

PRIMARY RESEARCH

Role of Islamic Financial Literacy in the Adoption of Islamic Banking Services: An Empirical Evidence from Lahore, Pakistan

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Abstract. The study aims to assess Islamic financial literacy among the residents of Lahore and to investigate how it influences adoption of Islamic banking services. A survey research design is used; the sample size for the study was 300, which included 230 males and 70 females. Purposive and convenience sampling techniques were used for sample selection. A survey questionnaire designed through a systematic assessment of the literature and identification of important concepts in relevance to Islamic banking was used for data collection. Analysis was done on SPSS and AMOS using structural equation modeling and other related interventions. The results show that majority of the participants have concerns about the legitimacy of Islamic banking services, the customer quality, quality of services and products, legitimacy of the Islamic banking system as operated, and the related factors. Further, it was found that the level of educational attainment among the masses, customer services, service quality, and legitimacy of Islamic banking influence the rate of adoption of Islamic banking services. The State Bank of Pakistan and other regulatory bodies should promote Islamic financial literacy and Islamic banking products' awareness among customers to increase adoption of Islamic banking services.

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JEL Classification: G2, Z12

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INTRODUCTION

In the span of the past few decades, a major and dynamic change has been seen in the banking environment. Financial systems have become more competitive with the passage of time. Islamic banking system has been evolving rapidly over the last three decades. It is one of the most dynamic systems that have emerged in the present times, and has been able to capture the interests of millions of individuals around the world (Atkinson & Messy, 2011).

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Both Islamic and contemporary economists have shown an interest in this system due to its core tenets and features. Despite of the fact that most of the Islamic banks are located within the Middle East and Islamic countries, a large number of international conventional banks have shown an interest in the Islamic banking system. Islamic financial products have been increasing in terms of their demand and range. The interest of Muslims in Islamic banking is based on avoidance from “Interest” that is the core feature of it. The conventional banking systems are based on using interest for funding their business ventures. However, Islamic banks claim to be free from such measures and principles. Islamic banking operates on the use of profit and loss sharing and trading that claims to be free from all forms of interest.

The large-scale prevalence of Islamic banks is the main reason for which this research has been undertaken. However, the present study is also aimed at investing the level of Islamic financial literacy that exists within Pakistan.

Prevalence of Islamic Banking Services

There is a strong rationale behind the prohibition of interest in Islam. A large number of Islamic economists have conducted studies with the aim of assessing the ideologies and rationales behind the prohibition of interest in Islam (El-Gamal, 2001; Siddiqi, 2004). Also, the importance of profit and loss sharing principle in Islam has been assessed (Ahmad, 2010).

Financial Literacy and its Relevance to Islamic Banking

Financial literacy refers to the level of understanding, awareness, and knowledge people have about the use of financial instruments. Consumers of Islamic banking can be empowered to make informed and more strategic financial decisions through increasing their financial literacy. The financial industry in Muslim regions has been flooded with numerous financial instruments both of conventional and Islamic categories. These instruments have been designed to target Muslims as well as Non-Muslim consumers (Chong & Liu, 2009). Hence, it is important for these individuals to have an understanding about these instruments, the differences, the mode of action, the profit and loss sharing mechanism, risk transfer, and how interest, in any form, is not being used in such systems.

The core area of the present investigation is Islamic Financial Literacy. In this regard, the level of financial literacy in terms of Islamic banking in Pakistan and a number of other Muslim countries has been reported weak (Kayed, 2008). However, the evidence in this regard is not sufficient due to which there is a need for conducting more detailed investigations (Hassan & Bashir, 2003). It can be argued that there is a lack of awareness among a wide range of Muslim factions about Islamic banking and other forms of Islamic financial literacy.

Research Gap

It is critical to note that a large population in Muslim countries, including Pakistan, does not have a clear understanding about Islamic banking services (Khattak, 2010; Lee & Ullah, 2010). The level of ambivalence, their queries and concerns about Islamic banking, their misconceptions, expectations about service quality, and the determinants of the choice of

Islamic banking in comparison to conventional banking have not been effectively explored. There is a gap in literature in terms of awareness and understanding about Islamic banking services.

Aims and Objectives

The Objective of this paper is:

- To estimate and assess the level of Islamic financial literacy among the residents of Lahore.
- To identify the determinants of Islamic financial literacy.
- To investigate the importance of Islamic financial literacy in influencing consumers towards Islamic banking services.

First section of the study introduces the topic being explored. Second section gives literature review, third section presents the conceptual framework, fourth section presents the research methodology, fifth section shows the results and interpretation while the section six concludes the research and provides recommendations and directions for future research.

LITERATURE REVIEW

Defining Financial Literacy

Akhtar (2007) defined financial literacy as a measure of the level or degree to which one has an adequate level of understanding about key financial concepts, measures, and approaches and possessing the ability and confidence to manage ones personal finances in the short and long run keeping in view the changing economic conditions.

