ISLAMIC BANKING IN INDIA: CHALLENGES AND OPPORTUNITIES

ABSTRACT

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Islamic Banking in India: Challenges and Opportunities

Abstract

Banking is an important financial institution in the present global economic system. Despite touching each and every part of our lives, conventional banks have still been viewed solely as financial institutions, which should concern themselves with only financial matters. Ethics and morality has not entered the equation. Interest which is the backbone of the conventional banking system is not allowed in four major religions of the world: Judaism, Christianity, Hinduism, and Islam. This need is fulfilled by the evolution of Islamic banking or participatory banking or interest free banking.

Islamic banking: Islamic banking is based on the twin principles of Islamic law (Sharia'h) and Islamic economics. It permits transactions on the basis of sharing of profit and loss; and prohibits the collection of interest. Contrary to the popular belief, Islamic banking is not just for Muslims. Currently Islamic banking is present in more than 75 countries worldwide. Globally, Islamic banking assets reached $1.8 trillion (INR 110 trillion) in 2013 and are said to be growing twice as fast as conventional banking assets.

Egypt is viewed as the pioneer of modern Islamic banking. The pioneering effort, led by Ahmad Elnaggar, took the form of a savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. Islamic banks are neither charity institutions nor some religious organization they are the profit making organization doing same work as done by the traditional interest based banks but with according to the Sharia'h. This is because Islam forbids lending or borrowing of money at a pre-determined rate (interest or riba). The approaches of Islamic banking are distinctly different from the ones of conventional banks. Islamic rules on transactions (known as Fiqh al-Muamalat) have been created to avoid this problem. The basic technique to avoid the prohibition is the sharing of profit and loss, via terms such as profit sharing Mudharabah), safekeeping (Wadiah), joint venture (Musharakah), cost plus (Murabahah), bonds and leasing (Ijara), insurance (Takaful).
Islamic banking In India: In India the development of Shariah compliant financial institutions had started well before the establishment of a few most prominent Islamic financial institutions the worldwide. But due to certain legal and other hurdles, these institutions could not grow beyond a certain limit and those which grew could not sustain themselves at that level for a longer time. Since the inception of modern Islamic banking, there have been several attempts to establish a Shariah compliant banking sector in India, however, financial legislation and regulations have reservations with respect to setting up Islamic banks in India. In the last few years, the discussions on the need and advisability for changes and amendments of existing legal framework are raised, and especially regarding the Banking Regulation Act 1949.

In considering the merit of Islamic banking in the context of India, one need to consider its demographics. The current Muslim population in India is over 180 million representing about 14% of the total population according to 2011 census. India is now one of the largest Muslim population in the world. It is surprising to note that one of the world's fastest growing economies has little or no facilities for its Muslim population to invest their money in a Sharia-compliant manner. Despite this demographic standing, Indian Muslims are mostly financially marginalized and excluded not just due to the unavailability of non-interest banking, but because a majority of them are poor, and hence, lack the requisite credit worthiness to engage in the modern financial and economic activities.

There are several individuals, groups, organizations, committees which are working on the roadmap to the introduction of Islamic Banking in India. Generally, their main focus is on legal and regulatory aspects of Islamic banking in India. Although there are many other areas which need to be focused on. So, there is a need to find out the major determinants for the introduction of Islamic banking in India and to prioritize these determinants.

Many national and International banks are interested in introducing Islamic banking services to Indian customers but they are still left with the following questions unanswered: what is the potential of Islamic banking for the Indian economy? What is the level of awareness of Indians about Islamic banking? What is the attitude of Muslims and non-Muslims towards Islamic banking in India? A study is required to find out and analyze the
attitude of Indian consumers towards Islamic Banking and their perception about the services of Islamic banking in India. An empirical study into consumers' perception and willingness to accept Islamic banking would give the required insight into structuring of Islamic banking services, whether such services can be introduced without any changes, as has been in the Middle East and other countries thus-far, and the viability of new players coming up with innovative Islamic banking products and services.

**Literature Review in Brief:** Interest-free banking seems to be a very recent origin. But actually it is much older than the modern concept of interest based banking. Interest free loans were practiced pre-Islam among Jews and Christians, and later advocated by socialists and economists. The Old Testament, in Deuteronomy, teaches interest free loans to the poor (Stein, 1956) and the Judeo-Christian thought views loans with interest as doing little for the economic brotherhood (Maloney, 1971). Indeed, not only Islam, but also Judaism and Christianity ask their followers to shun usury to avoid hell fire (Homer, 1977).

