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FACTORS INFLUENCING ISLAMIC BANKING ADOPTION: EVIDENCE FROM PAKISTAN

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A R T I C L E I N F O

A B S T R A C T

This study aims to examine the major factors influencing the Islamic Banking (IB) adoption of Pakistani customers. The data is collected from 279 conventional bank customers based in Rawalpindi and Islamabad. A descriptive statistical analysis, discriminant validity, and regression analysis are used to perform the analyses. With religious beliefs, values, life trends and banking behavior reveal that bank reputation, Islamic banking performance, and its compatibility impacts the usage intention positively and significantly. The perceived risk and complexity cast a negative influence on the intention of Islamic banking customers. Further, finding shows that the buyers of IB products have limited knowledge in Pakistan. This study could assist the practitioners as well as academicians in developing appropriate and effective policies to fascinate potential consumers. Regarding originality, this study is among the earliest studies conducted in the Pakistani context using Roger's diffusion innovation theory to interpret the intentions of the customers to adopt Islamic banking.

Disciplinary: Management Sciences (Banking).

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1. INTRODUCTION

With an annual growth of 20%, the Islamic Banking system has reported substantial growth for the last two decades (Dar et al., 2012). The assets of Islamic Banks (IB) were predicted to be $1.7 trillion and predicted to rise by 3.4 trillion (Ernst & Young, 2013). Though, this industry is underserved in numerous business sectors outside the Malaysia and Gulf countries (Kaabachi & Obeid, 2016; Thaker et al., 2019). Research on the number of markets with dense Muslim population remains unexplored. These countries include Pakistan and North African countries which are in developing stages in terms of Islamic finance markets (Wilson, 2011).

Pakistan is an economy in which conventional banking has remained in dominance for the last

sixty years. A few Islamic banks have been launched in the past few years, but they are offering very restricted services to the local marketplace. These banks' local banking action is actual partial representing two percent of the entire economic assets that is the US $1.07 billion. This deficiency created the need for Islamic banking services. Therefore, the petition for IB services has been increased considerably & local authorities exercised a lot of effort in designing and creating a new industry of Islamic banks in the Pakistani economy. According to Kaabachi and Obeid (2016), Muslim countries possess great potential for Islamic finance and Sharia-compliant products. The assets of Islamic finance create a magnitude of 40% of the net financial assets of Pakistan in the year 2018. These facts and figures present the idea that the Pakistani financial market presents a lucrative opportunity for Islamic banks to thrive in a country with a majority of conventional business.

Therefore, this study is grounded on Roger's innovation theory of diffusion for adaptation of Islamic Banking using the Pakistani framework (Rogers, 2003). This matter has been discovered on a rare basis in past literature (Echchabi et al., 2014; Feroz & Siddiqui, 2018; Thaker et al., 2019). In this paper, we have planned to cover this area of research. The results of the study possess the potential of meaningful application for academicians, practitioners, and managers for devising effective banking as well as marketing strategies.

1.1 PROBLEM STATEMENT

Islam is a widely spreading religion in the world (Abou-Youssef et al., 2015). According to estimation by El-Bassiouny (2014), there are approximately 1.57 billion followers of Islam worldwide. As there is an evident increase in the Muslim population around the globe so the industry of Islamic banking also has the opportunity to thrive. There is an increased demand for Islamic financial products by diverse religious customers around the world. There are on average 420 financial institutions providing Islamic financial services worldwide (Kaabachi & Obeid, 2016). The major aim of developing Islamic modes of financing and services is to provide services that comply with Islamic law and Shariah principles. Even though Pakistan is considered one of the largest nations around Muslim countries (Khan et al., 2017), this trend is relatively new. Taking this current state into view, this particular study aims to explore the determinants of adopting an Islamic banking system in emerging markets such as Pakistan.

