

PRIMARY RESEARCH

An Empirical Study of Sharī'ah Legitimacy of Islamic Banking Operations in Pakistan

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Abstract: The legitimacy of Islamic banking refers to the compliance with the precepts of Sharī'ah (Islamic law) of the pronouncements and their implementation, requisites of various contracts, as well as, realization of the welfare objectives. Therefore, the Islamic banks are supposed to follow the Islamic values focused to bring benefit to the society alongside the commercial motive. These distinguishing features establish identity of the Islamic banks separate from their conventional counterparts and require pursuing normative values of Islamic injunctions. The primary focus of this research is two folds: firstly, considering the legitimacy of Islamic banking practices in holistic perspective including normative concerns directed by Sharī'ah, and secondly, to gauge the perception of the customers of Islamic and conventional banks about the aforementioned approach of Sharī'ah legitimacy. The research has been commissioned by developing the constructs of Sharī'ah legitimacy through extensive review of the relevant literature. At the same time, the empirical analysis based on the opinion of 836 customers of Islamic and conventional banks in all the four provinces and the capital city of Pakistan has produced important conclusions regarding their perception about legitimacy of the Islamic banking practices. The key finding in the theoretical perspective is that the value judgements have been grossly ignored by the Islamic banks. The empirical research indicated that about half of the customers perceived Islamic banking as Sharī'ah legitimate. On overall basis, the other half viewed contrary to this or preferred to remain indifferent. There is a dire need that Islamic banks should look into the desired goals of Sharī'ah legitimacy in both contexts; the value judgement and the perception of the customers.

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INTRODUCTION

The Islamic banks, besides pursuing their business interests, ought to render the value judgements derived through *maṣāliḥ* (public interest at large) of the mankind. This has been emphasized by a number of research studies, for example Ahmed (2006), Ahmed (2011), Dusuki and Abdullah (2007), Laldin (2013), and Mohammed, Razak, and Taib (2008). Accordingly, Islamic Law dispenses justice, mercy, benefit, and wisdom. And, anything contrary to these values does not deem originating from the Law (Atiyah, 2007). The legitimacy of Islamic banking operations should, as such, refer to the compliance with the precepts of Sharī'ah (Islamic law), requisites of various contracts and operational processes, as well as, observance of the normative values resulting from the Islamic injunctions. The legitimacy of Islamic banking, Rosly (2010), suggests should, therefore, be perceived through *maqāṣid al-Sharī'ah*, alongside the commercial motivation.

The literature suggests that public opinion provides important basis for legitimizing the actions of any organization as concluded by Berrone, Gelabert, and Fosfuri (2009) and Hough and Bradford (2013). Suchman (1995) arrives at similar conclusion that various stakeholders, too, understand that such actions could be approved only when they meet the criteria of appropriateness within a framework of social norms, values, and beliefs. Similarly, Karataş-Özkan, Nicolopoulou, and Özbilgin (2014) and Rafay and Sadiq (2015) reach at the same inference that the organizations should operate in line with expectations of the concerned stakeholders. We therefore, understand that the opinion of the customers of Islamic and conventional banks helps evaluating legitimacy of the Islamic banking operations. Hence, the primary focus of this paper rests with to evaluate operations of Islamic banks in Pakistan in terms of their value-oriented contributions to the society and to empirically explore the opinion of the customers about Sharī'ah legitimacy of current Islamic banking operations. The paper attempts building future outlook of Islamic banks by enhancing efficiency and impact through value judgments. The main research area, as such, relates to the need to evaluate the operations of Islamic banks in the light of *maqāṣid al-Sharī'ah*, that is, whether or not the normative concerns have been attended to in addition to compliance of the operations with the prescribed contract mechanism. The policy implications for Islamic banking industry have been drawn in the light of Islamic values to facilitate achieving legitimacy of Islamic banking operations in the aforementioned context.

The rest of the paper is structured as follows. Section II presents the theoretical framework consisting of the requisites of Sharī'ah legitimacy of Islamic banking operations and review of current practices vis-a-vis normative values. Section III elaborates the methodology of empirical research including criteria for selecting the respondents, sample frame, design of questionnaire, conduct of survey, and techniques of data analysis. Section IV comprises results and interpretation of the empirical research, while Section V presents the conclusions and policy implications for the Islamic banking industry in Pakistan.

THEORETICAL FRAMEWORK

This section identifies the Islamic law as distinguished from the positive/man-made laws, by its origin, comprehensiveness, and universality, as well as, its application to the contemporary Islamic banking operations.

Islamic Law and Sharī'ah Legitimacy of Islamic Banking Operations

Interchangeably understood as Sharī'ah, the Islamic Law consists of *aḥkām e Shara'ī* [sing. *ḥukm*: a communication from the God Almighty) related to the human act(s). The jurists have classified the sources of Islamic laws into two broad categories, viz. (i) primary or material sources-Qur'ān (The communication of the God Almighty that was revealed to the Prophet Muhammad (PBUH) and Sunnah (the practice of the Prophet PBUH) and (ii) secondary or rational sources based on human reasoning but are in conformity with the principles set by the primary sources. Necessarily, the secondary sources have been formulated through *ijmā'* (consensus of opinions) and presents agreement of those who are qualified to hold *ijtihad* (Nyazee, 2006).