Islamic Financial Literacy

Currently, there is no commonly accepted definition of Islamic Financial Literacy. However Rahim, Rashid, and Hamed (2016) proposed a conceptual definition of Islamic Financial Literacy by keeping a close relationship with the general definition of financial literacy and defined it as “the ability of a person to use financial knowledge, skill, and attitude in managing financial resources according to the Islamic teachings”.

Measurements of Islamic Financial Literacy

It has been determined that the assessment of Islamic financial literacy involves an evaluation of the interest-free principle. Another important assertion in terms of measurement is that buying shares with a short level of price fluctuation is not speculation and therefore allowed in Islamic banking (Hasan & Asutay, 2011). Islamic banking is focused on investing money on the basis of profit and loss sharing methods. These institutions are focused towards providing a higher level of lease financing, trade financing and industrial financing; it is another aspect of Islamic banking.

Other important aspects of Islamic financial banking are *mudārabah*¹ and *qard al-*

¹*Mudārabah* is trust financing—a form of partnership where one party provides the funds while the other provides expertise and management. Profit is shared as per agreed ratio (50:50; 40:60 or any other) while business loss is borne by the capital provider. Loss due to negligence, if any, has to be borne by the *mudārib* (Ayub, 2012).

*hasan*². People at large do not understand-mechanism of Islamic banking services due to which they are less interested in using those services. As a result, the chances for Islamic banks to go into loss increase as they are unable to target a large population (Haron & Azmi, 2009).

Decision-Making in Choice about Islamic Banking

Studies have identified a wide range of factors that are important in terms of choosing Islamic banking. A core aspect central in terms of this decision-making is Service Quality. It should be noted that service quality is an important aspect and a source of competitive advantage for banks. Managers of financial institutions and bodies put a great deal of emphasis on service quality (Al-Tamimi & Kalli, 2009). Dusuki and Abdullah (2007) had reported that service quality, conformity with the principles of Islamic Sharī'ah, and the level of financial reputation of an Islamic bank were important determinants of the choice of Islamic banking.

CONCEPTUAL FRAMEWORK

In order to measure Islamic financial literacy and its effects on adoption of Islamic banking services, a conceptual model has been derived. The Figure 1 depicts independent variables that are Islamic banking and financial service knowledge, role of Sharī'ah Board, customer dealings, objectives of banking and financial institutions, Islamic banking and financial services, role of religion, legitimacy of Islamic financial systems, and customer satisfaction while adoption of Islamic banking services is the dependent variable.

The foundations of Islamic Banking theory are in the Sharī'ah Law. The Sharī'ah law, in terms of Islamic banking, is based on the idea that interest is prohibited because it has a wide range of negative effects on the society including: increase in poverty, unequal distribution of wealth, variance in purchasing power, credit crisis, and exploitation of individuals at the hands of creditors (Haron & Azmi, 2009).

TABLE 1
Abbreviations

| No | Phrase | Abbreviations |
|----|---|---------------|
| 1 | Islamic Banking and Financial Service Knowledge | IB&FSK |
| 2 | Role of Sharī'ah Board | ROSB |
| 3 | Islamic Banking and Financial Institutions Customer Dealing | CD |
| 4 | Objectives of Islamic Banking and Financial Institutions | OBFD&FI |
| 5 | Islamic Bank and Financial Services | IB&FS |
| 6 | Role of Religious Factor | RORF |
| 7 | Legitimacy of Islamic Financial System | LOIFS |
| 8 | Customer Satisfaction | CS |

²A type of loan in which the borrower is bound to make repayments for the original amount alone and without any form of interest (Haron & Azmi, 2009).