2. LITERATURE REVIEW AND HYPOTHESES DEVELOPMENT

The attitude of consumers to the Islamic Banking system and their products has gained a positive vibe in the recent arena. Though several variables have an impact on the decision of adopting Islamic banking system, literature shows contrasting findings in the past studies (Abdullah & Rahman, 2007; Abou-Youssef et al., 2015; Feroz & Siddiqui, 2018; Kaabachi & Obeid, 2016; A. K. Khan & Khanna, 2010; Thaker et al., 2019; Souiden & Jabeur, 2015). There are several other studies which testify that other factors besides the religious beliefs also determine the intention to use Islamic banking namely convenience of the bank, sociability, personal banking, competent bank staff, service quality, secrecy, pricing strategy, advertisement through media and consumer mindfulness (Abdullah & Rahman, 2007; Amin, 2011; Haron et al., 1994; Rammal & Zurbruegg, 2016; Thambiah et al., 2012). There are six main causes of Islamic banking adoption namely

comprehension philosophy, compliance with Shariah principles, service quality, religious inconsistencies, purchase intention of Islamic financial product and future horizons. According to the literature, high quality and fast services banking are crucial factors of the selection of Islamic banks (Polat et al., 2014). Other studies have integrated theory of reasoned action and diffusion innovation into the studies and results have shown that perceived behavioral control, subjective norm, complexity, attitude, relative advantage, and uncertainty are quite relevant to customers when choosing for Islamic banking system (Fishbein & Ajzen, 2011; Rogers, 2003). As shown in Figure 1, seven variables have been selected including consumer intention to adopt IB as a dependent variable while risk perception, complexity, relative advantages, awareness, compatibility and bank reputation as independent variables.
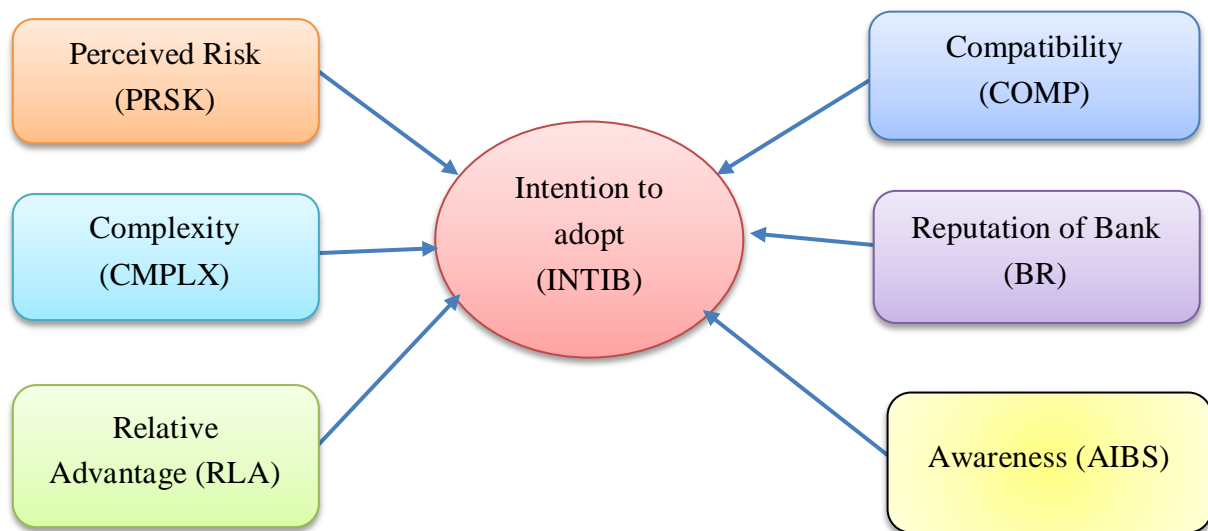

Figure 1: Theoretical Framework of Study

2.1 REPUTATION OF BANK

Numerous researches have highlighted the significance of reputation in selecting IB (Ahmad & Haron, 2002; Bashir, 2013; Echchabi & Aziz, 2012; Feroz & Siddiqui, 2018; Kaabachi & Obeid, 2016; Lateh et al., 2009; Thaker et al., 2019). For instance, Echchabi (2012) finds that the choice of an IB is mostly based on the value of services offered and the reputation of the said Islamic bank. According to Ismail et al. (2014), there is a robust association between the status and choice of Islamic housing finance in Pakistan.