The better performance of the Islamic banks in the dual banking system countries (i.e., Islamic banks working side by side with predominantly modern banking and financial institutions) calls for an explanation. It seems as though the need to compete with the conventional banks in attracting depositors' money, forces the Islamic banks to essentially follow the practices of conventional banks under Islamic garb and try to manage their portfolios more carefully so that their customers and investors do not get disillusioned (Kuran 1995). At the outset, it must be clear that Islam as a comprehensive way of life has its own broad and flexible economic principles which permit Muslims to construct their ideal economy irrespective of time and place (Siddiqi, 1970). Islamic banking is based upon the principle that the use of Riba (interest) is prohibited. This prohibition is based upon Sharia'h ruling. Since Muslims cannot receive or pay interest, they are unable to conduct business with conventional banks (Gerrard and Cunningham, 1997).

The Islamic finance industry has moved beyond borders and religion. Outside the key Muslim countries, there's been significant growth of this industry in the United Kingdom, Australia, Hong Kong, Korea, and United States. Since the first Islamic bank, Dubai Islamic Bank, was established in 1975, global finance institutions such as Citigroup, HSBC
and Standard Chartered have formed affiliates devoted to Islamic finance. Islamic financial services are currently very popular among the non-Muslims in different parts of the world (Knight, 2007). Unlike conventional banking, Islamic banking runs under the principles of partnership, mutual solidarity and reciprocal social development (Dusuki and Abdullah, 2007; Ahmed, 2000, Ali & Sarker, 1996). By analyzing the status of Islamic banking in different Muslim minority countries that these countries have adapted their legal, regulatory and taxation issues to accommodate Islamic banking system. All these all measures are not to please minority Muslim communities in their respective countries but to get the benefit of fastest growing Islamic banking and financial system.

**Attitude towards Islamic Banking:** A substantial literature on individual consumers’ attitudes towards conventional banking and services is already in place, especially concerning bank selection criteria (or patronage) and customer satisfaction. Moreover, most of this work is focused on banking. However there are few studies on individual consumers’ attitudes towards Islamic banks.

Customer’s perception has become an enduring research agenda in banking (Holliday, 1996). As Prophet Muhammad (PBUH) said that Muslims must accomplish anything in the most scientific and artistic way (Othman & Owen, 2001), it is vital to consider quality aspects to enhance customer management in Islamic banking. Erol and El-Bdour (1989) is considered to be the first study of individual consumers’ attitudes towards Islamic banking. A self-administered questionnaire was used to ascertain the attitudes, behavior and patronage factors of bank customers (both Islamic and conventional). The study found that bank customers (at least in Jordan) were generally aware of Islamic banks and their methods. Later, Omer (1992) surveyed 300 Muslims in the UK on their patronage factors and awareness of Islamic financing methods. At the time, Sharia’h-compliant products and services were primarily available through Islamic finance “windows” at conventional banks. The main finding was that a high level of ignorance prevailed among, Muslims in the UK concerning Islamic finance principles. This is generally consistent with findings elsewhere in the literature that Muslims living in a notionally Muslim country have a greater awareness and knowledge of Islamic banking than immigrant Muslims. Although UK Muslims were largely ill informed about Islamic methods of finance, religious
motivation comprised the most significant factor in their strong preference for Islamic banking services.

Metwally (1996) also used factor analysis to study the attitudes of Muslims in three Arabic dual-banking systems (Kuwait, Saudi Arabia and Egypt) towards Islamic banking. The results indicated that Islamic banks did not significantly differ from conventional banks in the benefits and costs of bank products and services and that Islamic banks equaled conventional bank in terms of staff competency and speed of the services. On this basis, and similarly to Omer (1992), it was concluded that religion was the primary factor in the choice of an Islamic banking institution. In Egypt, Hegazy (1995) compared the demographic profiles of four hundred customers of two banks: the Faisal Islamic Bank and the (conventional) Bank of Commerce and Development. The results showed that 98.8 percent of the Islamic bank’s customers were Muslims married with children, while 32.4 percent of the conventional bank’s customers were Christians and 54.3 percent were Muslims. This suggested that the choice of an Islamic bank is based, in part, on a religious motivation.

In Singapore, Gerrard and Cunningham (1997) also considered attitudes towards Islamic banking, though in the context of a banking system where no Islamic banks were yet present. While the survey results showed, as expected, that non-Muslims were completely unaware of Islamic methods of finance, Muslims fared little better. Once again, fast and efficient service and confidentiality were the primary motivations for bank selection as in Haron et al. (1994) study of Malaysian bank customers. Metwally (2002) considered the role of socioeconomic and demographic characteristics in the process of bank selection in Qatar. Two studies on the perceptions and understanding of Islamic finance deserve special note. In the first, Bley and Kuehn (2004) surveyed business students’ knowledge of financial aspects of Islamic and conventional banks in the United Arab Emirates (Sharjah). A finding was that while Arabic Muslims displayed a high level of knowledge of Islamic financial terms and concepts, non-Arabic Muslims students had a higher level of knowledge of conventional banking. Study found that most students’ banking knowledge was generally at a low level. Satisfaction on Islamic banking differs largely among different customer groups i.e. corporate customers, students etc. Recently a study by
Akhtar and Akhter (2011) is about the differences in the perception of university employees about Islamic banking in India. Differences were found in the level of awareness about Islamic banking as an alternative to conventional banking.