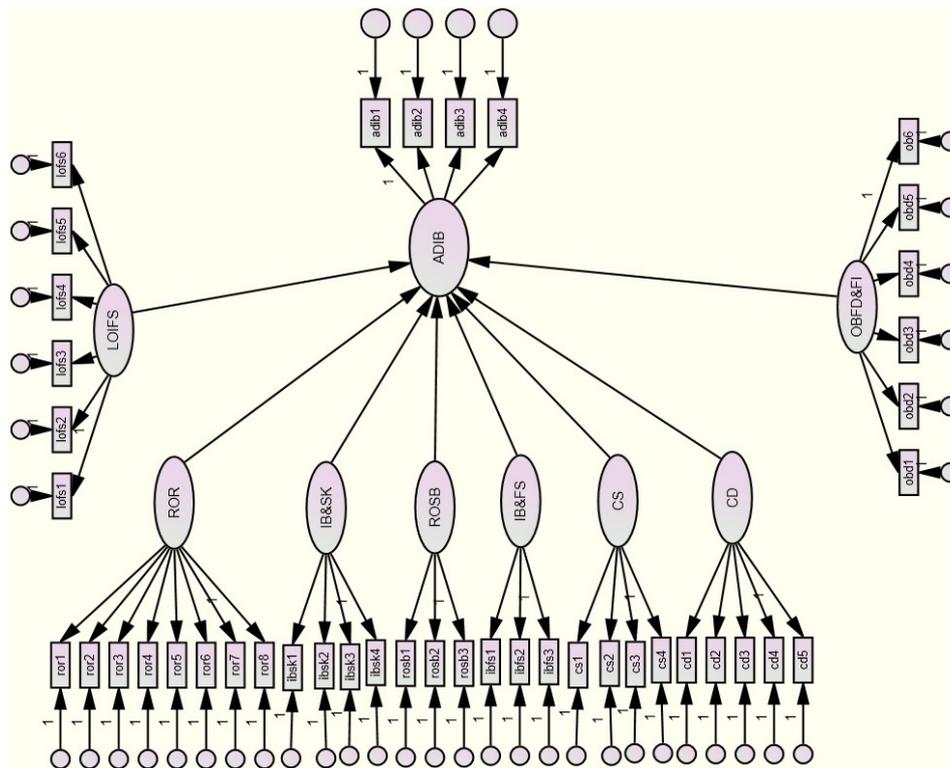


FIGURE 1. Theoretical framework

RESEARCH DESIGN AND METHODS

Research Design

The study used descriptive survey research design and structural equation model. This design was suitable for the purpose of documenting the views and opinions of individuals about Islamic banking (Amin & Isa, 2008).

Sample Plan

The targeted population for the research was Lahore. Convenience and purposive sampling techniques were used for sample recruitment and selection by approaching business and commerce students who had a bank account in any conventional or Islamic bank. 330 questionnaires were distributed out of which 316 were received. 16 questionnaires were dropped from the analysis during data cleaning process. Out of 300 questionnaires, 230 were males and 70 were female university students employed at different organizations in Lahore. It is important to note that the inclusion criteria for the study were to recruit those who had knowledge and experience of using banking services whether it be conventional or Islamic banking services.

Questionnaire Design

The first section of questionnaire collected demographic information from the participants, while the second section sought information about Islamic financial literacy of the participants and its effects on adoption.

Model’s Specification

The Structural equation model is used to assess the relationship of Adoption of Islamic Banking with that of selected independent variables.

The functional form can be expressed as

$$Adib_{it} = \alpha + \beta_1ib\&fsk + \beta_2rosb + \beta_3cd + \beta_4obfd\&fi + \beta_5ib\&fs + \beta_6rorf + \beta_7loifs + \beta_8cs + e$$

Reliability Analysis

Reliability represents the consistency and repeatability of measurements. It provides a statistical summary which helps to estimate the consistency and reliability of respondents answers to the set of questions or measures. In order to test the reliability or internal consistency of the scales developed to measure money attitudes and behavioral biases, Cronbach’s Alpha has been used in this research. It indicates the degree to which the items on a same test measure the same thing, and ranges from 0 to 1. Social and behavioral studies usually use Cronbachs Alpha as an indicator of reliability (Liu, Wu, & Zumbo, 2010). It is suitable to use Cronbachs Alpha for the reliability of this study as it is in behavioral finance. The coefficient alpha of 0.70 or more is considered adequate for the reliability of measurements (Cronbach, 1951; Nunnally & Bernstein, 1978). However, many other statisticians proposed that Cronbach’s alpha over 0.6 is acceptable (Shelby, 2011). This process was done using SPSS 21.

TABLE 2
Scale reliability of the survey questionnaire

| Cronbach’s Alpha | Cronbach’s Alpha based on Standardized Items | N of Items |
|------------------|--|------------|
| .700 | .795 | 40 |

Data Collection and Analysis

The empirical analysis for the present study was based on using a survey questionnaire on clients of the banking sector in Lahore. For the purpose of minimizing biases, the selection was done in a randomized manner. SPSS and AMOS software were used for the purpose of data analysis. The data were analyzed using SPSS 21. AMOS 21 was used to perform Structural Equation Model (SEM) analysis.

RESULTS AND INTERPRETATIONS

In this section descriptive analysis along with the results of structural equations modeling is presented.

Analysis of Demographic Variables

Data gathered on demographic variables of respondents include information regarding gender, age, and educational level. Following Table summarizes the respondents’ demographics.

TABLE 3
Demographics

| Gender | | Age | | | Qualification | | |
|--------|--------|-------|-------|----------|---------------|--------|-------|
| Male | Female | 20-24 | 25-29 | Above 29 | Graduate | M.Phil | Ph.D |
| 230 | 70 | 105 | 189 | 6 | 128 | 156 | 16 |
| 76.67% | 23.33% | 35% | 63% | 2% | 42.67% | 52% | 5.33% |

As mentioned in Table 3, majority of respondents were males representing 76.6%, while 70 were females representing 23.4%. Respondents of 20-24 years os age represent 35% of the total sample, 25-29 years old were 63%, and above 29 years were only 2%. As regards the qualification, 42.67% respondents were graduates, 52% M.Phil, and 5.33% Ph.D.

