated results revealed that the efficiency of banks at Gulf countries is more convincing than the world. It is also found that the conventional banks are more efficient than Islamic banks. Kaleem and Isa (2003) evaluated the Islamic and conventional deposit returns through an alternative econometric procedure. They further studied the impact of one deposit return on the other deposit return. They stated that Islamic banking industry contributed a significant development in the Muslim countries.

Bley and Kuehn (2003) investigated the relationship of different financial terms and concepts about conventional and Islamic banking among the university students. It was found that the knowledge of the terminologies used in conventional banking was higher than Islamic banking terminologies. It was further argued that religious sincerity is not only source to find the preference
for Islamic banking services. It was suggested that educating the understanding of the Islamic products would be compared to the conventional product would lead to better choices for consumer. Viverita (2011) evaluated that Islamic banks observed insignificant cost efficiency at 5% than conventional banks. It was also found that Islamic banks generated more profitability and revenue than Islamic banks.

Haron and Ahmad (2000) assumed that if, there is an effect of conventional theory on the Islamic bank customers then there is a strong relationship between the rate of interest on the deposit at conventional banks with the rate of profit of the deposited amount at Islamic banks. They realized the effect of interest rate on deposited amount at conventional banks and past dividend rates on deposited amounts at Islamic banks through adaptive expectation model in Malaysian banks. They found that according to Muslim customers there is a negative relationship between interest rate of conventional banks with the rate of return offered by the interest free banks.

Oluwanisola et al. (2000) argued that as muslims do consider this universe with dual view (this universe and hereafter) whereas the westerns seculars have materialistic view only. The inception of the conventional accounting systems in the Islamic organizations leads to mismatch the objective of the organizations with procedures used by that corporation. The researcher expressed that conventional accounting system carries western values and materialistic reality of profit whereas the Islamic ideology based on social welfare, justice and equity measures.

Jaffar and Manarvi (2011) evaluated the performance of Islamic and conventional banks through CAMEL test during the period of 2005-2009. The sample of their research is 5 Islamic and 5 conventional banks. It is found that Islamic banks performed better and having high liquidity than the conventional banks, moreover it is realized that conventional banks have pioneer in the management and having a good earning ability.

**Fig 1: Theoretical Framework**

![Diagram](image)

**Results & Discussion**

Table demonstrates the dispersion of survey as indicated by the sexual orientation. The outcome demonstrates that among the respondents 75 are male with 75 rates. Female respondents are 25 and rate was 25 of the aggregate. The male part of the gender contributed more in the study.
Table 1 - Distribution of sample respondents on the basis of gender

<table>
<thead>
<tr>
<th>Gender</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Male</td>
<td>75</td>
<td>75</td>
</tr>
<tr>
<td>Female</td>
<td>25</td>
<td>25</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

The correlation table shows significant positive relationship between services and products and customers satisfaction. The value in Pearson correlation for services and customers satisfaction is 0.806 which means that there is a positive relationship between Customer s’ satisfaction and services offered to them by banks. It means that with the increase in quality of services, the Customer s’ satisfaction level will also increase. This relationship is huge at 5 % level of importance. The estimation of Pearson correlation for the quality of products and Customer s’ satisfaction is 0.822 which also indicates a positive relationship between these two variables.

Table 2 – Correlation

<table>
<thead>
<tr>
<th></th>
<th>Services</th>
<th>Products</th>
<th>Customer’s satisfaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>Services</td>
<td>1</td>
<td>0.413**</td>
<td>0.806</td>
</tr>
<tr>
<td>Products</td>
<td>0.000</td>
<td>1</td>
<td>0.822</td>
</tr>
<tr>
<td>Customer Satisfaction</td>
<td>0.000</td>
<td>0.000</td>
<td>1</td>
</tr>
</tbody>
</table>

** Correlation is significant at the 0.01 level (2-tailed).

It shows insights demonstrate the quality of the dependability of the poll. The above table shows that our questionnaire is 87% reliable.

Table 3 - Reliability statistics

<table>
<thead>
<tr>
<th>Cronbach’s Alpha</th>
<th>No of Items</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.874</td>
<td>03</td>
</tr>
</tbody>
</table>

The above Table - 4 shows an output from SPSS. In the table it can be seen that Customer’s satisfaction is used as dependent variable, while quality of services and products are used as independent variables. There are four columns and four rows in this table. The first column shows the variable name, followed by the value of coefficient or beta, T value, and P value respectively. It very well seen from the table that results of Islamic banks has a coefficient value of 0.395, which means that Products are directly related with Customer s’ satisfaction. It further indicates that one unit change in quality of products will bring 0.395 units change in Customer s’ satisfaction.

If there is an increase of one unit in quality of products, it will increase the Customer’s satisfaction by 0.395 units and vice versa. Similarly the quality of services is also directly related with Customer s’ satisfaction as depicted by its B value i.e., 0.360. Moving to the next columns we have T and P values which show that whether or not the values of coefficient are significant.
In simple words, both these show that the values of coefficients are reliable and are not obtained by chance. If the T value for a variable is more than 1.96 at 5% level of significance, we say that this variable has a significant relationship with the selected dependent variable and vice versa. Similarly, for a variable with P value less than 0.05 at 5% level of acceptance will be considered as positive relationship with dependent variable.

Table 4 - Regression results of Products and customer satisfaction

<table>
<thead>
<tr>
<th>Customer s’ satisfaction</th>
<th>B</th>
<th>T</th>
<th>P</th>
<th>R²</th>
<th>F</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>1.471</td>
<td>5.700</td>
<td>0.000</td>
<td>0.65</td>
<td>4.245</td>
</tr>
<tr>
<td>Products</td>
<td>0.395</td>
<td>3.183</td>
<td>0.032</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Services</td>
<td>0.360</td>
<td>2.930</td>
<td>0.038</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Conclusion & Practical Implications

Owing to this discussion in mind, both the selected independent variables have positive relationship with customers’ satisfaction of Islamic banks. Keeping in mind the above discussion, the null hypothesis can be rejected and it can be concluded that there is a significant positive relationship between products (modes), quality of services and customers’ satisfaction. The results of this study have provided some useful information for common investors and customers as well as policy makers of Islamic banks.

References

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Appendix – 1

Questionnaire

Name (Optional): __________________________
Gender: □ Male  □ Female

Scale: 1: Agree 2: Strongly Agree 3: Neutral 4: Disagree 5: Strongly Disagree

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Services</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>True to the teachings of Islam?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Not different from other commercial banks except in complying with Shariah legal prescriptions with regard to product offering?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Promoting Islamic values and way of life towards staff, clients and general public?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Do not exploit its customers in any way?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Follow Islamic ethics?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Enhancing product and service quality.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Islamic bank do not involve in Riba (Interest), and instead of it use the method of profit loss sharing (partnership). Do you think it is better than western banking?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Islamic bank do not invest in industries with products and services involved (Alcohol, Pork and Gambling). Do you think it OK, for welfare of society?</td>
<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
</tbody>
</table>

Products

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Services</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Shariah scholars play their role while issuing different products?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>Shariah board acts as a trustee while issuing different products?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>Maximizing profits (good percentage of return to investors).</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>Promoting sustainable development projects</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Enhancing product and service quality.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Are providing enough retail products?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>The products are different from conventional?</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>