Sharī'ah legitimacy for the Islamic banking practices refers, generally to the conformity of the *fatāwā* (pronouncements) pertaining to the financial transactions to the Sharī'ah requisites and their application to such practices and related procedures and processes. However, observing moral virtues as enjoined by the Sharī'ah are ignored. Accordingly, the holistic approach provides the prime basis of the research that takes into account both the compliance with contractual mechanism and the normative concerns of the society.

Maqāṣid al-Sharī'ah and *Maṣāliḥ*—Bases of Inductive Reasoning

The theory of *maqāṣid* is supported by an inductive analysis of the Islamic Law. Lexically, the term, *maqāṣid al-Sharī'ah*, means facilitation for drawing benefit and repulsion of harm. Al-Raysuni (2005) cites the work of Al-Shatibi (in *Al-Muwafaqat fi usul al al-Sharī'ah*) and holds that the Law has been established to serve human interests in both the life in this world and the hereafter. The inductive examination of *aḥkām*, therefore, concludes that the rules prescribed by Sharī'ah are based on inner reasons and cause ultimate benefit the society and the individuals, and that, in the words of Ibn Ashur “all-purpose principle of the Sharī'ah is to achieve righteousness and goodness in the world and remove corruption from it” (El-Mesawi, 2006). That is why the *maṣāliḥ* based *ijtihad* has led to expand the scope of Islamic Law to extensively cover the normative obligations. In the same perspective, even *maṣāliḥ mursalah* being unrestricted and contained through juristic argument are deemed valid for a new universal good for the community and render their applicability as binding evidence (Kharofa, 2000).

Therefore, it becomes essential to allow what is beneficial and to avoid what is harmful for the community under all circumstances, especially when facing unprecedented problems and pressing diversity. As such, the question about validity and sustainability of Islamic banking arises and requires reviewing against the precepts of Islam for ensuring equity, fair distribution of resources, and equitable opportunity. While such values are opted by choice in conventional finance, these are essentially required in Islamic finance.

Review of Islamic Banking Operations in Pakistan vis a vis Normative Values

This sub-section reviews the Islamic banking operations and their relevance to the *Maqāṣid al-Sharī‘ah* with a view to ascertain compliance with value judgements. As depicted from the statistics issued by State Bank of Pakistan (2015), the major part of resources (70.54% of total financing) had been invested in fixed return instruments, i.e., *murābahah* (cost plus sale transaction), *ijārah* (Islamic lease), and diminishing *mushārahah* (underlying contract of which is *ijārah*, giving the banks fixed rentals). The *mushārahah*, mainly in the name of running *mushārahah*¹, occupied 11.39% of total financing and the rest 17.99% for other modes like *Salam* and *istiṣnā‘*. Contrary to this, the modes embedded with compassionate concerns like *muḍārabah* (A type of partnership where capital and management are provided by two distinct partners and business profits are shared) and *qard ḥasan* (an interest free loan), respectively, amounted to only 0.05% and 0% of the total financing, reflecting indifferent attitude of banks towards social conduct for the weaker segments of the society. It is pertinent to indicate that the customers value profit sharing products more than the fixed returns (Khan, Hassan, & Shahid, 2007) as the latter resemble conventional banking practices. Certainly, ignoring peoples’ expectations would result in adverse opinion of customers about the subject legitimacy.

The sectoral analysis, too, reveals that Islamic banks were serving the cause of corporate sector more as compared to the trend of banking industry as a whole. Similarly, the Islamic banks’ share in agricultural financing was negligible as compared to the banking industry (Khaleequzzaman, Mansoori, & Rashid, 2016). On the other hand, the statistics presented by the State Bank of Pakistan (2014) exhibit Islamic banks holding greater cash and balances to total assets and lower financing to deposit ratio than the banking industry. However, the Islamic banks have not adopted ways and means to invest excess liquidity in avenues like small and microenterprises, already grossly neglected by the both Islamic and conventional banks. In the same context, Islamic Financial Services Board (2013) also, emphasizes to embark policy move to link previously neglected market niches by the commercially oriented financial institutions and prescribes that the Sharī‘ah compliance should not be enough without responding to the ethical issues of poverty alleviation, financial inclusion, and responsible investments.

Conclusion

The most important conclusion of this section suggests that the Sharī‘ah legitimacy of Islamic banking practices should be understood in holistic perspective, rather than mere adherence to the compliance requirements applicable to the products and contracts/documentation of the related transactions. The normative concerns prescribed by Sharī‘ah should be considered integral part of the legitimacy framework. It has been established that the application of the Islamic law is rationalized through *maqāṣid al-Sharī‘ah* and is reflected through intent of the Lawgiver focused on welfare of the subjects. This foundation leads to the theory of

¹Running *Mushārahah* has been designed to serve the working capital need of the corporate sector but is devoid of the basic features pertaining to the mode of *Mushārahah*.

maṣālih whereby the benefit has to be realized and the harm prevented. That is why; the Islamic banks should be pre-occupied with normative move by instilling socially responsible behavior and altruism as against self-centered conventional finance.

