

From Adoption of Products and Services regarding Islamic Banking to Customer awareness in Pakistan

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ABSTRACT: *The aim of this study was to identify and analyze the awareness of Islamic Banking products and services in Pakistan. This study has used a survey method to conduct research by personally administering the questionnaire. In order to collect data from a valid sample of 238 customers drawn from the population, convenience non probability sampling was used. The population for the current study consists of all the customer of Islamic Banking in Faisalabad. This study used descriptive statistics, correlation analysis, linear regression analysis and stepwise regression analysis to test the hypotheses of this study. Results from this study showed that awareness of Islamic banking has a positive effect on Islamic banking products and services. Understanding of Islamic banking is positively associated with Islamic banking products and services. The perception of Islamic banking is positively associated with Islamic banking products and services.*

Keywords: *Awareness of Islamic Banking, Understanding of Islamic Banking, Perception of Islamic Banking, Islamic Banking Products and Services.*

The introduction of this empirical study describes the background of the Islamic Banking history of Pakistan as well as worldwide. In Pakistan Islamic bank first time introduce in 1977 Pakistan and others three countries (Egypt, Indonesia and Malaysia) has been trying to enact Islamic banking system at national level. The main purpose of Islamic financial system is a set of rules and laws according to Shariah. In Islamic laws collection and payment of interest is strictly prohibited. The commercial purpose of Islamic banking is the same as conventional banking but in Islamic banking system work under in the principles of Islamic laws. In Pakistan first time Meezan Bank 2002 provides the services on Islamic principles.

History of Islamic Banking in the Worldwide

According to Khir, Gupta, & Shanmugam (2008), Islamic banking was an abstract concept until the first half of the twentieth century. However, it has now become a full-fledged system and discipline. Islamic banking first gained its appearance in Egypt at Mit Ghamr by Ahmad El Najjar in 1963. In the seventies, many political changes have taken place in the Muslim countries which helps to facilitate the establishment of Islamic financial institutions. During this time, some Islamic banks came into existence in the Middle East. Examples are The Islamic Development Bank (IDB), the Dubai Islamic Bank (1975), the Faisal Islamic Bank of Sudan (1977), the Faisal Islamic Bank of Egypt (1977), the Bahrain Islamic Bank (1979), and the Philippine Amanah Bank (PAB) was set up in 1973, operates two windows for deposit transactions in commercial and Islamic. Later, Islamic banks and financial houses were established in Qatar, Sudan, Bahrain, Indonesia, Guinea, Denmark, Turkey, England, Jordan and Switzerland. Now, it is estimated that there are more than 250 Islamic banks operating in over 75 countries. Even in non-Muslim majority nations like the UK, Australia, United States of America, they are attempting to set up Islamic Financial Institutions.

It has been addressed by Ahmad Ashfaq (2010), Banking industry is playing an essential role towards economic development and wellbeing of any society. Banking activities are crucial for healthy economy, which leads towards the list of developed nations of the world. Industrial revolution during 18th century has expanded the trade and business activities by the inception of large-scale production. Banking gained importance as an essential facility to promote business operations. In today's global and borderless market, product/service quality and customer satisfaction may increase the performance of banks for the successful survival. In

Pakistan, banking activities are initiated after its independence on August 14, 1947. It has been said by Go (2008), Pakistani banking sector witnessed a major change due to key role of private sector having about 80% of banking assets.

Islamic Banking

State Bank of Pakistan (2015), defined Islamic banking as “banking in consonance with the ethos and value system of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shariah”. Islam is defined as total submission to Allah Almighty without any condition. It is a complete code of life that consists upon the instructions of Allah Almighty and the practices of the Holy Prophet Muhammad (Peace be upon him). Everyone in this world performs religious, social and economic activities in one's life. But most of the times social and economic activities are originated and linked with the religious activities. Islam provides a comprehensive set of instructions to face any challenge. Economic activities reflect the earning and spending pattern of people, which is closely associated with religion in the form of being permissible (Halaal) or forbidden (Haraam). The Holy Quran has clear instructions regarding business and trading activities as earnings from trade (Bai) is halal but interest (Riba) based activities are haraam. Banking activities are the part of economic activities and Islam allows riba-free banking only.