H$_1$: Bank reputation has a positive and significant association with the choice of IB adoption.

2.2 SERVICES OF ISLAMIC BANK ITS BENEFITS AND AWARENESS

Significance of customer consciousness on IB acceptance has been highlight by many studies in unlike situations (Khattak, 2010). A significant relationship among customer awareness and variables such as boldness Echchabi (2012), customer contentment for the Islamic banking system and usage intention of Islamic banks has been proved by various studies (Bashir, 2013; Gait, 2009). However, some other studies probed into the idea of practicing the Islamic financial system in the Pakistani market. For instance, Khattak (2010) noted that Pakistani consumers are unaware of the idea of how Islamic banks operate and provide services to their customers.

H$_2$: Bank awareness has a positive and significant association with the choice of IB adoption.

2.3 PERCEIVED RELATIVE ADVANTAGES

An innovative idea that has a marginal benefit over another idea being superseded is known as relative advantages (Rogers, 2003). In their study, Echchabi and Aziz (2012) concluded that banking practices include quality of service, pricing policy, social responsibility practices, and social prestige. The investigation affirms the above-expressed factors as the fundamental factors that clarify its present use by purchasers. In Malaysia, Amin et al. (2013) have supported the notable impact of a relative preferred standpoint on purchaser state of mind of Islamic banking.

H$_3$: The perceived relative advantage significantly and positively associated with the choice of IB adoption.

2.4 PERCEIVED COMPATIBILITY

It is described that the degree to which entrepreneurial activity is in accordance with socio-cultural norms and beliefs (Echchabi & Aziz, 2012). The above findings agree with the results of Aziz et al. (2015) in Morocco, which resulted that the customers' compatibility attitude is significantly related with the intention of adopting Islamic banking.

H$_4$: The factor of compatibility casts a significant and positive impact on the choice of IB adoption.

2.5 PERCEIVED COMPLEXITY

A negative relationship exists between the intention to adopt Islamic banking and perceived complexity (Jamshidi and Hussin (2013). It is considered by the several studies that simplicity is a major factor to adopt Islamic banking (Hamid & Nordin, 2001). Further, studies find that the intention of the customers to accept the Islamic banking system is positively associated with the product's simplicity (Amin et al., 2013). Similarly, it is expected that the customers' tendency to adopt Islamic banking is positively related to the comprehension and use of the product.

H$_5$: Perceived complexity is negatively associated with the choice of IB adoption.

2.6 PERCEIVED RISK

Perceived risk is explained according to the constructs of customer perception regarding the ambiguity and consequences of selling and buying of the product/service (Bauer, 1960). Generally, it can be seen in the past studies (Gerrard et al., 2003) that a negative relationship exists between perceived risk and adoption of the Islamic banking system (Gerrard & Cunningham, 2003). In this regard, Islamic Banking literature (Echchabi & Olaniyi, 2012; Yusof, 1999) shows that uncertainty has a negative impact on Islamic Banking customers.

H$_6$: PERCEIVED RISK IS SIGNIFICANTLY AND NEGATIVELY ASSOCIATED WITH THE CHOICE OF IB ADOPTION.

3. RESEARCH METHODOLOGY

We investigate factors influencing the usage of IB practices in Pakistan by using the following

method.

3.1 QUESTIONNAIRE AND SAMPLING

Questionnaires are distributed among respondents for the collection of data which are based on the theoretical framework. Developed questionnaires are used which have already tested by numerous studies. Pilot testing is conducted to confirm the reliability and validity of data. Convenience sampling is used as a sampling technique. The respondents are the customers of conventional banks who preferred conventional banking practices over IB practices. Questionnaires were distributed to the conventional bank's customers with the help of branch managers located in Islamabad city. 279 among the 400 questionnaires distributed got a response, thus providing a 70% response rate. There are three sections and in the first section, the main concern is to explore the knowledge regarding IB and actual utilization of Islamic concepts of banking. The second section is relevant to predicting the predicted variables. Concluding section is relevant to the collection of information on demographics of respondents.