**Research Gap:** Islamic banking is growing at a steady pace but, it is not free from issues, problems, and challenges. Numerous studies have been performed since the inception of the modern Islamic banking and finance. Conceptual issues underlying interest free financing (Ahmad 1981, Karsen 1982) have been the prime focus of these previous studies on Islamic banks. There is extensive coverage in the existing literature on the issues of viability of Islamic banks and ability to mobilize saving, pool risk and facilitate transactions. Adequate work is done by the Indian authors in the field of Islamic banking and finance. In Indian context most of the studies focus on the concept of Islamic banking, its feasibility and effect of different factors on Islamic banking. There is a lack of researches on the main determinants of Islamic banking in India.

There are a number of studies on determinants of commercial banking in India and abroad, but only a handful of studies look specifically at the Islamic banking sector. Previous studies in this area were mainly catered to service quality, customer satisfaction with Islamic financial services, behavior of customers and their perception regarding existing services and policies of Islamic banks, knowledge of Islamic banking in Singapore, Jordan, U.K., Pakistan, Malaysia, Kuwait, Iran, Indonesia, etc. Ample literature is available for the concept of Islamic baking, its practicality, models and its operations. Existing studies have focused on their respective countries or region. As a result, there is a lack of holistic view on Islamic banking in Indian context. Also, there is a lack of study to gauge the prospective customer’s attitude towards Islamic banking in India. An important question that remains to be answered is what would be the ultimate fate of Islamic banks, if they are introduced in India. Thus, the factors that affect the introduction and operations of Islamic Banking in India need due consideration.

**Objectives of the Study**

- To identify and rank the determinants of Islamic Banking in India.
➢ To find out the interaction among the identified determinants of Islamic banking in India.

➢ To develop an instrument for the measurement of attitude of consumers towards Islamic banking in India.

➢ To explore the differences in the attitude of respondents across demographic variables.

➢ To come up with suggestions for the potential marketers of Islamic banking in India.

**Methodology Adopted for this study**

For the sake of gaining clarity on the subject the study has been divided into two parts.

**a) Qualitative Study to find the Determinants of Islamic Banking in India**

These determinants (i.e. barriers and enablers) not only affect the implementation process of Islamic Banking in India but also influence one another. Therefore, it is important to understand their nature and their mutual relationships. This part of the study utilizes the Interpretive Structural Modelling (ISM) technique to understand the mutual influences among the determinants of Islamic banking in India are identified.

In this part of research, through ISM methodology, an attempted has been made to:

- Prepare the ISM-based models of important determinants impacting the introduction and operation of Islamic banking in India for establishing the relationship among these elements.

- Ascertain the driving power and dependence of different determinants for their respective categorization and implications in introduction and operation of Islamic banking in India.

After a review of existing literature, personal interviews of the subject experts were conducted by the researcher through personal visit. Wherever personal visits were not possible interviews were conducted through e-mail or telephone. A mix of judgmental and snowball sampling was used for choosing experts.
b) Empirical study to gauge the attitude towards Islamic Banking of Indian Consumers

Since consumers are going to use Islamic banking services and invest their money into Islamic banks. Therefore, an empirical study into consumer's attitude and willingness with respect to Islamic banking is a prerequisite for marketing related activities.

Consumer's attitude towards Islamic Banking was assessed using a questionnaire developed by researcher for the study. Following a pilot study of 40 respondents, some modifications to the items were made to adequately capture the concepts in the Indian context. Of the total 1600 questionnaires administered, only 884 questionnaires were returned by the respondents. Due to incomplete and illegible responses, only 756 questionnaires were found suitable for analysis purpose which amounts to an effective response rate of 47.25% which was considered satisfactory (Comrey & Lee, 1992 and Tabachnich et al., 2012).

It was found that the overall reliability of the scale is quite high as the value of Cronbach's alpha is 0.907, which is an indication of high reliability. Next, dimension wise Cronbach's alpha is calculated which indicates that almost all dimensions have Cronbach's alpha more than 0.6.

<table>
<thead>
<tr>
<th>Factors</th>
<th>Cronbach's alpha</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ideology</td>
<td>.820</td>
</tr>
<tr>
<td>Awareness about Features</td>
<td>.863</td>
</tr>
<tr>
<td>Knowledge about Benefits</td>
<td>.794</td>
</tr>
<tr>
<td>Prospects in India</td>
<td>.795</td>
</tr>
</tbody>
</table>

Confirmatory factor analysis (CFA) was used to examine the reliability and validity, whether the measures of a construct were consistent with the researcher's understanding of the nature of that construct (or factor). The measurement model included 22 items describing four latent constructs: Ideology, awareness about Features, knowledge about Benefits and Prospects, of Islamic banking India.
Hypotheses Based on Demographics

1. HoRA: Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their religion.

Similarly, four sub hypotheses were also developed with respect to Ideology towards Islamic banking, awareness about features of Islamic banking, knowledge about benefits of Islamic banking and prospects of Islamic Banking in India which are the four dimensions of consumer’s attitude towards Islamic banking.