METHODOLOGY OF EMPIRICAL RESEARCH

We have taken benefit of the theoretical framework in two respects, viz. determining constructs of Sharī'ah legitimacy of Islamic banking practices on one hand and using such constructs to conduct empirical research by gathering the opinion of customers about the subject on the other. The latter aspect has helped assessing sustainability of Islamic banks in case their practices met the perceived outlook of the banking customers.

Our research is descriptive in nature and aims to explain the opinion of the customers on the Islamic banking practices. Following the literature such as Adanza (1995) and Kothari (2004), this research also conforms to the procedure of investigation describing and interpreting the existing relationships, beliefs and trends developed among various customers. Further, as suggested by several researchers like Kothari (2004) we have applied both qualitative and quantitative techniques to arrive at the robust and credible findings. Our approach has been deductive where theorization has been used as a basis to conduct empirical part of the research (Blackstone, 2012).

Selection of Respondents

Following Bhattacharjee (2012) and Mishkin (2003), those stakeholder have been identified for the research who could express their opinion independently without any conflict of interest and who are considered essential in terms of our objectives. The shareholders, Sharī'ah advisors/members of Sharī'ah boards, Sharī'ah audit staff, internal auditors, and boards of directors of Islamic banks have not been considered to avoid any bias. The regulator (primarily, the State Bank of Pakistan) has also been excluded for the reason that all policy guidelines for Islamic banks are developed and enforced by SBP; therefore it becomes an interested party. The external auditors have also not been considered, as they do not disclose the affairs about their clients owing to the confidentiality requirement.

Accordingly, we have selected the most related stakeholders' group that include the customers of Islamic and conventional banks. Over time, the existence and operation of Islamic banks have raised awareness of the general public about the Islamic banking practices. Such conclusions have been drawn by Ahmad and Bashir (2014), Echchabi and Aziz (2012), and Imran, Samad, & Masood, (2011). Therefore, the customers are concerned with the Sharī'ah compliance of the Islamic banking products and services, a reason for which they join the Islamic banks in the first place. On the other hand, SBP's KAP study conducted by State Bank of Pakistan and Department for International Development (2014) reports that about 74% of the banked respondents expressed strong inclination to switch to Islamic bank. The study further explores that the customers of conventional banks have also expressed pent up demand to shift to the Islamic banks, presumably out of their own awareness about and the belief in Islamic banking. As inferred by Masood, Rehman, & Rehman (2014), it is also evident that the customers of Islamic and conventional banks form their opinion about Islamic

banking practices, and forward preferences and apprehensions in this respect, even about knowledge of the employees about Islamic banking. Therefore, the customers of Islamic and conventional banks present one of the most relevant segments of respondents in our research.

Sample Frame

Many studies conducted in Pakistan have extracted the sample based on the proportion of population spread over various provinces. However, owing to the smallness of the banked population in Pakistan (11%) disproportionately spread among provinces (Pakistan Micro-finance Network, 2009), we have instead used the spread of the Islamic banking branches for selection of the customers as they were to be interviewed in the branches. Therefore, the sample of customers has been drawn in proportion to the concentration of Islamic banking branches in the provinces and the Islamabad Capital Territory (ICT), combined with random selection process. The spread of Islamic banking branches has been taken from SBP's Islamic Banking Bulletin, December 2014 for ICT and four provinces of the country. We have however not considered Federally Administered Territories for security reasons and Gilgit-Baltistan (GB), and Azad Jammu and Kashmir (AJK) being distant and difficult areas, following Nenova, Niang, & Ahmad, (2009), Pew Research Centre. (2012), and Zaidi (2010).

In all, a sample of 850 customers was targeted; however, the response could be collected from 836, constituting an encouraging response rate of 98%. The size of our sample was larger than the other studies having focus on Islamic banking perception but targeting smaller samples in other studies like Ahmad and Bashir (2014) and Dusuki and Dar (2005) that surveyed 200 and 750 respondents, respectively.

Survey Instrument

Anonymous and bi-lingual (in both English and the national language i.e., Urdu) questionnaires were structured to allow, respectively, confidentiality and convenience of filling the requisite data. All the questions were grouped in different blocks in keeping with the objectives of the research and based on various factors (dimensions) of legitimacy extracted with the help of literature reviewed and theoretical framework developed for this research. Each factor consisted of four items (questions) focusing the main theme of the dimension. The dimension of the questionnaire common to each category of respondents styled as 'Sharī'ah legitimacy' was chosen as dependent variable as all other dimensions, in one way or the other, explained the opinion of respondents about Sharī'ah legitimacy of the current Islamic banking practices. All the other factors/dimensions, therefore, represented independent variables (See Table 1).

