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Determinants of Low Adoption of Islamic Banking in Pakistan

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Abstract

Purpose

The objective of this paper is to examine the reasons behind low penetration of Islamic banking in Pakistan. Specifically, the study investigates the differentiation of Islamic banks from conventional banks, the role of religion in choosing Islamic banking and the perception of Islamic banks amongst the consumers.

Design/methodology/approach

The study uses a mixed method approach, qualitative research along with a survey of users of conventional and Islamic banking. Factor analysis identified underlying dimensions and cluster analysis ascertained the differences between users and non-users of Islamic banking. Inferential statistics were used to test purported hypotheses.

Findings

The study finds that the users and non-users both perceive that Islamic banking is not completely interest-free. Furthermore, consumers presume that Islamic banks are more of eyewash and are not truly practicing Islamic banking. Moreover, religion is not a major factor that attracts new users but

there are also other important factors in marketing Islamic banking, such as service quality, convenience, branch network etc.

Originality/value

This is one of the sparse studies in the field of Islamic banking consumer behaviour, which uses focus groups of users and non-users, and in-depth interviews of experts, to identify the issues and factors considered relevant and important by the users rather than relying only on literature review. Furthermore, it also provides a profile of users versus non-users of Islamic banking which is very useful for segmentation and targeting of customers.

Keywords: Islamic Banks; Adoption of Islamic Banking; Mixed-method; Consumer perception

JEL code: B22; C38; F3; E58; G24

Introduction

Pakistan is predominantly a Muslim country with 95% of its population being monotheistic followers of Islam. However, the adoption rate of Islamic banking is still low in Pakistan. This study particularly focuses on the low adoption rate of Islamic Banking in Pakistan. Inherently appealing primarily to Muslims, Islamic banks (IB) have also been able to capture a wide market in non-Muslim countries. Over the past few years, the western banking market considers Islamic banking a profitable opportunity rather than a threat. Therefore, big market players like Citi Group and HSBC have opened Islamic banking windows along with their conventional operations (Warde, 2000). Nonetheless, Islamic investment and holding companies were established mostly in non-Muslim countries (M. S. Khan & Mirakhor, 1990). In fact, at an individual level, non-Muslim investors are also demanding Islamic banking products to achieve diversification benefits as well as directing their funds through Islamic banks due to their stringent and prudential lending (Hesse, Jobst, & Sole, 2008). Muslim countries have also been making efforts in revolutionizing their financial systems by fully adopting Islamic principles. Iran and Sudan have radically restructured their economies to operate on Islamic financial system

whereas Pakistan, Malaysia, Indonesia and United Arab Emirates (UAE) have a strong market for Islamic banking along with a widespread conventional banking network (El Qorchi, 2005).

Islamic Banking, unlike traditional banking system, operates on the principles of *Shariah* (Islamic Law). In *Shariah*, *Riba* (Interest or Usury) is strictly prohibited. Due to stringent requirement to avoid *Maysir* (Gambling) and *Gharar* (Uncertainty), Islamic banks have devised *Murabaha* and *Muzaraha* (agency), *Ijarah* (lease) and *Musharakah* (partnership) contracts, based on principles of profit and loss sharing, real asset backing and commodity trading. Many advocate Islamic Banking to be an ideal model (Dusuki & Bouheraoua, 2011; Iqbal & Molyneux, 2016; Warde, 2000). However, when it comes to its implementation, it faces a number of challenges such as lack of skilled human resource, subtle legal issues and requirements in Islamic contract law that conflict with the conventional law, which in some cases can void a contract (M. S. Khan & Mirakhor, 1990).

Empirical findings state that religion plays an important role in the adoption of Islamic banking and the general perception is that Islamic banking product are not truly *Shariah*-compliant. Presently, Islamic banks are trying to replicate conventional products by restructuring them according to *Shariah* Principles (Islamic Law), rather than developing new products, intrinsically based on principles of *Shariah*. Islamic banks are compelled to adapt to Western financing contracts due to lack of investment opportunities (Roy, 1991). Thus, Islamic banks might not be able to provide value addition to customers of conventional banks, who already have a variety of services at their disposal. Also they might not be able to attract religious Muslims who doubt the Islamic Banks's ability to provide truly *Shariah*-compliant products to its prime target market (Wahab, Lewis, & Hassan, 2007).

Global Islamic banking assets stood at US\$ 1 trillion in 2015 and experienced a growth rate of 16% in 2014 and 2015 (World Islamic Banking Competitiveness Report, 2016). Islamic banking has captured a

significant share of banking in some Muslims countries, according to the World Islamic Banking Competitiveness Report (2016), such as Malaysia (21.3%), UAE (21.6%), Qatar (25.8%), Bahrain (29.3%), Kuwait (25.8%) and Saudi Arabia (51.2%). Despite 95% Muslim population and a steady growth of the Islamic banking sector, the penetration rate of Islamic Banking in Pakistan is still low at 10.4%. Starting off in 1978, the Government of Pakistan gradually Islamized its financial system and on July 1st, 1985 “all transactions by banks were required by law to be conducted solely on an equity-participation basis” (M. S. Khan, 1986). Although it is widely claimed in the academic literature that the banking system in Pakistan is interest-free, it should be noted here that conventional and Islamic banking systems are still operating side-by-side in the country (S. R. Khan, 1987). Moreover, the interest rate is called “profit rate” in the constitution of Pakistan, but it is same as the conventional interest rate.¹