Results of the descriptive univariate variables are presented in Tables below.

TABLE 4
IB and financial service knowledge [No. and % age of respondents]

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|--|-------------------|---------------|--------------|---------------|----------------|
| I am aware of Islamic banking products. | 26 8.67% | 37 12.34% | 52 17.34% | 140 46.67% | 45 15% |
| I understand the Concept of Islamic Banking | 11 3.67% | 36 12% | 73 24.34% | 140 46.67% | 40 13.34% |
| <i>Muḍārabah</i> | 43 14.34% | 112 37.34% | 65 21.67% | 62 20.67% | 1 0.34% |
| <i>Mushārah</i> | 41 13.67% | 115 38.34% | 62 20.67% | 66 22% | 16 5.34% |
| <i>Murābahah</i> | 43 14.34% | 123 41% | 53 17.67% | 63 21% | 18 6% |
| <i>Ijārah</i> | 51 17% | 111 37% | 55 18.34% | 57 19% | 26 8.67% |
| I know that Islamic Banking involves Profit and Loss sharing principle. | 13 4.34% | 46 15.34% | 84 28% | 130 43.34% | 27 9% |
| There is no significant difference between the products and services offered by Islamic banks or conventional banks, except the difference in their names. | 21 7% | 65 21.67% | 111 37% | 80 26.67% | 23 7.67% |

Table 4 is about the latent variable, “IB&FSK” which includes the statements on Islamic banking products’ awareness. As per the results mentioned in the above Table, 21% (12.34 + 8.67) respondents are not aware of Islamic banking products; 61.67% (46.67% + 15%) say that they are aware. If we include the 17.34%, those who are neutral, it would mean that 39% are not aware of the Islamic banking products. Similarly, about 40% (including those who are neutral) do not understand the concept of Islamic banking. Only about 21% understand *murābahah*, while those who understand *mushārah* are 27 per cent. Those who understand the mostly used products of *murābahah* and *Ijārah* are 27% and 27.6%, respectively. Those who know that Islamic banking involves Profit and Loss sharing principle are about 52%, while 34.4% are of the view that there is no significant difference between the

products and services offered by Islamic banks or conventional banks, except the difference in their names.

TABLE 5
ROSB

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|--|-------------------|--------------|---------------|---------------|----------------|
| Products are offered after close inspection by the Sharī‘ah board. | 28 9.34% | 47 15.67% | 94 31.34% | 113 37.67% | 18 6% |
| Sharī‘ah boards review system and procedure of the new product launched. | 24 8% | 40 13.34% | 112 37.34% | 111 37% | 13 4.34% |
| Sharī‘ah boards give Sharī‘ah opinion on new product. | 26 8% | 35 11.67% | 91 30.34% | 135 45% | 13 4.34% |
| Sharī‘ah board acts as a supervisor. | 16 5.34% | 6 2% | 116 38.67% | 95 31.67% | 13 4.34% |

As per the results in the Table 5, respondents who understand that the products are offered after close inspection by the Sharī‘ah board are 43.7% (37.67 + 6), while only 41% (37 + 4.34) understand that the Sharī‘ah boards review the new products to be launched. It implies that about 60% are not aware of the provisions of the SBP’s Sharī‘ah governance framework according to which all products and processes have to be reviewed and approved by the Sharī‘ah boards. Similarly, about 50% know that Sharī‘ah boards give Sharī‘ah opinion on new product, while only 36% believe that Sharī‘ah board acts as a regulatory authority. The ratio of neutral persons (30-39%) may mean that they might not be even interested to know about the Sharī‘ah advisory system.

TABLE 6
Islamic banking and financial institutions customer dealing

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|---|-------------------|---------------|---------------|---------------|----------------|
| Islamic banks do not exploit their customers in any way. | 31 10.34% | 81 27% | 69 23% | 100 33.34% | 19 6.34% |
| Islamic banks dont indulge in misleading advertisements. | 14 4.67% | 103 34.34% | 88 29.34% | 73 24.34% | 22 7.34% |
| IB&FIs are in consonance with the principles of fair dealing, justice, and benevolence. | 14 4.67% | 49 16.34% | 133 44.34% | 79 26.34% | 25 8.34% |

Table 6 shows that those respondents who understand that Islamic banks do not exploit their customers and that Islamic banks are also not involved in the misleading advertisement campaigns are 40% (33.34 + 6.34) and 32% (24.34 + 7.34) respectively. Those who have a view that Islamic banks are involved in exploitation of their customers and give misleading advertisements are 37% (10.34 + 27) and 39% (34.34 + 4.67) respectively. Only 35% (26.34 + 8.34) are of the view that operations of Islamic banking and financial institutions are fair based on justice and benevolence; while 21% (16.34 + 4.67) believe that practices of Islamic

banking and financial institutions are not focused on the principle of fairness, justice, and benevolence. The number of those who are neutral (44%) implies the low level of literacy about the system.