TABLE 1
Factors and Items

Factor	Question/Item
Dependent Variable	
Sharī'ah Legitimacy	<ol style="list-style-type: none"> 1. The current Islamic banking practices are Sharī'ah compliant. 2. The current Islamic banking practices follow the teachings of Qur'ān, Sunnah, and <i>ijmā'</i>. 3. Islamic banking practices are free from <i>ribā</i> (interest). 4. Islamic banking is based on profit and loss sharing principle.
Explanatory Variables	
Performance	<ol style="list-style-type: none"> 1. Islamic banks perform better than conventional banks. 2. Islamic banks provide individual attention to customers more than conventional banks provide. 3. Islamic banks carry better image and reputation than conventional banks. 4. The service of Islamic banks is faster than conventional banks.
Optimism	<ol style="list-style-type: none"> 1. I believe that Islamic banks will progress in future because of more dedication towards Islamic principles. 2. Islamic banks are expected to refine their practices to become more Sharī'ah compliant in future. 3. Islamic banks are expected to improve their behavior to the customers. 4. Islamic banks are expected to disburse <i>qard ḥasan</i> to meet needs of the poor people.
Social justice	<ol style="list-style-type: none"> 1. Islamic banking practices promote social justice in the society. 2. Islamic banking promotes better circulation of wealth. 3. Islamic banks offer equity-based financing where they share the risk of loss with the client. 4. There is no gender segregation in availing financial services from Islamic banks.
Products' compliance	<ol style="list-style-type: none"> 1. The products offered by Islamic banks are Sharī'ah compliant. 2. The products are Sharī'ah compliant because they are approved by Sharī'ah advisor. 3. The products are Sharī'ah compliant because they are offered by Islamic banks. 4. The products are Sharī'ah compliant because we trust that they fulfil the Sharī'ah requirements.
Fair treatment	<ol style="list-style-type: none"> 1. Islamic banking practices extend fair treatment to all of their customers. 2. Islamic banks extend fair returns to all depositors. 3. Islamic banks charge lower rate of profit while financing small clients as compared to corporate clients. 4. The terms and conditions in the financial contracts are balanced and do not turn in favor of banks at the cost of clients.
Criticism	<ol style="list-style-type: none"> 1. Islamic banking faces criticism from different quarters which restricts me to believe in this system. 2. I am not convinced that Islamic banking is Sharī'ah legitimate. 3. Islamic banking products and practices are not based on Islamic injunctions. 4. Islamic banking is in fact another name of the conventional banking.

Data Collection and Analysis

The filled questionnaires, duly serial numbered and signed by the enumerators, were fed to excel sheet separately for each category of respondents. All data had been coded for analytical purpose and then transferred to the data analysis software. The analysis was started with univariate statistics, primarily to arrive at basic results like distribution of responses, ascertaining frequencies of various Likert scale points, and identifying and treating missing values, if any. Cross tabulation helped to workout joint frequency distribution of two or more variables. Therefore, the demographic profiles and bank information about the respondents has been cross tabulated against the questions pertaining to the opinion of the customers.

Factor analysis has enabled data reduction where certain variables have clustered together meaningfully (Field, 2009). However, we are concerned with the issue that the items do not measure the multiple factors to determine the goodness of fit of the model as prescribed by Pallant (2005). As suggested by the literature, such as Choong, Wong, and Lau (2012), Field (2000), Field (2009), and Landau and Everitt (2004), we have considered various thresholds/critical values related to communalities, eigenvalues, scree plot, varimax rotation, factor loading, etc. to ensure robustness of the factor analysis.

We have conducted reliability test of the sample data by computing Cronbach's Alpha to measure internal consistency through coefficient of reliability in case of Likert type scale. The values of cronbach's alpha, as shown in Table 2, for all variables were well above the threshold of 0.6 as suggested by Choong et al. (2012), Gan, Clemes, Wei, and Kao (2011), and Mawoli and Babandako (2011), hence proving greater internal consistency at preferred scale suggested as above. Therefore, all the variables were deemed reliable.

TABLE 2
Cronbach's Alpha

Factor	Cronbach's Alpha	No. of Items
1. Sharī'ah legitimacy	0.875	4
2. Performance	0.862	4
3. Optimism	0.860	4
4. Social justice	0.816	4
5. Products' compliance	0.921	4
6. Fair treatment	0.815	4
7. Criticism	0.774	4

Our KMO's sample adequacy value is more than 0.5 (Table 3) as suggested by Field (2009) and the Bartlett Test of Sphericity is significant at $p < 0.01$. Both the results help to assess factorability of the variables.