To the best of our knowledge, there is no comprehensive answer to the question that why Islamic Banks are unable to attract more users. Since perception plays an important role in the consumer behaviour, it is important to understand whether Islamic banks are able to communicate their fundamental differences from conventional banking system or not. Islamic banks are replicating conventional banking products to attract consumers towards the prime factor of Shariah compliance; however, it is not yet clear whether consumers perceive Shariah compliance as a credible point of difference. For instance, the most common financing technique is Murabaha, constituting more than

¹ State Bank of Pakistan: “As from April 1, 1985 all finances to all entities including individuals began to be made in one of the specified interest-free modes. From July 1, 1985, all commercial banking in Pak Rupees was made interest-free. From that date, no bank in Pakistan was allowed to accept any interest-bearing deposits and all existing deposits in a bank were treated to be on the basis of profit and loss sharing. Deposits in current accounts continued to be accepted but no interest or share in profit or loss was allowed to these accounts. However, foreign currency deposits in Pakistan and on-lending of foreign loans continued as before. The State Bank of Pakistan had specified 12 modes of non-interest financing classified in three broad categories. However, in any particular case, the mode of financing to be adopted was left to the mutual option of the banks and their clients. ” accessed from <http://www.sbp.org.pk/ibd/faqs.asp#q3> on 23-01-2018.

24% of total Islamic financing (State Bank of Pakistan, 2016) and is widely scrutinized for its proximity to conventional interest-based financing techniques (Sairally, 2002). This raises another important question: are Islamic banks clearly distinguishable from traditional banks? Proponents of Islamic banks and Shariah scholars have highlighted critical differences between the products of Islamic banks and those of traditional banks. Plausibly there are significant differences between the two from the Shariah point of view. However, it is critical to understand if consumers perceive Islamic banks to be different from non-Islamic banks or not. In order to answer this question, it is important to understand the perception that the consumers have about Islamic Banks. Gait and Worthington (2008) point out gaps in the survey literature of Islamic finance and propose that it is still in its infancy.

Our paper contributes to the literature by documenting the perceptions and attitudes of existing and potential customers of Islamic banks in Pakistan. This study endeavours to understand the low adoption of Islamic banks despite strong growth potential and government support provided to the industry. Currently, the gradual, rather slow, penetration of Islamic banks among the consumers is a major concern for the Islamic financial institutions in Pakistan. Therefore, this study particularly addressed these three important questions:

- *What is the perception of Islamic Banks amongst the consumer? **Hypothesis 3***
- *Do Islamic Banks differentiate themselves from Conventional banks? **Hypothesis 1***
- *Is religion a major factor in consumer's decision to opt for Islamic banking? **Hypothesis 2***

The rest of the study is organised as follows: Section 2 contains a review of some of the selected studies about the bank selection criteria and their services. Section 3 explains qualitative and quantitative methodology and data. The results of qualitative research and research hypothesis are explained in Section 4 and Section 5 respectively. The Results of quantitative research are given in Section 6. Discussion and conclusion are given in Section 7.

2. Literature review

A number of issues related to Islamic Banking have been discussed in marketing literature. For example, bank selection criteria, service quality of Islamic banks, subsequent customer satisfaction, and consumer' awareness about Islamic Banking are the important issues. A brief overview of each area is given below.

2.1 Bank selection criteria

Bank Selection Criteria, one of the most widely discussed topics, was stimulated by two studies - Erol and El-Bdour (1989) and Erol, Kaynak, and Radi (1990). Erol and El-Bdour (1989) studied the attitudes of customers towards Islamic banks and bank selection criteria. They found religion and new branches do not have a significant impact on bank selection. However, peer group influence affects the awareness and selection of Islamic banks. Erol et al. (1990) state that consumers in Jordan do not differentiate between the Islamic banks' products and that of the conventional banks. Haron, Ahmad, and Planisek (1994) contend that both Muslims and non-Muslims have common motives in selecting banks. Time efficiency and quick completion of transactions are important considerations for Malaysian consumers. Hegazy (1995) studied the bank selection criteria of Kuwaiti consumers. He concludes that consumers highly value convenience, credit availability, safety and security, customer comfort and bank's social responsibility image. Return is the most important consideration while selecting a bank along with timeliness and completing transactions.

Metawa and Almassawi (1998) studied the banking behaviour of Islamic bank users in Bahrain. For Islamic banking consumers, religion is an important motivation and the image that a bank adheres to Shariah principles contributes to the bank selection decision. Al-Ajmi, Abo Hussain, and Al-Saleh (2009) found that religion, social responsibility and services, value and efficiency, staff and easy access

are the highly valued aspects in the bank selection criteria. Rashid and Hassan (2009) found that convenience is not an important consideration while selecting a bank in Bangladesh. However, consumers do value efficiency and speed of completing a transaction, employees and core banking services. Khattak (2010) found that most of the customers adopt Islamic banking due to religion (primary reason), bank efficiency in the transaction, confidentiality of transactions and working hours. A recent study by Muhamad et al. (2015) found that electronic service, bank reputation and image are the dominant factors that influence customer's selection for the banks. Furthermore, they also pointed out that the religious factor is not primary factor for choosing Islamic banks. In another study, Zeshan (2016) noticed that usually customers prefers Islamic banks because of their simple process, safety, security and quick delivery of services.

Subsequent paragraphs discuss the different elements of bank selection criterion, which are service quality, customer satisfaction, bank image and knowledge of Islamic banks.