On similar pattern six more hypotheses were developed to test significant differences in consumer attitude towards Islamic banking across gender, age, occupation, education, income and place of residence.

For analyzing the data generated through questionnaire survey, mainly ANOVA procedure is used. However to be sure of the results of ANOVA, independent sample t test is also performed on the data.

Data Analysis and Interpretation

Part I: ISM Analysis

The relationship among various determinants of Islamic banking is analyzed. Further, the determinants are categorized as driving and dependent determinants through ISM technique. After a review of literature on Islamic Banking and the opinion of experts, both from academia and industry, 12 important determinants of Islamic Banking have been identified are:

i. Developments in the Global Economy  
ii. Political and Social Factors  
iii. Legal and Regulatory Factors  
iv. Ideology  
v. Mind-set of Regulator  
vi. Needs and Benefits  
vii. Nomenclature  
viii. Sharia’h Certification  
ix. Modification  
x. Manpower  
xi. Marketing  
xii. Financial Inclusion
A hypothetical model was initially developed with help of experts from the study, determinants were arranged in the order from bottom to top in order of one leading to the next level of determinants. Determinants with equal weightage were placed at the same level. From the model developed with the identified determinants in this research, it is clear that the most important determinant influencing the introduction of Islamic banking in India is the Ideology of the people concerned including policy makers, regulators, politicians and even consumers. Some of the important findings emerging from the ISM model are discussed below:

- Ideology has been found as the most important independent determinant. Other independent determinants are Developments in global economy, Social and political factors, Legal & regulatory factors and Needs & benefits. All of them have a high driving power but low dependency.

- Financial inclusion, human resource requirements, mindset of the regulator, Sharia’h certification, modifications and marketing are dependent determinants which are weak drivers but strongly depend on other determinants. So, the marketers should carefully monitor effects on these determinants to judge the effectiveness of Islamic banking.

- Nomenclature is the only determinant placed as a linkage determinant. It has a strong driving power as well as high dependence. This is the one, which is influenced by the lower-level determinants and in turn exerts influence on other determinants in the model.

**Part 2: Analysis of the questionnaire based survey data**

Frequency distribution containing data about gender, age group, occupation, highest qualification, religion, monthly income and city of residence were calculated for all the respondents. The respondents were predominantly male (72.60%). Majority of respondents were between 25 to 35 years of age (40.60%) followed by respondents of age group 36 to 50 years (33.33%). Nearly 19% respondents are below 25 years and 7% are above 50 years of age.

Nearly half of the respondents (48%) are employed in private sector organizations while 23% either self-employed or doing business. Majority of the respondents are either
graduates/post graduates (38.5%) or have some professional qualification (33%) while 7.5% are holding a doctorate degree. A small no of respondents (2.5%) are having religious education. Respondents are only from four religions. Majority of the respondents are Muslims (64%) followed by Hindus (18.65%), Sikhs (13.35%) and Christians (3.57%). Most of the respondents are from middle income bracket as 34.78% of respondents are of monthly income below 25k, 47.35% are of between 25 k to 50k, 12.83% are between 50k to 75k and only 6.35% are above 75k. 6.35% of respondents are NRI and rests are living in different classes of cities. 10.84% respondents are from metros 56.34% are from class A cities and 26.45% are from other class of cities.

Religion is supposed to be an important demographic variable in Islamic Banking. Surprisingly Muslims have acquired highest mean value only for two dimensions Ideology of Islamic Banking (3.84) and Benefits (3.74). It has been found that there is a significant variation of attitude towards Islamic banking with respect to religion of the consumer. Unlike common thinking mean values acquired by Muslims are not very high as compared to the consumers of the other religion. Muslim had acquired higher mean value only for the dimension ideology and knowledge about benefits of Islamic banking.

For the dimension knowledge about features of Islamic banking Hindus have acquired highest mean value while for the dimension prospects of Islamic banking in India Christians have acquired the highest mean value. It has been observed that in comparison to their non-Muslim counter-parts; Muslim respondents have obtained slightly higher mean values in almost all the dimensions of attitude towards Islamic banking. In order to probe deeper into the findings, the mean values are also tabulated across different demographic characteristics considered for the study. Across demographic characteristics almost a similar trend has been noticed i.e. Muslims have obtained high mean values as compared to the non-Muslims.

Surprisingly, the non-Muslim respondents with a Ph. D. / M. Phil degree, having income below INR 25 thousand a month, doing private service and other business, in the age bracket of below 35 years and are living in Class A cities have shown higher mean values
on account of the Ideology of Islamic Banking than Muslims in the respective demographic brackets.