TABLE 3
Factor Analysis

Factor	Item	Factor Loadings	KMO	Bartlett's Test of Sphericity	
				df	Sig.
Shari'ah legitimacy	1	0.805	0.820	6	0.000
	2	0.869			
	3	0.839			
	4	0.681			
Performance	1	0.706	0.812	6	0.000
	2	0.870			
	3	0.765			
	4	0.792			
Optimism	1	0.820	0.781	6	0.000
	2	0.836			
	3	0.819			
	4	0.654			
Social justice	1	0.745	0.783	6	0.000
	2	0.760			
	3	0.790			
	4	0.607			
Products' compliance	1	0.837	0.848	6	0.000
	2	0.904			
	3	0.822			
	4	0.888			
Fair treatment	1	0.685	0.782	6	0.000
	2	0.826			
	3	0.655			
	4	0.735			
Criticism	1	0.574	0.727	6	0.000
	2	0.632			
	3	0.848			
	4	0.682			

Factor Analysis

As shown in Table 3, the data pass the validity test as the Bartlett's test results are significant in all variables and prove that *R*-matrix is different from identity matrix, therefore, our factor analysis turns to be appropriate (Choong et al., 2012; Field, 2000; and Pallant, 2005). All variables in our sample show eigenvalue more than 1.0 and hence rule out the possibility of multicollinearity (Field, 2000).

Factor loadings define substantive importance of a variable to the factor (Field, 2000). The factor loadings in our sample range from 0.607 to 0.904, explaining 37% to 82% variance of the variables correspond to the ones suggested by the literature like Field (2009) and turn to

be more adequate than the prescribed standard.

Regression Analysis

We have conducted linear regression analysis in a cross-sectional framework by using Ordinary Least Squares (OLS). The general form of the regression model is presented in “(1)”.

$$Y_i = \beta_0 + \beta_1 X_{1i} + \beta_2 X_{2i} + \dots + \beta_k X_{ki} + \varepsilon_i \quad (1)$$

where:

- k represents number of explanatory variables and i represents the i^{th} number of respondent.
- The multiple regression model for a dependent variable, Y , with observed values, Y_1, Y_2, \dots, Y_N and k independent or explanatory variables with observed values X_1, X_2, \dots, X_N where $i = 1, 2, \dots, N$
- The term ε_i is the residual or error for the i^{th} respondent variable and represents the deviation of the observed value of the response from expected value of the model.
- The regression coefficients $\beta_0, \beta_1, \beta_2, \dots, \beta_k$ are estimated through least squares.

We have developed the base regression model shown as “(2)”.

$$\begin{aligned} & \beta_0 + \beta_1(\text{Performance})_i + \beta_2(\text{Optimism})_i + \beta_3(\text{Social justice})_i + \\ (\text{Sharī‘ah legitimacy})_i = & \beta_4(\text{Products' + Compliance})_i + \beta_5(\text{Fair treatment})_i + \\ & \beta_6(\text{Criticism})_i + \varepsilon_i \end{aligned} \quad (2)$$

The dependent and explanatory variables are defined in Table 1.

We have extended our base model to include demographic variables (dummies), viz. Gender, Income Level, Age, Province of residence, and Education. As prescribed by Newbold (1984), the inclusion of demographic variables has helped to predict the dependent variable more precisely as they may affect variance in dependent variable.

We have included dummies for all categories and excluded intercept from regression. We have preferred this approach over regression with an intercept term and inclusion of dummy variables one less than the number of categories for the reason that this approach enables us to directly compare the estimates across categories. We have also excluded data for ‘no response’ from regression analysis of those dummy variables where such data has been found, however ‘no response’ data has not been excluded from other regression models as the dummies are not the variables in bi-variate or multi-variate regression. That is why the ‘no response’ does not appear in the impact of dependent variable. However, one should note that proportion of ‘no responses’ is quite low.

EMPIRICAL RESULTS AND INTERPRETATION

This section discusses the empirical findings arrived at through various statistical tools (uni-variate, bivariate and multivariate analyses). The descriptive statistics has been used to explain

about the frequencies/proportions and results of cross tabulation/joint frequencies. The results of regression analysis have, first, helped to see the simultaneous impact of all the variables on the dependent variable and, second, to observe the effect of demographic variables inclusively.

Descriptive Statistics

Most of the respondents (87.2%) representing male gender, were from young and middle-aged groups (84.3%), had achieved middle level education (51.2%) and lived in urban areas (93%). The major proportion of respondents (68.4%) was earning income up to Rs.100, 000 (against per capita income of Rs. 157,605 as reported by the Pakistan Economic Survey 2015-2016 published by the Ministry of Finance, Government of Pakistan). About 52% respondents had relationship with the Islamic banks, more popularly using current and saving accounts, debit card, car *ijārah* and diminishing *mushārahah*. The data on various dimensions of Sharī'ah legitimacy, collected on five point Likert scale, reflected that about half of the respondents (40-46%) agreed that the current Islamic banking practices were Sharī'ah compliant, followed the teachings of Qur'ān and Sunnah, were free from *ribā*, and based on the principle of profit and loss sharing while the rest preferred not to agree with these dimensions or remain indifferent. *Ribā* in any exchange or sale contract is defined by *fiqh* scholars as "an unlawful gain derived from the quantitative inequality of the counter values in any transaction purporting to effect the exchange of two or more species (*anwā'*), which belong to the same genus (*jins*) and are governed by the same efficient cause (*'illah*) (Obaidullah, 2011 citing from Salih, 1992).