Service quality

Parasuraman, Zeithaml, and Berry (1988) examined the service quality of banks. They explored ten dimensions of service quality and refined into five dimensions. It was found that an increase in service quality and professional behaviour resulted in a greater customer satisfaction and reduced customer erosion. Levesque and McDougall (1996) investigated the influence of key determinants of service quality on customer satisfaction in financial institutions. They found a substantial impact of service problems on customer satisfaction and their intentions to switch. Sureshchandar, Rajendran, and Anantharaman (2003) documented that the relationship between service quality and customer satisfaction is becoming crucial with the increased level of awareness among bank customers. One can witness a healthy competition among conventional and Islamic Banks for the provision of quality service to retain satisfied customers for long-term benefits. Al-Tamimi and Al-Amiri (2003) found that

UAE consumers are satisfied with overall service quality of Islamic banks. The authors used the SERVQUAL (Service Quality) instrument and found that all the dimensions were positive and significant; however, empathy and tangibles were the most important dimensions. Ahmad, ur Rehman, and Saif (2010) found that customer satisfaction and service quality have a positive relationship in Pakistan for Islamic banks. As compared to conventional banks, the intensity of the relationship is higher in Islamic banks. Recently, Ali and Raza (2017) analyse the relationship between service quality of the bank and customer satisfaction and find that there is significant positive relation.

Customer Satisfaction

Metawa and Almosawi (1998) found that Islamic bank users are most satisfied with the investment accounts. In addition, the employees have been highly satisfying in Islamic banks in Bahrain. Naser, Jamal, and Al-Khatib (1999) found that Islamic bank users in Jordan are satisfied with almost all the aspects of the products. The consumers consider that employees “play a significant role in company-customer interaction”. However, customers are concerned that Islamic banks have limited number of branches and opening hours. Okumus (2005) found that Islamic finance house users are most satisfied with the efficiency of completing the transaction, followed by advice offered by Islamic finance house’s employees and their friendliness. UAE consumers are also satisfied with overall service quality of Islamic banks (Al-Tamimi & Al-Amiri, 2003). Khattak (2010) analysed the customer satisfaction and awareness level towards the Islamic Banking Institutes. They found customers to have mixed feelings – satisfaction towards some services and dissatisfaction towards others. Among others, Ali and Raza (2017), Zeshan (2016) and Muhamad et al. (2015) also show that service quality of Islamic banking is directly related with customer satisfaction.

Bank Image

Al-Tamimi and Al-Amiri (2003) found that most UAE consumers prefer Islamic banks and have a positive image of Shariah-compliant banks. The image of the bank is most influenced by the products offered and then the service quality and religiosity. At the basic level, however, consumers do not differentiate between the image of a conventional bank and that of an Islamic bank. Thai consumers perceive the social image of the Islamic banks as an important consideration as compared to the conventional banks (Lateh, Ismail, & Ariffin, 2009). Recently, Tara, Irshad, Khan, Yamin, and Rizwan (2014) analysed the performance of Islamic banking in Pakistan. Their analysis was based on 150 respondents, representing the Muslim community from metropolitan as well as rural areas, all over the country. Their results show that there is a significant apparent adoption criterion regarding Islamic Banking. Among others, financial teaching, reputation, and networking are the important criterion for acceptance to Islamic Banking.

Knowledge of Islamic Banks

Gerrard and Barton Cunningham (1997) examined the consumers' knowledge of Islamic banks. Consumers in Singapore have limited knowledge of Islamic banking. They found Muslim consumers have a little knowledge while the non-Muslims are completely unaware of Islamic banking concepts. However, for Muslims in Singapore, religion is an important consideration for selecting Islamic banks, but they also value high return on the deposits. Naser et al. (1999) found that consumers are aware of Islamic banking products but they do not use them. Rammal and Zurbruegg (2007) studied the awareness of Islamic banks among Muslims consumers in a non-Muslim country – Australia. They found a significant number of willing and aware consumers who are ready to use Islamic banking products. However, the consumers are unaware of basic functions and principles of Islamic banks. The

Australian Muslim consumers would be willing to open an account in an Islamic bank if it promises to be truly Shariah-compliant and provides timely services through branch network and ATM's. Lateh et al. (2009) found that majority of Thai consumers are aware of the basic principles of Islamic banks – prohibition of interest, but they are not actually aware of the products and services offered by Islamic banks. Al-Ajmi et al. (2009) found that users of Islamic banks are more aware of Islamic banking products than the non-users in Bahrain.

With reference to Pakistan, Tara et al. (2014) examine the performance of Islamic banking in Pakistan and find that there is a significant acceptance criterion regarding Islamic Banking. Furthermore, financial teaching, reputation, and networking are the important criterion for acceptance to Islamic Banking, which further increases their knowledge about this sector. Another recent study by Zeshan (2016) investigates the customer preferences regarding Islamic and conventional banking in Pakistan. Their results indicate that education plays an important role in the choice of Islamic and conventional banking. For instance, their results indicate that hat customers having bachelor degree prefer to choose conventional banks while customers with master degree prefer Islamic banks. However, safety and security is dominant factor in opting Islamic banking system in Pakistan.

Another study on Malaysia by Harun, Rashid, and Hamed (2015) examines the relationship among religiosity, perception, training and products' knowledge of Islamic banking employees for Malaysia. Their results suggest that there is a need of Islamic knowledge for the management staff working in this sector. Moreover, they highlighted the importance of special courses and training programs, which may help in achieving their objectives. With regards to the Muslims living in Europe, Yusoff and Shamsuddin (2017) confirm that that British Muslims are keen to adopt the Islamic banking system with its reputation.