Islamic and Conventional Banking

The basic aim of the Islamic banking is to perform interest-free activities based on principles of Shariah and carry out only Halaal (permissible) transactions. The most important feature of Islamic banking is the sharing of risk among the investors, the bank and the borrowers. Islamic banking focuses on fairness and freedom as a centrally controlled and individually managed system according to the instructions of Allah Almighty. The existence of two bank streams i.e. conventional banks and Islamic banks requires a study to analyze service quality, customers' satisfaction and bank performance in Pakistan. It has been defined by Al-Jarhi and Iqbal (2001), Islamic bank as a banking institution conducting all known banking activities including borrowing and lending without interest. It mobilizes funds on the basis of Mudarbah or Wakalah and may accept demand deposits as interest free loan. It deploys funds on profit and loss basis or may advances on debt creating basis according to the principles of Shariah being an investment manager.

Islamic banks play a vital role in the economy to promote productive activities that enhance economic growth and prosperity. Islamic banks ensure stable economy; fair distribution of income; reduce injustice; risk sharing, lesser financial crisis; facilitate production and business activities. It is said by Chapra, (1985); Iqbal and Mirakhor (1999), interest-free (profit and loss sharing) system is viable and superior to an interest-based system. Islamic banks deal in equity based (profit/loss) contracts that are more suitable for the economy as compared to interest-oriented conventional banks. Similarly, both banking streams provide a set of products and services that requires a comparative study to assess their performance on the basis of service quality and customers' satisfaction.

Pakistani Banking Sector

State Bank of Pakistan is the central bank of Pakistan that regulates the banking sector by devising monetary policy according to changing environment. Pakistani banking sector has shown outstanding performance during last few years due to greater participation of private sector and foreign investors. Services sector is growing component of gross domestic product (GDP) all over the world as evident from last few decades. Pakistan has also experienced an unprecedented growth in the services sector especially banking sector due to its increasing contribution towards GDP. There are more than 52 banks actively working in Pakistan to provide quality service to meet customers' expectation. It has been elaborated by Arby (2003), the performance of commercial banks in Pakistan. It is found that the profitability of state owned banks has reduced as compared to private banks with the passage of time. Financial sector especially banking industry enjoyed numerous benefits from structural transformation of state owned banks to private banks. Currently, there are several banks that are providing services to customers according to the principles of Sharia'h. At the end of April 2007, there were 6 full-fledged Islamic banks with 108 branches and 13 conventional banks having 58 branches offering interest free products in Pakistan.

Research Objective

To identify the effect of awareness of Islamic banking products and services in Pakistan
 To explore the effect of understanding of Islamic banking products and services in Pakistan
 To investigate the effect of perception of Islamic banking products and services in Pakistan

Research Questions

How much influence the awareness of Islamic banking products and services in Pakistan?
 How much influence the understanding Islamic banking products and services in Pakistan?
 How much influence the perception of Islamic banking products and services in Pakistan?

Research Significance

Banks make heavy investments to attract larger customers for better profitability but these efforts are useless until and unless proper customer management by provision of quality services. This study may help the practitioners, bank managers, and academician and policy makers to find out the most important dimension of service quality that yields more awareness, understanding and perception for customers in Pakistan. Similarly, it also investigates the relationship of awareness in Islamic banking system of Pakistan. There is no research available in the literature that could show a relationship between awareness, perception and understanding in Islamic banking of Pakistan. According to Sarker (1999), found that Islamic banks could survive in less dominated profit-loss environments to compete with the conventional banks. Siddiqui (1985) evident that Islamic banks ensure just and equitable distribution of resources as compared to conventional banks. As per Burki and Niazi (2003) financial reforms and changes in governance have improved the performance of Pakistani banking sector over time

Hypotheses of the Study

H1(a) There is significant relationship between awareness of Islamic banking products and services.
H1(b) There is no significant relationship between awareness of Islamic banking products and services.
H2(a) There is significant relationship between understanding of Islamic banking products and services.
H2(b) There is no significant relationship between understanding of Islamic banking products and services.
H3(a) There is significant relationship between perception of Islamic banking products and services.
H3(b) There is no significant relationship between perception of Islamic banking products and services.

Literature Review

In this chapter, it will include the review of relevant articles or journals which are related to awareness, understanding and perceptions of Islamic banking products and services in Pakistan. Explanation of

different types of contracts used in the products of Islamic banking will be also included in this chapter. Then, this chapter would review the relevant theoretical models and propose conceptual model for this study. After proposing conceptual model, testable hypotheses will be developed for this study.