For Prospects of Islamic banking in India mean value acquired by the non-Muslims are much higher than that of Muslims in most of the demographic brackets. On the whole, it may be inferred that education, experience and exposure to new ideas broadens the perspective of people which makes them appreciate and accept the good things offered by other religions. It appears that the educated non-Muslim respondents view Islamic banking as an interest free banking system based on ethics, risk sharing with an in built mechanism to control the exploitation of the masses. It may be safely concluded that very much like the Muslims, the non-Muslims too are anxiously waiting the introduction of interest free banking in India.

Although Males have acquired higher mean value towards Ideology of Islamic Banking than females but females have acquired higher mean values in the remaining three dimensions of attitude towards Islamic Banking in India. This shows that females have more positive attitude towards Islamic banking.

It has been found that occupation of the respondents effect significantly the attitude of the consumers. This may be because of the reason that consumers in different occupation interact with different type of people and have different work culture. It has been found that government job holders, have acquired less mean value in the dimensions Ideology, awareness about features and knowledge about benefits of Islamic banking, as compared to the private job holders, self-employed and others, but they acquired higher values more sure about the prospects of Islamic banking in India.

The present study shows that educationally more qualified consumers have more positive attitude towards Islamic banking. They have scored highest mean value in all dimensions of attitude except the dimension prospects of Islamic banking in India.

Although they have acquired a very high value for prospects of Islamic banking too. As their exposure to global system and their awareness about the recent developments in financial market is more than that of those who are comparatively less educated.
Unexpectedly consumers with Islamic religious education from madarsa have acquired highest mean value only for the dimension prospects of Islamic banking, this shows that there awareness level about the Islamic banking system is low. This may be because of the reason that in Indian madarsa education system exposure to other field is very low. Below graduates and graduate/post graduate consumers have shown almost similar attitude. While those with professional degrees have moderate attitude towards Islamic banking. Respondents with professional qualification and those having M. Phill/Ph.D., have shown a slightly higher positive attitude than those who are with graduate/post graduate degree or below.

Results shows that consumers who have more income, have more positive attitude towards Islamic banking as compared to the other income groups. Next in positive attitude are people from lower income group as the mean value acquired by these groups is just less than consumers of higher income group but much higher than that of middle income group consumers. Consumers from the upper middle income group (50K to 75K) have shown the least positive attitude towards Islamic banking.

Variation in the mean values of four dimensions of attitude towards Islamic banking in India with city of residence is shown in NRI respondents with acquired highest mean value for all four dimensions of attitude. While respondents from metro cities shows the lowest mean values. Among those consumers who are living in India consumers from class A cities has acquired the highest mean values for all four dimensions of attitude except prospects of Islamic banking in India, followed by metro cities and other cities. Other cities have acquired the highest mean value among consumer's living in India only for dimension prospects of Islamic banking in India.

Summary of the Hypotheses Testing

All seven null hypotheses had been tested for the significance and the results of the hypotheses testing found that six out the seven main hypotheses of the study are not supported. Which shows that consumer's attitude towards Islamic Banking varies significantly with respect to all chosen demographic variables except gender.
Marketers need to focus on demographic characteristics like religion, age, income, occupation, education and present city of residence of the consumers when designing products and developing strategy for Islamic banking in India.

Table 2 Summary of Hypotheses Testing Results Based on attitude towards Islamic banking with respect to demographic variables

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Hypothesis</th>
<th>Result</th>
</tr>
</thead>
<tbody>
<tr>
<td>H₀RA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their religion.</td>
<td>Not Supported</td>
</tr>
<tr>
<td>H₀GA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their gender.</td>
<td>Partially Supported</td>
</tr>
<tr>
<td>H₀AGA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their age group.</td>
<td>Not Supported</td>
</tr>
<tr>
<td>H₀OA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their occupation.</td>
<td>Not Supported</td>
</tr>
<tr>
<td>H₀EA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their educational qualification</td>
<td>Not Supported</td>
</tr>
<tr>
<td>H₀INA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their monthly income.</td>
<td>Not Supported</td>
</tr>
<tr>
<td>H₀RA</td>
<td>Significant differences do not exist in consumer's attitude towards Islamic banking with respect to their city of residence.</td>
<td>Not Supported</td>
</tr>
</tbody>
</table>

Findings Related to Patronizing Islamic Banking in Various Hypothetical Situations

Since there is no Islamic bank in India the respondents were requested to give their immediate reaction to a few hypothetical scenario/situation posed before them. This was done primarily with the intention to gauge their reaction to the possible introduction of Islamic banking in India. Their responses is summarized in the following section. An attempt has also been made to see whether there is any difference in the responses of Muslims and non-Muslims.
When the respondents were asked about their reaction, to the opening of Islamic bank in India, 37.78% Muslims and 15.24% non-Muslims respondents said that they will immediately open an account with such type of bank. Expectedly, Muslims have shown greater enthusiasm than non-Muslims in opening an account with Islamic bank as there is a significant difference in the responses.