TABLE 7
Objectives of Islamic banking and financial institutions

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|---|-------------------|--------------|---------------|---------------|----------------|
| Profit maximization is the main goal of Islamic banks. | 15 5% | 79 26.34% | 81 27% | 94 31.34% | 31 10.33% |
| Promoting saving awareness. | 21 7% | 34 11.34% | 106 35.34% | 123 41% | 16 5.33% |
| Providing opportunity to earn income as per Islamic values. | 13 4.34% | 24 8% | 95 31.67% | 150 50% | 18 6% |
| Good source to promote Islamic values. | 8 2.67% | 34 11.34% | 102 34% | 129 43% | 27 9% |
| Offering viable and competitive financial products. | 9 3% | 44 14.67% | 86 28.67% | 128 42.67% | 33 11% |

Table 7 on literacy about the objectives of the IFIs shows that 42% (10.33 + 31.34) respondents believe that Profit maximization is the main goal of the Islamic banks. Those who consider that Islamic banks are helping in the promotion of saving awareness are 46% (41 + 5.33). Fifty six% (50 + 6) believe that Islamic banks are providing *halāl* income generation opportunities while 52% consider that Islamic banking is an effective platform for the promotion of Islamic values. Similarly, 53% respondents consider that Islamic banks are offering viable and competitive financial products. The neutral respondents who are unaware of the basic objectives of Islamic banks and implementation status are 27%, 35%, 32%, 34%, and 29%, respectively.

TABLE 8
Islamic bank and financial services

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|--|-------------------|--------------|--------------|---------------|----------------|
| Providing enough retail products. | 32 10.67% | 40 13.34% | 85 28.33% | 116 38.67% | 27 9% |
| Contributing to social welfare. | 19 6.33% | 47 15.67% | 94 31.34% | 114 38% | 26 8.67% |
| Collection and distribution of <i>zakāh</i> . | 9 3% | 33 11% | 50 16.67% | 162 54% | 46 15.34% |
| Performance judged only through good percentage of profit/return. | 20 6.67% | 44 14.67% | 94 31.34% | 116 38.67% | 26 8.67% |
| IB&FIs use modern technology in performing banking transactions. | 21 7% | 22 7.33% | 74 24.67% | 145 48.34% | 38 12.67% |
| Islamic banking system completely serves as an alternative banking system. | 21 7% | 47 15.67% | 95 31.67% | 95 31.67% | 42 14% |

Table 8 shows that about 47% (138.67 + 9%; 38 + 8.67) respondents have a view that Islamic banking and financial institutes are providing enough retail products and are contributing to social welfare, meaning that remaining 53% either do not agree with the two statements or are neutral. Regarding the view that IBIs are involved in the collection and distribution of *zakāh*, 69% have a positive view. Out of the total, 47% (38.67 + 8.67) and 61% (48.34 + 12.67) respondents consider that Islamic banks’ performance is judged only through the percentage of profit/return., and that modern technology is used in performing bank transactions, respectively. Those who do not have any idea about the performance measurement or the use of technology by Islamic banks are 31% and 25%, respectively. Only 46% respondents have an idea that Islamic banking system completely serves as an alternative banking system.

TABLE 9
Religious factor

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|--|-------------------|--------------|---------------|---------------|----------------|
| Reason behind using Islamic banking is religious. | 10 3.33% | 28 9.33% | 71 23.67% | 138 46% | 53 17.67% |
| The Islamic banking system was introduced because Muslims are prohibited to take <i>ribā</i> . | 7 2.33% | 35 11.67% | 47 15.67% | 137 45.67% | 74 24.67% |
| Non-Muslim customers are not interested in utilizing the Islamic products and services. | 27 9% | 93 31% | 118 39.33% | 48 16% | 14 4.67% |
| Islamic Banking is meant for Muslims only. | 72 24% | 75 25% | 114 38% | 28 9.33% | 11 3.67% |

Table 9 on the role of religion in adopting Islamic banking reveals that 64% (46 + 17.67) respondents consider religion as the cause behind using Islamic banking, while 38% have the view that religion has no role in adopting Islamic banking. Similarly, 42% consider that Islamic banking was introduced because of *ribā* prohibition. It is a serious view in the Muslim-majority country like Pakistan. Its main cause could be the banking products that, according to many, might be a replica of the conventional banking products. Forty percent of the respondents do not agree with the statement that non-Muslims are not interested in utilizing the Islamic products and services; while 21% (16 + 4.67) respondents consider that non-Muslims are not interested in Islamic banking. Just 13% respondents have a view that Islamic banking is meant for Muslim only, 38% are neutral in this respect, while the rest 49% consider that Islamic banks are for all-Muslims and non-Muslims.