3. Methodology and Data

In this study, we used the mixed method technique, which is a combination of qualitative and quantitative research. Usually, the mixed method is designed by different methods used in marketing research, such as the timing and priority were given to each data type (i.e. sequential or concurrent), and the combination (or mixing) of the types of data (qualitative and quantitative), for detail, see Harrison and Reilly (2011) and Ivankova, Creswell, and Stick (2006). We are using quantitative dominant mixed method research (Johnson, Onwuegbuzie, & Turner, 2007), sequential exploratory research, qualitative followed by quantitative research. This research design normally places priority to qualitative research but there is “one possible variation on this design is to give the priority to the second quantitative phase. The primary objective is to conduct quantitative research but qualitative research is done in the first phase “to identify or narrow the focus of the possible variables” (Creswell, Plano Clark, Gutmann, & Hanson, 2003).

The research was carried out in two phases. First, a qualitative research was conducted to obtain consumer and expert perspective towards Islamic banking and its products. Three focus groups were organized – first and the second, dealing with users and non-users of Islamic banking respectively, the third comprising of both users and nonusers. Following the findings of Khattak (2010) about the profile of Islamic banking users in Pakistan, the selected respondents were highly educated, mostly in the age bracket of 30-40 and were at the middle-income level.

Four in-depth interviews were conducted – three with managers of Islamic banks and one with the manager of a conventional bank. All focus groups and in-depth interviews were audio recorded and field notes were also taken to capture non-verbal behaviour. Qualitative data was transcribed verbatim and analysed using content analysis to identify themes and sub-themes.

The questionnaire, based on literature review and findings of the qualitative research, was pre-tested and went through various iterations. The unit of analysis was consumers visiting a bank. Following Muhammad Awan, Shahzad Bukhari, and Iqbal (2011) who conducted a study on conventional and Islamic banks in Pakistan, we define the criteria for respondent selection as any customer walking into the branch. The data was collected through two methods – self-administered and personal interview. MBA final year students visited both Islamic and conventional banks for data collection. We used systematic sampling method for this study as it was used previously in a similar context (Butt et al., 2011). The interviewers approached every 4th person entering the bank in a given timeslot and requested to fill out the questionnaire. The interviewers were instructed to contact the next person in case a customer refused to fill out a questionnaire and then follow the process of approaching every 4th person after a customer agreed to fill out a questionnaire. A systematic approach provides a better degree of control and procedural advantage which might be helpful for survey studies with the short sample (Patton, 2002). A total of 100 usable questionnaires were obtained. In this context, there are two types of literature available. First, a sample size of 10-30 (Hill, 1998; Isaac & Michael, 1995) or 12 participants is considered as a good sample. Second, Hertzog (2008) highlights upon an extra care towards the nature of the study and urges to make decisions on a case-to-case basis. Treece and Treece Jr (1977) proposed 10% of the initially targeted sample to be sufficient for an analysis. Furthermore, based on the available literature, a sample size of 100 is enough for the statistical analysis and hypothesis testing. Specifically, for a t-test sample greater than 30 is considered as a large sample having enough degree of freedom (Dunn, 1961).

In the second phase, we used factor analysis, which is the most common analysis technique in survey-based studies. We used this method to analyse the bank selection criteria of Pakistani consumers. Further, this method identified the most important variables that affect the consumers' choice of bank.

Since there are two groups – users and nonusers – in our sample, cluster analysis was used to identify if and how the perceptions of two groups differ on various aspects.

4. Results of Qualitative Research

The objective of the qualitative research was to develop a better and deeper understanding of user's perspective, non-user's perspective and an expert's opinion about Islamic banking as well as its products. The moderator's guide is developed based on extensive literature review, which directed the process. The findings are discussed below:

4.1 Focus Group

Most of the members were of the opinion that generally people lack awareness about Islamic banking and agreed that to “create awareness” marketing and media should play an important role. Most people identified “Trust” as an important factor that can potentially influence the behaviour of the users. People generally do not trust Islamic banks and the claims that they are investing as per Islamic ways and laws. In this regard, “Transparency” was highlighted as the key and the respondents emphasized that the State Bank of Pakistan or the Government should play the role of regulating the Islamic banks to be transparent in disclosing information to the stakeholders. The respondents believed that “Ulema” (religious scholars) are the real marketer of Islamic banks and they have the knowledge to influence people by describing the difference between permissible and impermissible transactions. Some participants opined that Islamic banks are not offering attractive products. Islamic Banks should also try to gain a “competitive advantage” by extending service hours. For most people, an Islamic product is more important than the “Islamic ambiance and atmosphere” in the bank. However, most people agreed that Islamic ambiance will play an important role and will leave an impact on the customers.

Another important factor which can influence the behaviour of the “customers is the quality of service and number of branches”. Participants were of the opinion that Islamic banks are few in number and the number of branches is limited as well. They should focus on increasing the number of branches and improving the quality of service. The “outlook for the Islamic banks” has to be changed in order to bring a more Islamic view of the bank.