More than half (54%) of the consumers will go for Islamic bank only when it provides better profit than the existing conventional banks. So, for growth and sustainability Islamic bank need to perform better than conventional banks, failing which, they will not get a good number of customers and even they may lose some from their existing customers. Less than 3% of consumers responded that they will continue with their existing banks. So there is a big size of prospective customer base.

In case of non-distribution of profit, by any Islamic bank, there is a significant difference in the responses of Muslims and non-Muslims. It has been observed that only 12.03% of respondents will immediately transfer their money to fixed return conventional banks. Expectedly Muslims as compared to non-Muslims are more attached to Islamic banks nearly 56% of Muslims were remain depositors in Islamic bank whereas only 30% non-Muslim depositors are likely to keep their money in Islamic banks.

When asked about the main reason which motivates the people to deposit money in an Islamic bank. There is a significant difference in the responses of Muslims and non-Muslims as shown in table 4.80. Only 15% respondents put religion as sole reason whereas a majority of 53% ranked religious and profitability reasons combined as the main reason which motivates them to deposit their money in an Islamic bank. For non-Muslims a majority of 46.10% has put profitability reason as the main reason. For Muslims, Islamic Banking is a matter of faith as well as business but for non-Muslims it is purely business so their reason for patronage and acceptability of Islamic banking are different from those of Muslims. Here has been attempt to measure the minimum acceptable profit on deposits and maximum acceptable margin\(^1\) for patronizing an Islamic bank.

\(^1\) Extra mark up money given to banks
There is no significance difference in the responses of Muslims and non-Muslims for the minimum expected profit for patronizing an Islamic bank. Results show that nearly 77% of respondents will accept Islamic banking if they will offer equal or more profit than conventional bank. It shows that 21.15% of Muslims and 10.41% of non-Muslim consumers will deposit their money in an Islamic bank even if they offer less than 20% less profit than conventional bank.

While this proportion decreases drastically when profit is reduced further. About a quarter of consumers (26.59%) consumers will go for Islamic bank if the offer at least equal profit offered by existing commercial banks. 40% of the respondents will go for Islamic bank if their offering is 20% more than that of commercial banks.

A whopping 65% of consumers will go for a loan from an Islamic bank provided rate for lending is not more than what is being offered by conventional banks. If lending charges, charged by Islamic banks are at least 20% less than what is being offered by the commercial banks percentage of consumers opting for it will reach 96%.

It has been found that when a situation come to patronizing Islamic banking approximately only 5% of the consumers will go for Islamic bank even they offer 20% less than offer by the commercial banks this no increase with the increase in profit, when profit is at par no of consumer increase to 50% and reach near 90% in case of 10% more profit. While in case of lending if lending rate is 20% less than that of commercial banks about 96% of consumers will go for an Islamic bank, this proportion reduced to about 75% when rate of lending by Islamic banks is equal to that are being offered by existing commercial banks. Only 22% of Muslim will go for lending from an Islamic bank if their rates are higher than commercial banks. So for sustaining in the market Islamic banks need to provide better rates or at least equal rates than the rates offered by existing banks to consumers.

When it was asked to the respondents whether they would recommend Islamic banking to others, more than half (55%) of the respondents were in favor of recommending Islamic banks to others. This percentage in case of Muslims is slightly greater than that of non-Muslims.
Challenges for Islamic Banking in India: The journey of Islamic banks throughout the world has been an interesting one. On one hand, at the time of its introduction in most of the countries of the world, it has faced opposition in one form or the other. Some of the common problems faced by Islamic banks are resistance to change, issues related to acceptability of Islamic banks, opposition from some publics, lack of political will, issues related to legal and regulatory framework, etc. Some challenges which are specific to the Indian context. Which are mentioned as under:

- It has been found that the Ideology of Islamic banking is the strongest independent determinant which has the maximum influence on the banking system. People from all sectors either regulators, policy makers, politicians, social activists, bureaucrats, bankers or customers have some preconceived notion, e.g. Islamic banking is for Muslims only, banking without interest is not possible, religion and financial matters are two different things, etc. Even some people from the Muslim community have expressed their doubts and reluctance towards Islamic banking.

- The findings of the study have highlighted the lack of awareness among the masses regarding Islamic banking as one of the obstacle in the way of Islamic banking in India.

- Among Muslims, criticism has been raised against the banking approach itself. Some allege that it is nothing but the changes of nomenclature only, while others question its capability to meet all the financial requirements of modern economies. Some go further to say that the whole exercise is futile, with the macro level money creation process remaining the same, what is being attempted through the so called innovative products is nothing but a cosmetic touch given to the existing practice of banking.