Awareness of Islamic Banking

It has been said by Khattak (2010) and Okumuş (2005), customer's awareness level towards Islamic banking products in Pakistan and Turkey is good in some of the general products like current accounts and time deposit account. However, for some of the Islamic financial products such as Murabahah and Ijarah, most of the customers are unaware of them. Khan (2010), interested in examining the awareness and usage of various Islamic bank products and services among Islamic bank customers in Pakistan. Their results show that there is a high level of customer awareness of some general products such as current account and saving account.

A study conducted by Ramdhony (2013), in Mauritius on the awareness of customers on Islamic banking terminology and the view of toward the Islamic banking products. It found that 82% are having awareness out of those 14% that are not aware of Islamic banking products. This study also highlighted a significant relationship between people's awareness and religion. The more pious the greater chance getting to familiar with the people, the greater chance getting to familiar with the Islamic banking products.

It has been elaborated by Akhter (2011), conducted a survey on employees in Islamic banks' in Pakistan and found various understanding level of awareness towards the Islamic banking products.

According to Doraisamy, Shanmugam and Raman (2011), found that exposure and knowledge of Islamic banking is through one's own effort prior to property purchase, recommendation by friends, through working experience and through advertisement and promotions. Although the banking system has been in existence for over a half century, awareness on its products and services are hardly known by most people even though a majority of the Muslim community are aware of such products and services Furthermore, this lack of awareness has led to differing opinions on products and services offered by the Islamic banking.

Understanding of Islamic Banking

It has been elaborated by Karim & Affif (2005), In Pakistan, the awareness of Islamic Banking is quite high

but the understanding about Islamic Banks is still not sufficient. According to Rammal and Zurbruegg (2007), some respondents who had held a halal banking product were not even aware of the profit and loss sharing concept. This show that they do not understand about the concept of their products and this would also indicate that some financial institutions have been guaranteeing profits. This was against the Syariah principles as gains made on investment without risk is merely interest rather than profit.

It has been defined by Loo (2010), study in Pakistan shows that the non-Muslims still could not understand the concept of Islamic banking even though there are a lot of advertising campaigns that targeted at them. However, for Muslims, 100% of them agree that they understand the concept of Islamic banking.

Perception of Islamic Banking

In a study conducted by Lateh, Ismail and Ariffin (2009), that examining the perception of the customers towards the objectives, characteristics and criteria of selecting Islamic bank, it was revealed that Pakistan customers perceived that there are no differences between the Islamic bank and the conventional bank products and services, except in the names used to highlight the Islamic Banking products. According to Karim and Affif (2005), beside the perception that an Islamic bank is a bank that operates under Islamic principles, other important perceptions are Islamic banks are meant for Islamic consumers only, limited facilities provided compared to conventional banks and do not have a huge customer base In Pakistan. In the study conducted by Thambiah et al. (2011), it shows that perception of urban banking customers on IRB is different with the rural banking customers, about perceived complexity, uncertainty and observably.

Islamic Banking Products and Services

It has been reported by AL Baraka Islamic Bank (2013), Islamic banking offers an array of products and services to its customers with the objective of satisfying different type of investments and financial needs.

Murabahah is a particular kind of sale where the seller expressly mentions the cost of the sold commodity he has incurred, and sells it to another person by adding some profit or mark-up thereon.

Ijara (leasing) permits the client to purchase assets for subsequent leasing for a certain period of time and at a mutually agreed upon amount of rent.

Mudarabah is a special kind of partnership where one partner gives money to another for investing it in a commercial enterprise. The investment comes from the first partner who is called “rabb-ul-mal”, while the management and work is an exclusive responsibility of the other, who is called “mudarib”.

Musharakah is a relationship established by the parties through a mutual contract. Therefore, it goes without saying that all the necessary ingredients of a valid contract must be present here also. The kind of musharakah is, Shirkat-ul-milk: it means joint ownership of two or more persons in a particular property. Shirkat-ul-aqd: it means a partnership affected by a mutual contract.

Muqarada (bonds) allows a bank to issue Islamic bonds to finance a specific project. Investors who buy muqarada bonds take a share of the profits generated by the project as well as assuming the risks of losses.