“Return” coupled with “customer convenience” and “fast execution of transaction” determines the performance of the bank. Islamic Banks lack “market penetration” and customer “accessibility”. The rural “geographical locations” can be targeted as at least half the respondents asserted (and the other half agreed) that these areas are under the greater influence of religion and are likely to shift Islamic banking to adhere to Islamic law. Few people were of the opinion that security of the capital is another factor, which can influence the behaviours. Islamic bank should provide a “security” of the capital and can start earning attractive returns by investing in profitable Shariah-compliant projects. However, some participants also consider the Islamic mode of banking a window dressing of conventional banking and believe that instruments of Ijarah, Modarabah and Musharaka are only new names given to interest-based tools. New instruments should be used to attract the customers coming from an educated background and “clarity” should be brought about in the meaning and usage of the instrument.

All the members agreed on the fact that Islamic banks are the same as conventional banks. It is just a new way of marketing an old product. The “underlying product/service mechanism” is the same. Majority of the most participants contend that the Islamic mode of banking can only exist in a vacuum or closed economy where there is an Islamic pool of fund. The banks shall have to, at the minimum, create an acceptable “Islamic pool of fund” that is away from the interest system in order to attract the more literate class of society.

Respondents were concerned that the employees are not trained or educated in the “knowledge of Islamic banking” and hence they do not fully represent the Islamic banking system. The consumers, as was quoted in a personal instance by a participant and agreed upon by others, get confused and are eventually turned off by the incomplete information they receive. The banks have to provide the expertise to the employees in order to make the model more viable and effective.

4.2 In-depth Interviews

The experts were asked questions about the current state of Islamic banking in Pakistan and major challenges that the industry is facing. They were also asked to share their perspective about consumer’s response to Islamic banking and their concerns about it. The analysis of transcription revealed the emergence of a number of themes such as religion, customer service, banking product, profit-loss sharing system, and customer awareness.

Although religion seems to be an important factor in choosing a bank, it is not the sole factor behind the decision. Customers are getting mental satisfaction by using these services because the Shariah Advisory Board approves the Islamic banking products. Almost all of the experts believe that the most important factor behind choosing an Islamic bank is religion. However, it limits the scope of Islamic banks because Islamic banks cannot expand their services in the sectors that are not allowed by Islam.

The customer service and banking products also influence the customer’s attitude toward an Islamic bank. The profit loss sharing system and low customer awareness about Islamic finance are creating more uncertainties and ambiguities in the system. The current accounts are being used as a substitute for Islamic banking products. Because of the ambiguity in Islamic products and uncertainties in returns, people are inclined toward these accounts. Some of the experts felt that their human resources are

unable to perform fully because of the complexity of the products. Customers have low awareness about Islamic banking in general.

Branch network plays an important role in a customer's decision to choose a bank. The network category is also linked to convenience because a larger network increases convenience for customers. Islamic banks are smaller than conventional banks. Although the size is benefitting them by being more flexible, however, most of the experts felt that the size is limiting their opportunity to expand business and provide services to the customers.

5. Research Hypotheses

After extensive qualitative research based on both focus group and in-depth interviews, we identify variables that are considered important in bank selection and then we develop hypotheses to test the low penetration of Islamic banks in Pakistan. We used Religion, Profitability, Location, Service Charges, Transaction Efficiency, Range of Services, Bank Reputation and Investment Opportunities as variables to find the selection criteria of the banks and check their significance.

It is commonly perceived that Islamic banks are same as conventional banks. Al-Tamimi, Lafi, and Uddin (2009) found that consumers have the same image of Islamic and conventional banks. Both types of the banks have same image and consumers perceive them same as well. Interestingly, the findings of our qualitative research corroborate with literature. Thus, it would be important to see whether Islamic banks are able to differentiate themselves from their conventional counterparts.

H1: Islamic Banks are unable to differentiate themselves from Conventional Banks

Erol and El-Bdour (1989) found that religion is not a reason for choosing Islamic banks in Jordan, whereas Hegazy (1995) proved empirically that Kuwaiti consumers chose Islamic banks for religious reasons. Similarly, Metawa and Almosawi (1998) and Al-Ajmi et al. (2009) found that religion is an

important consideration in bank selection. From time to time, the discussion about the importance of religion in choosing banks has been raised, but no definite finding exists in the literature that religion is the sole reason for choosing Islamic banks. In the qualitative research as well, it became apparent that consumers want Islamic banks to operate and present themselves as Islamic. Respondents in qualitative research mentioned the role of religion in the adoption of Islamic banking but users did not find it important. Therefore, we posit that religion is not the sole factor in the adoption of Islamic banking.

H2: Religion is not the sole factor in choosing an Islamic Bank

There is mixed evidence in the literature that religion is sole reason to choose the Islamic banking. For detail, see Erol et al. (1990), Al-Tamimi et al. (2009), Okumus (2005) and Ahmad et al. (2010).

In the qualitative research, it became apparent that consumers feel that Islamic bank employees are not prepared for the challenges posed by the consumers as they have limited knowledge of Islamic finance. Secondly, in the literature review, it is widely contended that Return, Products and Services and Employees play an instrumental role in bank selection decision. It is posited that consumers do not have a positive image of Islamic banks, in general, leading to lower adoption.

H3: Consumers do not have positive image of Islamic banks

6. Results of Quantitative Research

6.1 Survey Respondents

The majority of bank users in our sample are male, as more men tend to use bank services compared to women. Since our objective was to capture middle-aged and serious bank users, 73% of our sample constituted people between the age of 26 and 45. Out of total bank users, 95% are educated with least a high-school certificate. People from almost all income strata were interviewed to understand their motives in selecting a bank. However, 52% of bank-goers have an income above 60,000 PKR per

month, which is considered relatively higher income bracket. Table 1 shows the demographic profile of our survey respondents.