TABLE 10
Legitimacy of Islamic financial system

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|--|-------------------|--------------|---------------|---------------|----------------|
| Islamic banking and financial personnel have proper knowledge of Islamic teachings and it works accordingly. | 15 5% | 61 20.34% | 77 25.67% | 123 41% | 23 7.67% |
| Islamic Banking is according to the Islamic principles. | 11 3.67% | 59 19.67% | 95 31.67% | 111 37% | 24 8% |
| Rules and regulations given by Sharī'ah experts are according to Qur'ān and Sunnah. | 9 3% | 55 18.33% | 88 29.34% | 125 41.67% | 23 7.67% |
| Conformity with the norms of Islam and then in accordance with customers preferences. | 8 2.66% | 56 18.67% | 101 33.67% | 117 39% | 18 6% |
| IB and financial institutions are investing in less risky options. | 6 2% | 48 16% | 121 40.33% | 108 36% | 17 5.67% |
| By adopting Islamic banking, customers believe that they Indulge in Islamic business. | 30 10% | 60 20% | 96 32% | 88 29.34% | 26 8.67% |

Table 10 reveals that 49% (41 + 7.67) and 45% (37 + 8) respondents consider that Islamic banking and financial personnel have a proper knowledge of Islamic teachings, and that Islamic banking is working according to the Islamic principles, respectively. Those who consider that rules and regulations given by the Sharī'ah experts are according to Qur'ān and Sunnah are 49% (41.67 + 7.67), while 22% consider that the opinion by the Sharī'ah scholars might not be according to the Islamic principles. 45% (39 + 6) respondents believe that Islamic banking system is in accordance with the norms of Islam and also according to the customers preferences; while 21% (18.67 + 2.66) are of the view that the Sharī'ah norms and the client's preferences are not implemented. While 42% respondents believe that Islamic banking and financial institutions are investing in less risky options; about 18% (16 + 2) have an opposite view. The percentage (40%) of neutral respondents in this regard reveals those who have no idea about risk assessment in the banking system. Thirty eight percent (29.34 + 8.67) have a belief that by adopting Islamic banking customers they indulge in Islamic business; 30 percent disregard this concept, while 32% are neutral in this regard.

TABLE 11
Customers' satisfaction

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|---|-------------------|--------------|---------------|--------------|----------------|
| The practices of transparency by Islamic banks are more visible than that of conventional. | 17 5.67% | 49 16.33% | 135 45% | 82 27.33% | 17 5.67% |
| Islamic banks provide assurance, reliability, and empathy as significant factors for customers' satisfaction. | 4 1.34% | 40 13.33% | 102 34% | 135 45% | 19 6.33% |
| Products and services in Islamic banks are more expensive than conventional banking. | 32 10.67% | 75 25% | 112 37.34% | 68 22.67% | 12 4% |

Table 11 on customers' satisfaction reveals that 33% (27.33 + 5.67) respondents have a view that Islamic banks are more transparent; while 22% (5.67 + 16.33) say that Islamic banking institutions are not emphasizing on transparency procedures. The remaining 45%

respondents are not aware of transparency in Islamic banking system. Out of the total, 51% (45 + 6.33) respondents understand that Islamic banks provide assurance, reliability and empathy as significant factors for CS; 15%(1.34 + 13.33) do not think that assurance, reliability and empathy are significant factors. The respondents who consider that product and services of Islamic banking are more expensive than those of conventional banking system are 27% (22.67 + 4%), while 36% (10.67 + 25) are of the view that Islamic banking services are not more expensive.

TABLE 12
Adoption of Islamic banking

| Statement | Strongly Disagree | Disagree | Neutral | Agree | Strongly Agree |
|--|-------------------|--------------|---------------|---------------|----------------|
| I am willing to switch to a <i>halal</i> IB product given the same quality as that of conventional banking services. | 10 3.33% | 45 15% | 31 10.33% | 152 50.67% | 62 20.67% |
| A perception that Islamic banks don't completely follow Islamic principles acts as a barrier to the adoption of IB. | 9 3% | 34 11.33% | 68 22.67% | 162 54% | 27 9% |
| Willing to switch to a profit and loss agreement where you might incur losses. | 17 5.67% | 57 19% | 124 41.33% | 88 29.33% | 14 4.67% |
| Willing to switch without finance facilities by Islamic banks. | 12 4% | 55 18.33% | 102 34% | 79 26.33% | 52 17.33% |