The proportion of those who agreed strongly that practices of Islamic banks were compliant with Sharī'ah was, however, lower (18-20%) than those who just agreed (24-28%). About half of the respondents perceived Islamic banks performing better than the conventional banks, owing mainly due to better image.

On overall basis, about half of the respondents were convinced that Islamic banking practices were Sharī'ah compliant and meeting, in one way or the other, the social values embedded in *maqāṣid al-Sharī'ah*. But, at the same time, one cannot ignore the proportion of the respondents that have disagreed or remained indifferent on account of these dimensions. Although, disagreeing can be differentiated from being indifferent, yet taking together constitutes the other half whose opinion cannot be simply ignored.

The outcome of the joint frequencies of various dimensions of Sharī'ah legitimacy and demographic variables has led to important conclusions. The firmest believers of Islamic banking practices were found in Baluchistan province, followed by KPK, Punjab, ICT, and Sindh provinces of the country. More or less, the similar ranking among the provinces was found while assessing proportion of the customers believing that Islamic banking practices were based on: i) Qur'ān and Sunnah (KPK: 71.6%; Balochistan: 53.0%; Punjab: 37.5%; Sindh: 33.7%; and Federal Capital: 25.6%); ii) principle of profit and loss sharing Sunnah (Balochistan: 76.4%; KPK: 63.2%; Punjab: 50.0%; Sindh: 32.9%; and Federal Capital: 32.6%), and iii) free from *ribā* (Balochistan: 76.5%; KPK: 70.5%; Punjab: 41.9%; Federal Capital: 37.2%; and Sindh: 30.0%). Such results are also confirmed by the KAP study conducted by SBP (2014). The analysis of the different age groups believing in legitimacy

of Islamic banking practices reveals that the younger (18-40 years) and middle-aged (41-50 years) people believed more in this context than the older ones (51 years and over), depicting that the Islamic banking was more popular among younger generation.

Regression Analysis

The results of the regression analysis as shown in Table 4 reveal that independent variables (Performance, Optimism, Social justice, Products’ compliance, Fair treatment, and Criticism) significantly affect the dependent variable. The adjusted R^2 (0.573) reveals that the model has explained 57.3% variance in the dependent variable. The F -statistic suggest that, overall, the model is a good fit as the associated p -value is considerably below the acceptable level of significance. Since the collinearity statistics indicate the value of $VIF < 10$ and Tolerance Level > 0.1 for all variables, our model is saved from multicollinearity.

TABLE 4
Results of Regression Analysis

Predictor	Standardized	t -stat	p -value	Collinearity Statistics	
	Coefficients			Tolerance	VIF
	β				
Constant		0.000	1.000		
1. Performance	0.128	3.564	0.000	0.399	2.507
2. Optimism	0.151	3.738	0.000	0.312	3.204
3. Social justice	0.083	2.070	0.039	0.320	3.129
4. Products’ compliance	0.423	10.997	0.000	0.347	2.886
5. Fair treatment	0.025	0.691	0.490	0.405	2.469
6. Criticism	-0.175	-7.427	0.000	0.926	1.080
Dependent variable	‘Sharī‘ah legitimacy’				
R^2	0.576				
Adjusted R^2	0.573				
F -statistic	187.629				
p -value of F -statistic	0.000				

The estimated coefficients indicate that ‘Performance’, ‘Optimism’, ‘Social justice’ and Products’ compliance’ leave positive, while ‘Criticism’ leaves negative impact on ‘Sharī‘ah legitimacy’. The positive values of the estimated coefficients suggest that the customers’ perceptions about ‘Sharī‘ah legitimacy’ increase with independent variables. On the other hand, the estimated negative coefficient for ‘Criticism implies that the level of ‘Sharī‘ah legitimacy’ would decline when the criticism regarding Islamic banking products and procedures increases.

We find that the ‘Products’ compliance’ ($\beta = 0.423$) has caused the most effect on Sharī‘ah legitimacy followed by ‘Criticism’ ($\beta = -0.175$) ‘Optimism’ ($\beta = 0.151$), ‘Performance’ ($\beta = 0.128$), ‘Social justice’ ($\beta = 0.083$), and ‘Fair treatment’ ($\beta = 0.025$). As such, the Islamic banks are required to offer Sharī‘ah compliant products in case the Sharī‘ah legitimacy has to be enhanced. On contrary, any outside criticism levelled against Islamic banking practices

like the consensus fatwa issued locally in 2008 has affected the belief of the respondents adversely. Although, the size of the impact of 'Criticism' on Sharī'ah legitimacy is expected to be much lesser than the one to be left if the products were Sharī'ah compliant, still any lapse on Sharī'ah compliance of products will give room to outside criticism and Sharī'ah legitimacy would be adversely affected. Since all variables are significant ($p < 0.01$), even the smaller magnitude of the coefficients does matter and is expected to bring impact on the Sharī'ah legitimacy of Islamic banking practices. Accordingly, people's attitude of being optimistic about future progress of Islamic banking reflects a positive sign that could help building confidence over the Islamic banks. Similar findings have also been arrived at by Loo (2010). But, at the same time, it is expected on the part of Islamic banks to perform better than conventional banks in terms of providing individual attention to the customers, building better image and reputation, and affording efficient services to their customers.