Salam literally means ‘futures’. A buyer pays in advance for a designated quantity and quality of a certain commodity to be delivered at a certain agreed date and price. It is limited to fungible commodities and is mostly used for the purpose of agricultural products by providing needed capital prior to delivery.

Istisnaa is a contract in which a party demands the production of a commodity according to certain specifications and then the delivery of it from another party, with payment dates and price specified in the contract.

Theoretical Framework

Figure 1 about here

Methodology

This study used the way to distribute the questionnaires among respondents. Data has been collected through questionnaires and administrated by the researcher. The data collection approach was non- probability sampling and sample size of 238 respondents taken. The population for this study consists of all Islamic banking branches customers of Faisalabad. The questionnaire was filled by the customer in the non-contrived environment and researcher interference was minimal.

Instrumentation

The questionnaire items in this study adopted and adapted from past literature. Each question of scales measured at Five points, Likert Scale, these options are ranged from 1 to 5, “strongly disagree” assigns value “5” “strongly

disagree” values “1” and “3” explains the “ Neutral” response of consumers.

Awareness of Islamic Banking

For measuring the variable of AW, this research adopted questions Buchari, Rafiki and Al Qassab (2014), of this measurement includes 3 items.

Understanding of Islamic Banking

The scale used in the study was adopted from previous work of Ling (2012) this scale also used by 5 Items was selected.

Perception of Islamic Banking

To measure the Perception of Islamic Banking 4 item questionnaire adopted from the study of Ling (2012).

Islamic Banking Products and Services

This variable adapted from the study of Ling (2012), to Islamic Banking products and services and their measurement includes 4 items.

Reliability Analysis

Cronbach (1951) explained that the coefficients get closer to ($\alpha = 1.0$) are better in reliabilities and if the coefficients are more than ($\alpha = .70$) are considered acceptable for social sciences. Inter item's consistency reliability or Cronbach's alpha reliability coefficients were obtained of one dependent variable “Islamic banking products and services” as well as three independent variables “Awareness” “Understanding” and “Perception”.

Table 1 about here

Results

Table 2 about here

Above table mentioned that mean and standard deviation values of different variable. For Awareness of Islamic Banking (AW, Mean = 4.36, Standard deviation = 1.23), for Understanding of Islamic Banking (UN, Mean = 4.37, Standard deviation = .436) for Perception of Islamic Banking (PE, Mean = 4.36, Standard deviation = .428) and for Islamic Banking Products and Services (IPS Mean = 4.46, Standard deviation = .342). Given data shows that the high values of the mean and the low values of standard deviation indicates that customer of Islamic banks have agreed with the given statement in the questionnaire about all variables.

Table 3 about here

Awareness (AW) and Understanding (UN) are significantly and positively correlated to each other ($p < .01$, $r = .381$). Awareness (AW) and Perception (PE) are

significantly and positively correlated to each other ($p < .01$, $r = .417$). Awareness (AW) and Islamic Banking Products and Services (IPS) are significant and positively correlated to each other ($p < .01$, $r = .344$). Understanding (UN) and Perception (PE) are significantly and positively correlated to each other ($p < .01$, $r = .342$). Understanding (UN) and Islamic Banking Products and Services (IPS) are significant and positively correlated to each other ($p < .01$, $r = .353$). Perception (PE) and Islamic Banking Products and Services (IPS) are significant and positively correlated to each other ($p < .01$, $r = .444$).

H1. Awareness of Islamic Banking (AW) has a positive effect on Islamic Banking Product and Services (IPS).

Table 4 about here

Results of the regression analysis show that overall this model for hypothesis 1 was significant and positive with an overall F value of 49.4 ($p < 0.01$). That shows that fitness of the model. However, R square = .297, this explained 29.7% of the variation in the Islamic Banking Products and Services as a dependent variable that is explained by the 'Awareness of Islamic Banking' AW as independent variable. Results also explicated that 'Awareness of Islamic Banking' AW had the positive impact on 'Islamic Banking Products and Services' IPS as indicated by the standardized beta value ($p < 0.01$, $\beta = .299$) means 29.9% increase in one unit of Islamic Banking Products and Services (IPS) due to one unit increase in Awareness (AW). Furthermore, the result shows that individual AW is associated reasonably with IPS ($p < 0.01$, $t = 6.82$). According to the results of regression analysis, hypothesis No. 1 was accepted. The results of this study established that customer has awareness of Islamic banking products and services.