Table 1 shows the sample characteristics, and it reports that 68 % of the respondents are males, while 32% are females. The ages of 75% of the respondents are between 25 and 49 years. 25.5 % of the respondents have diplomas while 48.15% of them completed their university education. 41% of the respondents are private-sector employees.

Table 1: Sample characteristics

Variables	Frequency
Gender	
Male	189
Female	90
Age (years)	
18-24	25
25-34	85
35-49	124
50-65	26
Above 65	19
Level of education	
Illiterate	8
Primary	29
High school	19
Secondary	29
Diploma	71
University	115
Postgraduate	8
Employment sector	
Public	69
Private	114
Self-employed	61
Retired	35

4. ANALYSIS OF DATA

In this study, the two-step approach is applied for data analysis. In the first step, models have

been used to test the reliability and validity of scales items used in the variables of the study. In the second step, hypothesis tests have been performed.

In the first step, internal reliability has been measured through Cronbach's alpha while validity has been tested through factor loading, convergent, and discriminant validity. Regarding constructs' reliability, Hair et al. (1998) suggest that if all the value of Cronbach's alpha is above 0.7, the instrument is internally consistent. In this regard and as shown in table 2, the values of Cronbach's alpha are above the suggested values. Regarding validity, Fornell and Larcker (1981) suggest that if the value of factor loading is above 0.5, the convergent validity of the instrument can be established. As shown in Table 2 below, the value of factor loadings is well above 0.5 and consistent with Khan et al. (2019).

Table 2: Reliability Measures

cc	Items	Factor loadings	Alpha Cronbach's	Validity	AVE
BR	BR1	0.822	0.865	0.821	0.828
	BR2	0.848			
	BR3	0.77			
	BR4	0.77			
AIBS	AIBS1	0.858	0.800	0.550	0.645
	AIBS2	0.855			
	AIBS3	0.744			
	AIBS4	0.722			
RLA	RLA1	0.753	0.847	0.750	0.632
	RLA2	0.833			
	RLA3	0.852			
	RLA4	0.811			
	RLA5	0.744			
COMP	COMP01	0.911	0.870	0.770	0.837
	COMP02	0.894			
	COMP03	0.828			
	COMP04	0.865			
CMPLX	CMPLX1	0.777	0.817	0.640	0.643
	CMPLX2	0.722			
	CMPLX3	0.892			
	CMPLX4	0.876			
PRSK	PRSK1	0.855	0.825	0.660	0.660
	PRSK2	0.844			
	PRSK3	0.788			
	PRSK4	0.750			
INTIB	INTIB1	0.855	0.885	0.950	0.811
	INTIB2	0.913			
	INTIB3	0.988			

(Relative advantage=RLA, Reputation of the Bank = BR, Risk Perception= PRSK, Complexity= CMPLX, Awareness = AIBS, Compatibility=COMP, Intention to choose IB= INTIB)

To measure the discriminant validity, Hair et al. (1998) that the constructed value has to be higher than other constructs of the model. Table 3, all the value of a construct is over and above from the other construct in the model.

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Table 3: Discriminant Validity Measures

Construct	RLA	BR	PRSK	CMPLX	AIBS	COMP	INTIB
RLA	0.660						
BR	0.220	0.680					
PRSK	0.250	0.210	0.660				
CMPLX	0.180	0.150	0.140	0.670			
AIBS	0.250	0.230	0.230	0.180	0.550		
COMP	0.280	0.250	0.280	0.140	0.280	0.770	
INTIB	0.210	0.210	0.170	0.080	0.170	0.327	0.880

The hypothesized relationships have been tested by using regression analysis. Statistical package of social sciences (SPSS) has been used for analyzing the data. The results depict that the reputation of the bank has a direct influence over the intention of the customers to choose the bank. The relative advantage of one bank over the other also casts a major impact on the intention to choose the bank. On similar foundations, the complexity of the procedures, compatibility and perceived risk are also the factors that are majorly considered by the bank users while selecting for one. However, contrary to the expectations the impact of awareness on choosing the bank has not been accepted. Table 4 given below shows the summary of the hypotheses.