[Table-1]

6.2 Factor analysis

Eight factors were identified in the factor analysis with the eigenvalue greater than one. Only items with loading of greater than 0.50 values were retained for analysis after iterations. A test of reliability, Cronbach α was calculated for the factors and coefficient value above 0.7 is considered good as it shows that the measures are reliable (Nunnally, 1978; Selltiz, Wrightsman, & Cook, 1976). The Cronbach α for our factors ranges from 0.709 to 0.980, which indicates that the variables are a reliable measure of bank selection criteria. Table 2 shows that seven factors emerged with a minimum of 2 to a maximum of 11 items.

[Table-2]

From the factor analysis, we have identified seven factors that contribute to the bank selection criteria. Factor 1 is concerned with returns offered, service charges, customer care, employee know-how, marketing efforts, branch network, the influence of Ulema (religious scholars), the role of media in creating awareness, technology and other factors that contribute to the customer satisfaction. Based on the measures, this factor can be called “*Customer Satisfaction*” as it measures the satisfaction of bank consumers with these attributes of a bank. Factor 2 deals with confidence in authentic Islamic banking and Shariah advisers, personalized services and employee attitude – politeness and helpfulness. Hence, this factor can be named as “*Confidence in Bank Operations and Employees*”. Factor 3 comprises high returns, wide range of services, investment diversification opportunity, wide network, efficient services and financial advice. As these measures concern the rationale for banking with a particular bank, this

factor is called “*Reasons for Banking*”. Factor 4 is affected by the intrinsic as well as the extrinsic perception of a bank. Consumers motivated by basic principles of Islamic banking are further attracted by the physical appearance of a bank. Therefore, this factor is “*Extrinsic and Intrinsic Perception of a Bank*”. Factor 5 concerns important aspects of service quality – customer service, low service charges, banking services around the clock and efficient completion of transactions. Therefore, we name factor 5 “*Service Quality*”. Next, factor 6 is concerned with confidentiality and convenience in selecting a bank. We name this factor as “*Trust in Bank*”. Factor 7 is of most importance to us as we are concerned with the low adoption of Islamic banks and this factor explains how bankers can work to induce more consumers to select an Islamic bank. We name factor 7 as “*Shariah Compliance*”.

Customer Satisfaction is at heart of the bank selection criteria. In our sample, the customer satisfaction dimension explains the maximum variance (24%). Customers’ satisfaction is primarily affected by the returns provided by the bank (Hegazy, 1995). Therefore to attract a larger pool of consumers, Islamic banks need to provide competitive returns. Secondly, for consumers to choose an Islamic bank, religion is an important consideration. On the other hand, employees play a significant role in attracting consumers (Naser et al., 1999). In our second factor, employee attitude serves as an important measure of confidence of consumers in bank’s authenticity and reliance. In contrast with Okumus (2005), we find that high return and, efficiency and speed in transaction completion, rather than religion, play a crucial role in bank selection criteria.

6.3 Cluster Analysis

The next step of our investigation is cluster analysis to identify the factors that are important to a certain group of the respondents. Cluster Analysis is used to divide the data into small meaningful and useful groups for additional analysis (Díaz-Pérez & Bethencourt-Cejas, 2016; Punj & Stewart, 1983;

Tan, 2006). The first step in cluster analysis was to find the number of clusters that existed in the data. To find the number of clusters, we followed the hierarchical clustering method where we looked for the maximum drop in the agglomeration schedule. The number of clusters turned out to be three. Then we applied the K-means algorithm to find out the actual clusters. The details of clusters are given in figure 1.

[Figure-1]

Cluster 3, with only three users and a significant overlap with cluster 2, therefore, it is not considered for further analysis. Thus, we are left with cluster 1 and 2. In **Cluster 1**, we have consumers who are not satisfied with the current benefits and returns but are very particular about religion and want Religious Ambience, Differentiation, and Faith. **Cluster 2** is influenced by a broader set of factors: Service Satisfaction, Employee Behaviour, Service Quality, Convenience and Authenticity of Operations.

As we can see from the data that cluster 1 is the biggest cluster with 59 respondents and it has all the Islamic bank users as well. Cluster 2 only contains non-users of Islamic banking. Cluster 1 contains the people who are using Islamic banking or want to move to Islamic banking because of faith and religious reasons. However, in cluster 2, people are not worried about religion. Instead for them, service quality, convenience, branch network etc. are more important criteria for the selection of a bank. Demographics data for each of these clusters is given in Table 3.

[Table-3]

6.4 Hypothesis testing

At the start of our primary research, we came up with three hypotheses as mentioned earlier in the paper. After the cluster analysis, we tested the hypotheses using the data we had collected. The t-test for all hypotheses turned out to be significant. The results are given below in Table 4.

[Table-4]

In line with Erol et al. (1990), we find that Islamic banks are not able to differentiate themselves from their conventional counterparts. However, religion is an important factor, yet it is not the sole reason for choosing Islamic banks. In contrast with UAE consumers, as studied by Al-Tamimi et al. (2009), Pakistani consumers have the wrong perception of Islamic banking. From the data, Hypothesis 2 proves that there are factors other than religion for the selection of Islamic banks. The results about other factors with their mean values are given below in Table 5.