H2. Understanding of Islamic Banking (UN) is positively associated with Islamic Banking Products and Services (IPS).

Table 5 about here

Results of regression analysis show that overall this model for hypothesis No. 2 was significant and positive with an overall F value of 40.86 ($p < 0.01$). That shows that fitness of the model. However, R-square = .290, this explained 29% of the variation in the Islamic Banking Products and Services as a dependent variable that is explained by the 'Understanding' UN as independent variable. Results also explicated that 'Understanding' UN had the positive impact on 'Islamic Banking Products and Services' UN as indicated by the standardized beta value ($p < 0.01$, $\beta = .289$) means 28.9% increase in one unit of Islamic Banking Products and Services (IPS) due to one

unit increase in 'Understanding of Islamic Banking' UN. Furthermore, the result shows that individual UN is associated reasonably with IPS ($p < 0.01$, $t = 7.45$). According to the results of regression analysis, hypothesis No. 2 was accepted. The results of this study established that customer has understanding of Islamic banking products and services.

H3. Perception of Islamic Banking (PE) is positively associated with Islamic Banking Products and Services (IPS).

Table 6 about here

Results of regression analysis show that overall this model for hypothesis No. 2 was significant and positive with an overall F value of 34.72 ($p < 0.01$). That shows that fitness of the model. However, R-square = .307, this explained 30% of the variation in the Islamic Banking Products and Services as a dependent variable that is explained by the 'Perception' PE as independent variable. Results also explicated that 'Perception' PE had the positive impact on 'Islamic Banking Products and Services' PE as indicated by the standardized beta value ($p < 0.01$, $\beta = .272$) means 27.2% increase in one unit of Islamic Banking Products and Services (IPS) due to one unit increase in 'Perception of Islamic Banking' PE. Furthermore, the result shows that individual PE is associated reasonably with IPS ($p < 0.01$, $t = 5.6$). According to the results of regression analysis, hypothesis No. 3 was accepted. The results of this study established that customer has perception about Islamic banking products and services.

Practical Implications

Awareness, understanding and perception of Islamic banking in Pakistan is a new concept for the customer of Islamic banking because most of the customer is no have information about the Islamic banking products and services. The main objective of this study is to determine the level of awareness, understanding and perception of Islamic banking product and services in Pakistan. Previous relevant researchers have done most of the research which the respondents are both customers and managerial staff. This study limited the scope of respondents to customer only so that the Islamic bankers could have a more specific view on the customer profiles. It helps to enhance the understanding of Islamic bankers towards Islamic products and services in Pakistan for their awareness, understanding and perception. In addition, the research on Islamic banking is not as many as conventional banking. In Pakistan, there is lack of research on Islamic banking. Hence, this research could contribute to the research papers in Pakistan and the

future researchers who are interested to study on the Islamic banking could use this study as a reference. In this study, it shows that 60.0% of respondents aware of the existence of Islamic Banking in Pakistan. Although more than half of the respondents aware of the existence of Islamic Banking, but this is not sufficient. This is because even though uneducated customers are no aware of Islamic banking in Pakistan, this does not guarantee they will use Islamic banking products and services. In the study conducted by Khattak and Rehman (2010), the percentage of respondents who are aware of Islamic Banking and do not use it stood at 19.9%. So, the Islamic bankers have to ensure that customers aware of Islamic banking so that the usage of Islamic banking by customer will be higher. Based on the results in Chapter four, it indicates that the respondent's awareness level towards Islamic banking products is good in some of the general products such as deposits product and insurance products. The top three Islamic banking products that gain highest awareness from the respondents are deposit, insurance and investment products. These three products could be the main products that Islamic bankers use to attract customer. By attracting customer to use these products, Islamic banker could cross sell other products which are not so popular among the respondents such as financing products- equity based, financing products debt based and money market in instruments. .