- There is a common thinking that Islamic Banking is only for Muslims, and it is meant to serve some religious purposes only. There are some social groups which are regularly propagating against Islamic banking by associating Islamic banking with terrorist funding. This is a baseless allegation against Islamic banks. As long as transparency is maintained and regular audits are performed under RBI guidelines, Islamic banking will remain a viable business activity.
• In a plural and secular country like India, misunderstanding among the majority community needs to be addressed through awareness creation. Islamic banking is only a mechanism for financing business without providing debt. It is also to be focused that it is based on ethics and Socially Responsible Investment (SRI). It needs to be show cased that 40% customers in Islamic banks in Malaysia are Chinese non-Muslims and in UK, 20% customers of Islamic banks are non-Muslims. Islamic banking is not merely for Muslims in terms of an interest-free transaction but it is also a profitable activity for the non-Muslims. Islamic banking was launched primarily for Muslims but in general it is beneficial for all the communities.

• Some of India's policymakers resist any reforms. They fear that abandoning directed lending would raise rural unemployment, arguably the country's biggest social challenge. And losing the captive market for government bonds would increase the state's borrowing costs. But helping productive firms expand is the best way to reduce poverty, increase employment, and boost government revenues for spending on rural welfare.

• Recommendations of Sinha committee report (2006) is now a big challenge for Islamic banking in India. The report is of the view that Islamic banking is not possible in India without properly understanding the working of Islamic banks globally. It has pointed out that the theory of Zakat fund and Sharia board are against India laws. RBI should re-examine its stand on interest free banking and government of India should amend the regulations to accommodate interest free banking / Windows as per the recommendation of Raghuram Rajan Committee Report (2008).

• At present regulations and tax regimes would make Islamic banking products less favorable to customers. Indian banking laws do not explicitly prohibit Islamic banking but there are provisions which make Islamic banking an almost unviable option. Banks in India are governed under the Banking Regulation Act 1949, Reserve Bank of India Act 1934, Negotiable Instruments Act 1881, and the state and central Co-operatives Acts. One of the most distinguishable features of these Acts is that they define Banking in such a way that Banks can accept deposits from the public only for further lending. A number of sections such as section 5 (b) and 5 (c) of the Banking Regulation Act 1949 prohibit banks from
investing on profit and loss sharing (PLS) basis. Further, section 8 of the Banking Regulation Act 1949 reads, “No banking company shall directly or indirectly deal in buying or selling or bartering of goods”. No major changes in the regulatory, legal and fiscal framework needs to be made only a few amendments are required in tax laws to accommodate Islamic banking.

- Nomenclature is the single linkage determinant which needs to be dealt with care. Sometimes obliging one will create distance from the others. Giving an Islamic name does not always suggest that it is not acceptable to non-Muslims and strongly valued by Muslims. While a giving a general nomenclature to Islamic banking is likely to dilute its core Ideology.

- RBI has shown concern over Sharia'h Advisory Boards in Islamic banks. Sinha committee reported that dual regulation is not possible. RBI is taking Sharia’h advisory board as a regulatory body while Sharia’h board is not a regulatory body. It is a panel of experts which is there just for advisory and certification purpose.

- There is a lack of adequate human resources in the field of Islamic banking and finance. There is an abundant supply of people specializing in the area of economics and finance. Also, there is no dearth of scholars in the area of Islamic law. What is found missing is the manpower specializing both in economics and Islamic jurisprudence. This has resulted in a lack of an interdisciplinary focus. Only a few institutions in India are presently offering courses in Islamic banking and finance.

- Operational problem worth mentioning is the product development and modifications according to Indian scenario. Additional efforts are required in product handling and administration.

**Opportunities for Islamic Banking in India**

- Islamic banking industry has experienced fast development in the recent decades, rising demand and increasing popularity around the world. It is fast emerging as an alternative to the interest based conventional banking. In order to match with the pace of
the global economy, Indian policy makers can hardly afford to ignore the global potential of Islamic banking system. The adoption of Islamic banking is not just offering an alternative system of banking to the customers, it is a step in the direction of integrating with the world market.

• The global financial crisis of 2007-09 has acted as a catalyst to redefine financial markets in favour of Islamic banking. In many emerging economies, Islamic banking institutions are leading the way to provide services to under banked populations previously ignored by conventional banks. To Muslim business (and non-Muslim business), Islamic banking is a viable alternative for their financial needs.

• Besides being the world’s second most populous country, India is also the world’s second most populous Muslim country. It is Asia’s third largest and one of world’s fastest growing economies. Its Muslim population is estimated to be between 160-200 million. Potential of the Indian Muslims still remains largely untapped and underutilized. It is reported that in India, thousands of crores earned in interest is kept in suspended accounts as some of the Muslims do not claim it. The assets controlled by Muslims are estimated to be $1.5 trillion and growing at 15% a year. In Kerala alone, it is reported that this money could be above Rs.40,000 crores. Research reveals that a handsome bulk of money in India owned by the Muslims is lying idle which if invested on a profit sharing basis and utilized properly, can have a major impact on the Indian economy.