Most of the factors in our analysis, built on various dimensions of *maqāṣid al-Sharī'ah*, cause legitimacy of Islamic banking practices to varying degree. We have also extended our model to include the demographic variables enabling to predict the dependent variable more precisely as they might affect its variance. It was expected that these variables would predict the dependent variable more accurately (Newbold, 1984) and help shaping the relationship better (Argue, Johnson, & White, 1999).

The results reveal that F -statistic remains significant for all demographic variables. The adjusted R^2 has either slightly improved or remained static except the province of residence of the customers, thereby, depicting firmer relationship of the latter with the dependent variable.

The standardized coefficient of the male gender has turned insignificant in explaining the Sharī'ah legitimacy of Islamic banking practices. However, the female gender has depicted statistically significant but negative impact on Sharī'ah legitimacy. The finding is supported by the literature (Ahmad & Bashir, 2014) that women being constrained by mobility are affected less by the religious factors and hence have lesser perception about Islamic banking practices. The other studies like Khan et al. (2007) and Metawa and Almossawi (1998) have, however, excluded gender from their study while evaluating behavior of Islamic banking customers in Bangladesh for the reason that Islamic principles of banking do not distinguish women from men. The estimated coefficients of other explanatory variables have either not or negligibly changed. The inclusion of the gender into our model does not affect the impact of the other variables in regression. Alternatively, the effect of other variables remains robust.

Our results suggest that the level of income does not have any statistically significant impact on people's perception regarding Sharī'ah legitimacy of Islamic banking practices. These results, however, do not correspond to the literature; for example, Gan et al. (2011), where the effect of income was found significant while assessing customers' satisfaction level in New Zealand's banking sector. However, our results correspond to certain extent to SBP KAP study (State Bank of Pakistan, 2014) where the incidence of demand for Islamic financial services increases with increase in income level from low to middle and then decreases as income further increases. In our view, the results of our analysis are interesting depicting that the religious preference remains independent of the income levels of the people

reflecting that religion is the prime factor in preferring Islamic financial services.

Since the age and attitudes are strongly related (Meidan, 1996), therefore, the age has become one of the important attributes to be considered by the banks. Our regression results are highly significant for the young and older categories; however, the relationship has turned negative in case of the former category and positive for the latter, reflecting that the older respondents are more likely to believe in Shari'ah legitimacy of Islamic banking practices whereas the younger do not. We can infer that the old people (over the age of 50 years) consider the Islamic banking practices Shari'ah legitimate that might be the result of their increased knowledge and analytical ability about Islamic banking. The relevant literature also finds that older customers (56 years +) were significantly satisfied with the banking services, as concluded by Gan et al. (2011) as compared to the young and middle aged where the relationship was found insignificant.

We may infer that Islamic banks are ignoring the vital segments of younger and middle-aged population (e.g., 84.3% of the total respondents in our sample) that are less likely to believe in Shari'ah legitimacy of the current Islamic banking practices. The situation necessitates to focus more on the young and middle-aged customers and pursue them demonstrating Islamicity/legitimacy of Islamic banking to build their confidence. The population of Pakistan, as reported by Government of Pakistan (2015) pertaining to age groups 20-34 and 35-49 years is considered younger and middle-aged respondents respectively, (as in our sample) constitute 82.90% of total population correspond to our sample size.

The respondents hailing from Sindh and Baluchistan showed statistically significant relationship with dependent variable; however, the direction of relationship appears negative in the former's and positive in the latter's case. We can therefore conclude that the respondents of Baluchistan are more likely to believe in Shari'ah legitimacy of current Islamic banking practices. The SBP KAP study corresponds to our results in respect of Sindh. The statistical significance in case of other provinces could not be established.

The impact of the level of education on Shari'ah legitimacy of Islamic banking practices does not turn significant for all levels except the lower level of education (primary, matric, vocational, and other). The effect is even negative for middle and master level of education. The literature also supports insignificant results in case of middle education level (diploma etc.) and higher education level (graduation and above) (Gan et al., 2011). Our results are also confirmed by a number of studies, for example Hungerman (2011) and Meisenberg, Rindermann, Patel, and Woodley (2012) that the impact of religiosity decreases with the level of education and intelligence. Our positive relationship in case of the respondents who did not go to school is also confirmed by these studies. One may understand that the respondents with no or low level of education might have little capacity to analyze and make out their own outlook and, rather, believe in what they hear and see. However, the positive relationship at the higher level of education, especially in our case, might be due to the presence of the respondents with specialized education in Islamic banking and finance. But, our findings turn contrary to other studies like State Bank of Pakistan (2014) and Dar (2004) concluding a positive impact of education on demand for Islamic financial services, presumably with increased knowledge about Islamic banking (Tara, Irshad, Khan, Yamin, & Rizwan, 2014).