Recommendations for Future Research

The scope of this study is limited to the awareness, understanding and perception of Islamic Banking products and services in Pakistan. The potential research area is on the satisfaction and selection criteria towards Islamic banking. This is because satisfaction would lead to higher patronage and by knowing the selection criteria; Islamic bankers can put more effort in these criteria to attract more customers. The future researchers could also include managerial staff as their target respondents in order to find out the solution in Pakistan are aware of Islamic banking as the previous studies show that there are still customers that not aware of Islamic banking in Pakistan. In addition, the demographic variables in this study is limited to three variables, in the future research, the future researcher could include more demographic variables in order to have a more complete overview of the profiles of the respondents. Furthermore, to have a complete view of the customers in Pakistan, it would be ideal for the sample population to include respondents from Pakistan other cities of Islamic banks in the future research.

Conclusion

The main objective of this research is to determine the awareness, understanding and perception of Islamic banking product and services in Pakistan. This study has a total of 238 respondents and data collected was being analyzed by using SPSS 20. The level of awareness towards Islamic banking is considered as high however the level of understanding is just at moderate level. As for perception, it is varied among the respondents. Some of the demographic variables have significant relationship with awareness, understanding and perceptions. Educational level has the most significant relationship with all the variables. The summary of statistical analysis, discussion of major findings and implications of the study have included in this chapter. Limitation faced during the whole research and recommendations for future research have been discussed in this chapter as well. Lastly, this research has met its objective by knowing the level of awareness, understanding and perception of Islamic banking product and services in Pakistan.

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Appendix

Figure 1: Theoretical Framework

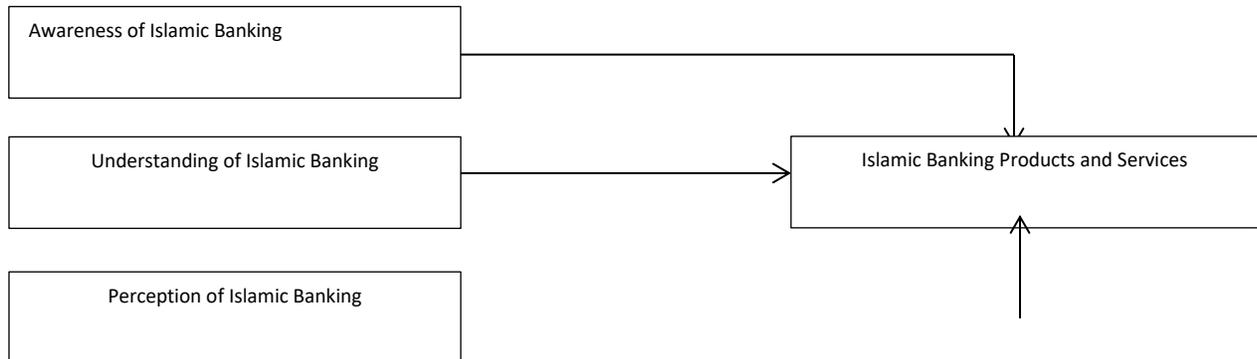


Table 1: Reliability analysis

Variable	Items	Alpha
AW	3	.780
UN	5	.690
PE	4	.607
IPS	4	.658

Table 2: Descriptive Statistics

	N	Mean	St. Deviation
IPS	238	4.46	.342
AW	238	4.361	1.23
UN	238	4.372	.436
PE	238	4.366	.428

Table 3: Correlation analysis

	AW	UN	PE	IPS
AW	1			
UN	.381**	1		
PE	.417**	.342**	1	
IPS	.344**	.353**	.444**	1

* $p < .05$, $n = \text{Total Respondents} = 238$, AW = Awareness UN = Understanding, PE = Perception, IPS = Islamic Banking Products and Services

Table 4: Results

Predictors	Islamic Banking Products and Services				
	B	R ²	ΔR^2	F	T
Step1		.192			
Step 2					
AW	.299*	.297	.095	49.4	6.82
*P<.05, DV= Islamic Banking products and services (IPS) AW = Awareness					

Table 5: Results

Predictors	Islamic Banking Products and Services				
	B	R ²	ΔR^2	F	T
Step1		.210			
Step 2					
UN	.289*	.290	.099	40.86	7.45
*P<.05, DV= Islamic Banking products and services (IPS) UN = Understanding					

Table 6: Results

Predictors	Islamic Banking Products and Services				
	B	R ²	ΔR^2	F	T
Step1		.240			
Step 2					
PE	.272*	.307	.109	34.72	5.6
*P<.05, DV= Islamic Banking products and services (IPS) PE = Perception					