Table 4: Hypothesis Testing

Hypothesis	Path	B-value	T-value	Decision
One	BR-INTIB	0.739	4.791	Accepted
Two	AIBS-INTIB	0.055	-0.627	Not Accepted
Three	RLA-INTIB	0.274	3.491	Accepted
Four	COMP-INTIB	0.411	6.751	Accepted
Five	CMPLX-INTIB	-0.232	-4.029	Accepted
Six	PRSK-INTIB	-0.209	-3.385	Accepted

5. DISCUSSION

The outcomes of the study reveal that bank reputation shows a positively significant relationship with intention to choose the Islamic banking system. These results are in line with the findings of Dusuki and Abdullah (2007) which show the fact that reputation and good image of the bank are important in the eyes of the customers while the selection of Islamic banks. Hoq et al. (2010) and Amin et al. (2013) have also found similar kinds of outcomes that the reputation of the bank plays an important role in the selection criteria of Islamic banking services. As per the findings of these scholars, a suitable image of the bank strengthens the confidence of the customers in the selection of Islamic banking services. Furthermore, the outcomes of this study reveal that the awareness regarding the Islamic banking system does not have any impact on intention to use Islamic banking products/services. The results of this study show compliance with the findings of Echchabi et al. (2014), which also identify that no impact of awareness exists with Islamic banking adoption in Pakistan. Additionally, the relative advantages have a positive and significant impact on the intention to choose the IB system. These findings coincide with the outcomes of (Muhamad, 2011). The next variable of the study named compatibility shows a significantly positive association with choosing Islamic banking. According to the expectation, complexity influences the intention to choose Islamic banking negatively. This negative outcome agrees with Thambiah et al. (2011).

In this examination, the model fitness was the primary measure utilized as a part of testing the hypothesis. Coefficients and t-values are the measures which explained the significance levels and estimate limits for interrelations between predicted and predicting factors. The model has shown goodness and fitness in a proper way. The results show that there exists a positive association between bank reputations, compatibility, relative advantages, and intention to adopt. On the flip side, complexity and perceived show negatively significant association with Islamic banking adoption. Furthermore, no influence of awareness is reflected on the intent to choose Islamic banking system. As it is evident from the results, Pakistani customers consider the reputation and image of the bank as an important factor while deciding to choose an Islamic banking system. Furthermore, the results show Pakistani bank customers consider that there exists an evident advantage in choosing Islamic banks over conventional banks. Furthermore, the outcome states that compatibility is positively and significantly related to the usage of Islamic banking. The next outcome of the study shows an inverse relationship of complexity with usage intention. Islamic banking is not as common in Pakistan as the conventional banking system; also, it is relatively new. The results of the awareness also shed light on the lacking knowledge of Pakistani customers about Islamic Banking products. If banking processes or conditions are complex, then the usage intention of Islamic banking is bound to decline. As per the expectations, the perceived risk is negatively related to Islamic banking usage intention. The higher the customer perceives the risk, the reluctant he becomes to use Islamic banking.

6. CONCLUSION

The analysis of the model has revealed the selection criteria of the Pakistani banks' users. The usage of banking services is elevating in Pakistan as compared to the past times. As the literacy level is increasing, more people are earning money hence the usage of the banking services is increasing. The bank users consider a relative advantage, bank reputation, risk perception, complexity of banking procedures and compatibility as important decision factors. Since there are quite a big number of banks which are operating in the country so the competition is intense. The banks in Pakistan can increase their chances of selection by spreading the positive reputation of the bank services. The questions regarding the risk of using banking in the minds of customers could also be reduced by efficient advertising campaigns. The communication of the better relative advantage of your services in comparison to the competitor banks could also increase the chances of bank selection. The decrease in the complex bank procedures could upsurge the chances of bank selection. The compatibility with other banks in the market could also maximize the possibility of more usage of banking services. The banks also need to disseminate the information regarding their services in simpler language to build a prominent position in the minds of customers.

7. AVAILABILITY OF DATA AND MATERIAL

Data can be made available by contacting the corresponding author.

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