We may emphasize, as in case of the age group, that the situation requires Islamic banks to devise strategies, specific to different levels of education to convince them about legitimacy of the Islamic banking practices.

CONCLUSION AND POLICY IMPLICATIONS

Conclusion

The respondents perceived the objectives of Sharī'ah legitimacy to be achieved by the Islamic banks as (i) the social justice is extended, (ii) the products' compliance with Sharī'ah is ensured, and (iii) expectations of the respondents about excellence in Sharī'ah compliance and social justice are achieved. The outside criticism (by Sharī'ah scholars/jurists outside Islamic banks) on Islamic banking practices has left negative and significant impact on 'Sharī'ah legitimacy'. The positive values of the estimated coefficients suggest that the customers' perceptions about 'Sharī'ah legitimacy' improves with independent variables. On contrary, any outside criticism levelled against Islamic banking practices, like the consensus *fatwá* of '*ulamā*' issued from Jamia Islamiyyah Allama Binori Town, Karachi in 2008 labelling Islamic banking as Sharī'ah non-compliant, affects the Sharī'ah legitimacy adversely. However, if the products and practices of Islamic banks conform to the principles of Sharī'ah, the impact of such *fatāwá* would be lessened. Otherwise, the negative perception about legitimacy of Islamic banking practices would be observed.

The female gender had depicted statistically significant but negative impact on Sharī'ah legitimacy owing to lesser mobility and limited access to the financial services than the men. The respondents' perception about legitimacy of Islamic banking practices diminishes with increase in income up to medium income group, but it again had risen with further increase in the level of income. In line with our expectations, it confirms association of age with the knowledge and analytical capability.

As regards the province of residence, the respondents from Baluchistan (least developed region in the country) were more likely to believe that Islamic banking practices were Sharī'ah compliant. The relationship of Sharī'ah legitimacy with education did not turn significant for all levels of education except the lower one (up-to 10 years of schooling). Our results confirm that impact of religiosity decreases with the level of education and intelligence. Our analysis also infers that the seniors in age (over 50 years) consider the Islamic banking practices Sharī'ah legitimate that might be the result of their increased knowledge and analytical ability about Islamic banking. Gan et al. (2011) also find significant relationship in case of old-aged customers (56 years +) while insignificant relationship with customers' satisfaction for young and middle-aged groups. One may understand that the respondents with no or low level of education might possess little capacity to analyze and make out their own outlook and, rather, believe in what they hear about the fatwa/pronouncement of the banks Sharī'ah board as communicated to them by the banks staff.

Policy Implications

The following policy implications have been framed to be considered by the various stakeholders.

Managements of Islamic Banks

1. The Islamic finance should be pre-occupied with the wellbeing of the society. That is, the Islamic banks should be required to observe the spirit behind the Islamic principles through their operations devising ways and means that should facilitate redistribution of wealth and widen access to the financial resources. To achieve this end, the Islamic banks are required to consider their social obligation, stakeholders' interest, rather than that of shareholders only, and Sharī'ah compliance in broader perspective.

2. The Islamic banks, instead of serving mainly the cause of the corporate sector, should equitably extend access of their services to the small and micro-enterprises instead of channeling finance mainly to the corporate sector as being currently practiced. Emphases are required to disburse *qard ḥasan* to the needy people and charging lower price of the banking services to the small entrepreneurs as compared to the corporate businesses.

3. The Islamic banks must take the notice and devise the strategies to finance the women for home-based and Small and Medium Enterprise (SME) production activities. We strongly feel that, women being half of the population of the country should not be ignored and targeted productively by offering women friendly services like women specific branches or counters.

Sharī'ah Boards of Islamic Banks

The Sharī'ah boards of Islamic banks should consider revisiting the Sharī'ah legitimacy criteria of the Islamic banking practices and include *maṣāliḥ* based injunctions transpired through *maqāṣid al-Sharī'ah* to meet normative objectives related to value judgement, distributive justice, and equity. They ought to allocate certain proportion of the financing portfolio towards poverty alleviation pursuits like micro, small farmers and small enterprise finance, equity based modes of finance, and *qard* for needy.

State Bank of Pakistan

1. SBP, in its capacity as regulator, of Islamic banks may take note of the current situation and devise policy to advise Islamic banks to allocate certain proportion of financing to small farmers and microenterprises as mandatory targets.

2. SBP may also consider relaxing regulatory constraints to facilitate flow of funds to the NGO sector in view of its informality, uniqueness, and inability to offer physical collateral in case Islamic banks opt to finance the small and microenterprises.

3. SBP should consider amending the governance framework for Islamic banking institutions by including the requisites *maqāṣid al-Sharī'ah*.

Other Recommendations

1. The academia is the most useful resource to undertake research on various key issues of Islamic banking operations. The institutions of higher education equipped with Sharī'ah and finance knowledge should integrate the Islamic banking industry and realize more Sharī'ah legitimate solutions in diverse fields of Islamic banking and finance.

2. Our research has inferred that young generation believes more in the contemporary

Islamic banking system. Therefore, the educational institutions be targeted more in this respect to approach young people in addition to the other segments.

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