Table 12 on adoption of Islamic banking shows that 71% (50.67 + 20.67) respondents are willing to switch to any *halal* Islamic banking product which is of the same quality of conventional banking services (in terms of rate). If we also consider neutral respondents in this regard, it would mean that 29% (3.33 + 15 + 10.33) are not willing to switch to a *halal* Islamic banking product. The respondents who consider that the perception, “Islamic banks don't completely follow Islamic principles” acts as a barrier to the adoption of IB are 63% (54 + 9). Those who are willing to switch to a profit and loss agreement where they might incur any losses are 34% (29.33 + 4.67). Survey also denote that 44% (26.33 + 17.33) respondents are willing to adopt Islamic banking system without credit facilities. If the neutral respondents are also taken as non-willing respondents, it would mean that 56% (18.33 + 4 + 34) respondents are reluctant to adopt Islamic banking facilities without financing facilities by the Islamic banks.

Structural Equations Modelling

TABLE 13
Goodness of the fit of model

| Goodness of fit tests | Statistics |
|---|--|
| Chi-square test | Value: 3136.988 Degree of freedom: 824 <i>p</i> -value: 0.0000 |
| Root Mean Square Error of Approximation (RMSEA) | Value: 0.069 |
| Comparative Fit Index (CFI) | Value: 0.882 |
| Tucker Lewis Index (TLI) | Value: 0.871 |

Table 13 shows different goodness of fit statistics of the model. Chi-square test is a conventional model to test the model fit but there are several limitations attached to it. Sample size and assumption of multivariate normality sometimes give us significant p -value of Chi-square (McIntosh, 2007). Further, RMSEA test's value lies between 0.05 and 0.08, which, according to Hutchinson and Olmos (1998) shows a reasonable fit while MacCallum, Browne, and Sugawara (1996) consider it a good fit. Values of CFI and TLI lie between 0 and 1. Value closer to 1 indicates a better fit, where value ≤ 0.90 indicates a reasonable fit and their value ≥ 0.95 indicates a good fit. In the Table, above CFI is depicting a better fit and TLI is depicting a reasonable fit of the model (Bentler, 1990; Hu & Bentler, 1999).

Interpretation

TABLE 14
Standardized WLSMV estimation

| Variables | Estimate | <i>S.E.</i> | <i>Est./S.E.(t value)</i> | <i>p</i> -Value |
|--------------------|----------|-------------|---------------------------|-----------------|
| IB&FSK | 0.122 | 0.060 | 2.033 | 0.042** |
| ROSB | -0.136 | 0.105 | -1.297 | 0.194 |
| CD | 0.224 | 0.095 | 2.354 | 0.029** |
| OBFD&FI | -0.320 | 0.711 | -0.449 | 0.653 |
| IB&FS | -0.046 | 0.268 | -0.172 | 0.864 |
| ROR | 0.164 | 0.082 | 2.007 | 0.044** |
| LOIFS | 0.596 | 0.074 | 8.100 | 0.000*** |
| CS | 0.172 | 0.098 | 1.749 | 0.080* |
| <i>R</i> - squared | | 0.560 | | |

Dependent variable: Adoption

*(significant at 10%), **(significant at 5%), ***(significant at 1%)

Table 14 shows that IB&FSK, CD, RORF, LOIFS, and, CS have a positive relationship with adoption whereas ROSB, OBFD&FI, and IB&FS have a negative relationship with adoption. 1 unit increase in IB&FSK will increase ADIB by .1222 while 1 unit increase in ROSB will cause a decrease in ADIB by .0136. Similarly, 1 unit increase in cd will increase ADIB by .224, while 1 unit increase in OBFD&FI will decrease the ADIB by .320, 1 unit increase in INIB&FS will decrease the ADIB by .046, 1 unit increase in ROR will increase ADIB by .164, 1 unit increase in LOIFS will increase ADIB by .596 and 1 unit increase in CS will increase ADIB by 0.172.

p -values of IB&FSK, CD, ROR, and LOIFS are less than 0.05 and of CS is less than .1, depicting that these variables are significant in terms of impact while all other variables are insignificant. R-square illustrates 56% variation in dependent variable, i.e., adoption is explained by independent variables collectively.

Discussion

The overall results of all the Tables indicate that 40% respondents have the knowledge of Islamic banking and financial services, while 60% are not aware of the Islamic banking sys-

tem. Secondly, 43% respondents are satisfied with the ROSB, while 57% are unsatisfied. Thirdly, around 50% respondents believe that Islamic banking and financial institutions are focused on their principle objectives. In addition to this, 53% respondents understand that Islamic banking institutions are competent to provide all required financial services. Only 42% respondents believe that the religious factor is a baseline for the adoption of Islamic banking while 58% do not accept that religious factor has any importance behind the adoption of Islamic banking. Moreover, 45% respondents approved the LOIFS. Survey also reveals that 63% respondents were not satisfied with the customer dealing services of Islamic banks. Lastly, the survey also implies that 53% respondents are prepared for the adoption of Islamic banking system.