[Table-5]

In contrast with Erol and El-Bdour (1989) and in line with Okumus (2005) and Metawa and Almosawi (1998) religious motivation is a major factor in selecting Islamic banks. Secondly, in congruence with the Naser et al. (1999) hypothesis that customer satisfaction is affected by branch network and location, we find that consumer place high importance on the factors given in our sample as well. We proved that customer satisfaction contributes majorly in the bank selection criteria. Therefore, in this regard, we comply with Ahmad et al. (2010) that there is a strong relationship between service quality and customer satisfaction.

7. Discussions and Conclusion

The overarching objective of this study was to explore and discern the reasons for low adoption of Islamic banking in Pakistan despite 95% population of Muslims in the country. We used a mixed

method approach and started with understating consumer perceptions and expert's opinion in a free-flowing, semi-structured format of qualitative research. Based on the findings of qualitative research and supplemented by literature review, we identified the variables of interest and developed a structured questionnaire for walk-in customers of banks.

We first conducted factor analysis for data reduction, to reduce the number of items to manageable number, and to identify the underlying dimensions. We found seven major criteria used by the consumers to select an Islamic bank: customer satisfaction with various aspects of services offered by the bank, confidence in bank's operation and its employees, a compelling reason for using the bank, overall perception of the bank, overall, service quality, trust and Shariah compliance of the bank. Satisfaction of customers with bank's services and its operations appears to be the most important dimension for bank selection. In terms of services, consumers are mostly concerned about rate of return offered by the bank, variety of services and bank network. Generally, users believe that the returns offered on investment in Islamic banks are not at par with those offered in conventional banks. We believe this could be one of the prime reasons that conventional bank users (or non-users) are reluctant to switch banking modes. Users also assert that Islamic banks need to diversify and increase the variety of services they are offering in order to attract and secure a larger clientele. Branch network is one of the most important things for many customers, as they want easy access to their bank's branch no matter where they go. In order to secure a wider customer base, Islamic banks need to invest more in expanding their branch network.

Customer are also concerned about bank's ability to create awareness about Islamic banking. A large majority of non-users believe that there is not enough dissemination of information to the public about the products and services offered by Islamic banks. Relative to conventional banks, customers see paucity of marketing efforts by Islamic banks to inform and persuade customer about new products and

services. Customers acknowledge that Islamic banks have begun to pour more money into marketing efforts but it seems minuscule as compared to conventional banks. Customers also blame general media for not allocating sufficient time and resource to provide relevant information about Islamic banking.

The role of Shariah advisors is considered important in lending credibility to the bank and creating awareness about authenticity of its operations. Non-user of Islamic banking have serious reservations about genuineness of claims made by the banks and consider Islamic banking to be only a window-dressing scheme. Shariah advisors, thus, can play a more active role in promoting legitimacy of Islamic bank and can alleviate the fears of non-users. On the same token, banks need to ensure that they provide proper training to their employees to become service oriented and knowledgeable about their products. It is important to recognize that potential customers of Islamic banks are not willing to compromise the level of service quality and expect the same level of service offered by conventional banks. Customers also anticipate high level of return and diversity of products.

We performed cluster analysis to discern differences between users and non-users of Islamic banking. Two distinct groups emerged from our analysis: cluster mainly comprised users, who are mostly married with master's degree and above average income and cluster two with majority of non-users who comprise both single and married, with bachelor and master degree, and income less than that of users. Users are concerned about religion and thus adopt Islamic banking while non-users are not concerned about religion but expect banks to offer good services in general. It is, therefore, important for banks to offer products and services at par with conventional banks to attract non-users.

Based on qualitative research and literature review we formulated and then tested three hypotheses. As it is evident from cluster analysis, there is a variation in expectations of users and non-users from Islamic banks. Users require Islamic banks to differentiate themselves from conventional banks by offering products and services that are Shariah compliant. However, our first hypothesis, Islamic banks

are unable to differentiate themselves from conventional banks as supported. Thus, Islamic banks are unable to attract a large number of potential users who might not believe that products offered by Islamic banks are authentic. Third hypothesis - consumers do not have a positive image of Islamic banks, further strengths and supports this assertion. Thus, it is essential for Islamic banks to nullify the image that their products are identical to conventional banking products and not Shariah compliant. It was found in the literature that some users of the Islamic banks do not consider religion as a major determining factor. In cluster two, we found some users who do not consider religion an important factor in opting Islamic banks. Hypothesis 3 – religion is not the sole factor in choosing Islamic bank, further supported our finding.

8. Managerial implications

Currently, we see that the market share of Islamic banks is a mere 6.7%; however, based on our research we believe that there is a huge market potential for Islamic banking. There are clearly two segments Islamic banks need to target; first group adopts Islamic banking due to religious considerations while second group considers non-religious factors more important.

For Islamic Bank users and those non-users for whom religion, returns, and differentiation are the key drivers, following steps can be taken:

- Islamic banks can work with the State Bank of Pakistan (SBP) in undertaking projects to develop new products to improve the array of services and to increase the profits.
- Islamic banks need to improve their marketing strategy by encouraging collaboration between Media and Shariah Advisors in creating awareness amongst the masses about Islamic banking
- Islamic banks need to highlight how they are different from conventional banks and provide adequate training to their employees to dispense accurate knowledge to potential customers.

For user of conventional bank, not driven by religion to switch from conventional to Islamic banking, marketing efforts can be focused on other attributes such as:

- Improving the quality and variety of services and highlighting the convenience, location and branch Network
- Emphasising Islamic banks are at par or better than conventional banks in offering banking products and services.