Amongst all variables, IB&FSK, CD, and the RORF are statistically significant at 5% whereas LOIFS and CS are significant at 1% and 10% level of significance respectively. Whereas the ROSB, OBF&FI, and IB&FSK are insignificant. Positive relationship between IB&FSK shows that higher the score of participants on Islamic financial literacy, the higher is the probability for adoption of Islamic banking services. There are number of studies that have provided support for the findings of the present investigation (Bley & Kuehn, 2004).

Another important finding was that about 50% of the respondents had some awareness about the concept of Islamic literacy and banking. More than 50% of the participants were not aware of the concepts of *muḍārabah*, *mushārah* and other related core financial contracts/instruments in Islamic banking. Also, compliance with the principles of Islamic Sharī'ah is an appealing factor for those consumer segments that give importance to religion. Study conducted by Bizri (2014) that carried out a survey of Islamic banking consumers based in Lebanon provided support for the findings of the present study.

A large number of consumers prefer Islamic banking due to their desire to use financial services from an interest-free institution. They have a preference to consider banks that provide *ḥalāl* income and profits to them in comparison to conventional banks that focus on earning money in an un-Islamic manner. For this reason, Islamic banks need to make sure that their consumers are not misled into any service without their awareness. Their confusions in terms of interest rates, profit and loss sharing, and other core Islamic financial instruments and concepts can lead to negative perceptions.

Another important finding was seen in terms of the role of the Sharī'ah Board. About 48% of the participants had shown a preference for products and services offered by Islamic banks after a thorough level of review by the Sharī'ah Boards. It implies that majority also takes into account how the products are actually applied or implemented by the banks. Further, the majority of the participants perceived that Islamic banks also tend to exploit their customers just like the conventional banks. There are some studies that have shown that a number of banks in Muslim regions are consistently using the "Islamic" labels in order to attract new customers. However, a number of them do not comply with the principles of Islamic Sharī'ah. Mohieldin (1997) had reported that banks in countries like Egypt invested 20% of their money in *murābahah* contracts while about 80% in conventional banks that operate on interest. Such violations had a negative impact on consumers perceptions and

they were not able to understand the differences between Islamic banking and conventional banking.

It was also found that almost all participants were interested in using Islamic banking because of the prohibition of *ribā*. The findings are in accordance with a great deal of literature on this area which asserts that more than 90% of individuals using Islamic banking are Muslims and prefer to use it because of the prohibition of *ribā*. Other important determinants identified in the present investigation were the quality of customer services, legitimacy of the Islamic banking system, and other related factors that have a significant role to play in terms of influencing customers to adopt Islamic banking services.

The results of SEM have also showed that with an increase in educational attainment, service quality, religious compliance, and legitimacy of the Islamic banking systems, an increase will be seen in the adoption rates of Islamic banking. The literature that has provided support for these findings is extensive in nature.

CONCLUSION

The study has established that Islamic financial literacy is an important indicator of adoption of Islamic banking. The level of adoption has been slow due to the lack of awareness and education among the masses. The main objective of this research is to determine the awareness, understanding, and perception of Islamic banking products and services and their effect with regard to adoption. This study has a total of 300 respondents. It can be concluded that the conventional banking sector in Pakistan is quite competitive and has been able to maintain a large customer base. Islamic banking in comparison has not been able to effectively penetrate the market. Islamic banks in this regard need to incorporate a wide range of awareness creation and educational measures for increasing the rate of adoption. It is also critical for them to provide high quality, legitimate, *halāl*, and wide-spanned services in order to become profitable and in order to attract a large customer base.

More specifically, 50% of the respondents were aware of Islamic banking services but most of them were not aware of the different concepts used in Islamic banking. About half of the population scores low on Islamic financial literacy. A majority of the participants had concerns about the quality of services and financial instruments offered by Islamic banks.

Policy Implications and Limitations

Adoption of Islamic banking can be increased with an increase in education, financial literacy, improved customer services quality, and legitimacy of banking services in terms of compliance with the principles of the Sharī'ah. So, the State Bank of Pakistan and other regulatory bodies should promote Islamic financial literacy and Islamic banking and finance products' awareness among the customers. The study used quantitative data analysis due to which the exact reasons behind the lack of awareness cannot be assessed. Also, the sample size was limited to Lahore city, that too of University graduates due to which the external validity or generalizability of the study can be questioned. Particularly, the Sharī'ah scholars, the business community, and the general public are not covered under the sample.

Future Research

- Future studies on this area can be conducted for assessing causal factors behind customer preferences about Islamic banking, also including the rural area's population.
- Mixed method designs and approaches can be used for effective research findings.
- Future studies should target multiple cities and regions in Pakistan with broader coverage of all major groups for obtaining more generalizable results.

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