Islamic banks need to develop a better understanding of both the segments and vary their communication message to appeal to each segment. We believe that it is quite possible to convert a large number of conventional bank users to Islamic banks by recognizing the significance of our findings implementing the recommendations of this study.

List of Tables

Table 1: Demographic Profile of the Respondents

Label		Frequency
Gender	Male	72
	Female	28
Age Group	25 or less	14
	26-35	47
	36-45	26
	45-55	6
	55-65	4
	Above 65	3
Marital Status	Single	41
	Married	59
Education	Bachelors or above	54
	F. Sc. or A-level	41
	Less than Matric or O-Levels	5
Monthly Income	Less than PKR 20,000	14
	PKR20,001 to PKR 40,000	20
	PKR 40,001 to PKR 60,000	14
	PKR 60,001 to PKR 80,000	26
	Over PKR 80,000	26
Occupation	Self-employed/Professional	43
	Managerial	30
	Clerical	2
	Retired	8
	Student	17

Table 2: Factors Considered Important in Selecting a Bank

Factors	1	2	3	4	5	6	7	8
1. Customer Satisfaction (Cronbach α = 0.892)								
Returns Offered	0.91							
Service Charges	0.94							
Customer Care / Financial Counseling	0.94							
Employee's Know How	0.89							
Marketing Efforts	0.90							
Variety Of Services	0.92							
Branch Network	0.90							
Influence Of Ulema	0.90							
Role of Media in Creating Awareness	0.89							
Technology	0.89							
Other Reasons for Satisfaction	0.94							
2. Confidence in Bank Operations and Employees (Cronbach α = 0.980)								
Confidence In Authenticity of Islamic Banking		0.62						
Confidence In Bank's Shariah Advisors		0.79						
Personalized Service		0.86						
Friendly/Politeness		0.84						
Helpful		0.83						
3. Reasons for Banking (Cronbach α = 0.729)								
High Returns			0.73					
Wide Range of Services			0.81					
Investment Diversification Opportunity			0.79					
Wide Network			0.82					
Efficient Services			0.72					
Financial Advice			0.62					
4. Extrinsic and Intrinsic Perception of a Bank (Cronbach α = 0.893)								
Other Basic Principles of Islamic Banking				0.61				
Bank has Modern Contemporary Outlook				0.80				
Bank's Ambience is Islamic				0.87				
Separate Department or Counters for Ladies				0.84				
5. Service Quality (Cronbach α = 0.840)								
Customer Service					0.72			
Low Service Charges / Transaction Costs					0.75			
24/7 Availability of Service					0.80			
Efficiency Of Transactions					0.72			
6. Trust in Bank (Cronbach α = 0.912)								
Confidentiality of Customer Information						0.60		
Location (Close Proximity)						0.59		
Branch Network (Number Of Branches)						0.65		
7. Shariah Compliance (Cronbach α = 0.709)								
Banking According To Shariah i.e. Interest Free							0.63	
Banking Done On Risk And Profit Sharing i.e. For Mutual Benefit							0.87	

Table 3: Demographic Data of Clusters

Profile	Cluster 1	Cluster 2
Gender	Male	Male
Marital Status	Mostly Married	Single and Married
Age	26-35	26-36
	36-45	36-45
Education	Mostly Masters	Bachelors and Masters
Income	Above Rs.80,000	20,001-40,000
		60,001-80,000
Occupation	Self-employed/Professional	Self-employed/Professional

Table 4: Hypotheses Testing

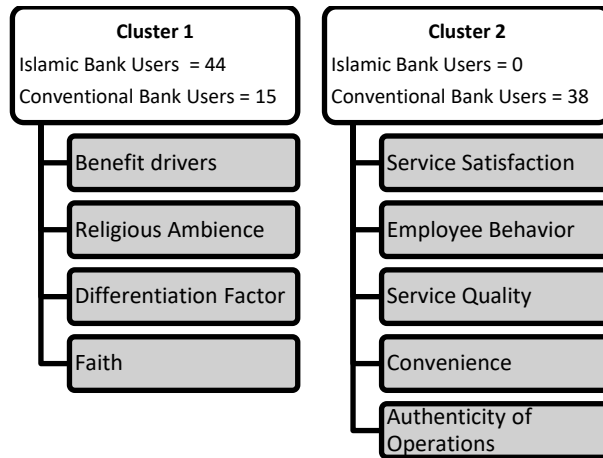
No.	Hypothesis	t-test	t-value	Mean Value
1	Islamic Banks are unable to differentiate themselves from Conventional Bank	True	16.91	4.16 (Agree)
2	Religion is not the sole factor in choosing an Islamic Bank	True	28.00	3.97 (Agree)
3	Consumers don't have positive image of Islamic banks	True	18.56	4.29 (Agree)

Table 5: Other Factors affecting Bank Selection Criteria

Reasons of Selecting an Islamic Bank	T-test	Upper Value	Lower Value	Mean
Faith in Religion	True	4.37	3.97	4.17
Location	True	3.40	2.88	3.14
Bank reputation	True	3.89	3.37	3.63
Branch network	True	3.69	3.19	3.44
Profitability	True	3.71	3.19	3.45
Service charges	True	4.09	3.61	3.85
Range of services	True	3.91	3.45	3.68

List of Figures

Figure 1: Clusters in Data



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