• India has become one a major hub for financial services in South Asia. India has two stock exchanges that are among the five largest in the world. Half of Fortune 500 companies have their presence in India. India needs direct investments, portfolio Investments, venture capital investments and investments in infrastructure sector. The Investment commission has identified 25 key sectors spanning infrastructure, manufacturing, services, natural resources and the knowledge economy. These require an aggregate investment of $ 500 billion. An estimated $ 1.5 trillion funds are available for investment in the Middle Eastern Islamic countries, largely from higher oil prices. By 2020 these countries will have will have $ 9 trillion to invest. About $ 800 billion Arab money

has moved from the US and Europe to other regions after 9/11. If government of India wants to tap this huge fund then it should make way for Islamic banking and finance in India.

- It has been found that on the whole in comparison to their non-Muslim counterparts; Muslim respondents have obtained slightly higher mean values in almost all the dimensions of attitude towards Islamic banking. However, the non-Muslim respondents who are graduates, post-graduates, M. Phil or Ph.D., are above 35 years of age, are private sector employees are and living in class A cities have shown a higher mean value on account of the features and benefits of Islamic banking than Muslims in the respective demographic bracket. For prospects of Islamic banking in India mean value acquired by the non-Muslims are much higher than that of Muslims in most of the demographic brackets. These are some of the positive signals in the favour of introduction of Islamic banking in India.

- The present study shows that consumers who are living abroad (NRI) have shown a positive attitude towards Islamic banking. Unlike other consumers they are living in the city/country where Islamic banking is already operational, so different attitude is shown by them in study is quite obvious. Indians working in Middle East and Middle Eastern companies flush with petrodollars can also be a good source of financial resources for Indian banking institutions offering Islamic banking services.

- It has been found that in case of an unlike event of non-distribution of profit by an Islamic bank only 12.03% of consumers will immediately transfer their money to conventional banks. Others will continue their transactions with Islamic bank either because of their religious beliefs or expectations of higher profit in subsequent years. Expected, Muslims as compared to non-Muslims are more drawn to Islamic banks nearly 56% of Muslims would remain depositor in Islamic bank because placing a deposit with a non-Islamic Bank contravenes Islamic principles, whereas only 30% non-Muslim depositors keep their money in Islamic bank.

- The findings indicate that the a large number of respondents would be receptive to the idea of dealing with Islamic banks as long as the organization that is providing the
service is at par with the existing commercial banks. This is a great opportunity for Indian financial institutions.

- Sachar Committee report of 2006 & Raghuram Rajan committee report of 2008 highlighted numerous issues involved in Muslims accessing bank credit and the discrimination by scheduled commercial banks in facilitating credit and other services in Muslim-concentrated areas. The Raghuram Rajan committee has recommended that measures should be taken to permit the delivery of interest-free finance on a larger scale, including through the banking system it would be possible, through appropriate measures, to create a framework for such products without any adverse systemic risk impact. Based on the recommendations of this report, the United Progressive Alliance government started the Prime Minister’s New 15 Point Program for the welfare of minorities, and included the target of enhanced credit support to Muslims for economic activities.

- For the first time government has shown interest in Islamic finance business in India. This indicates that Islamic finance is going to grow from its current position. Various players in the corporate sector like Tata, Taurus have launched Sharia’h compliant products, several state governments are looking at exploring and capitalising on Sharia’h compliant financing options. RBI has given permission to first Sharia’h compliant NBFC to start its operation in Kerala.

- Ministry of Minority Affairs is keen to bring its financing arm (National Minority Development Finance Corporation) under Sharia’h and they are looking at further strengthening of Sharia’h compliance of various Muslim-centred activities that fall under the Wakf Act or related to performing Hajj. Looking at the overall developments at private, government as well as international levels it can be expected that India is likely to become the next big market for Islamic banking services in the world.

- The Kerala High court in February 2011 dismissed Dr. Subramanian Swamy’s petition and approved Kerala Government’s decision to float Sharia’h based Non-Banking Financial Company (NBFC). Kerala high court judgment in favor of Islamic banking is a big boost for Islamic banking in India.
A few Islamic MFIs (Micro Finance Institutions) in India have scored the most significant notable successes. From the Muslim Funds of Western UP to Toor Bait-ul-Maal of Hyderabad, the Bait-un-Nasr of Bombay and Islamic Welfare Society of Bhatkal, they have had several successful attempts at relieving the financial burdens of people in need. These helping hands have not been confined only to the social & personal sphere but have also aided small businesses, agriculturists and persons seeking to defray expenses for obtaining overseas employment - all of which have a direct economic impact on the well-being of those concerned. Success of these MFIs can be taken as the foundation for the introduction of Islamic banking in India.

Conclusions: Determinants of Islamic banking in India have its significance because of the fact that Islamic banking in India is emerging as a political and social issue. This is primarily due to the fact that Islamic banking is regarded as a religious/charity system in the mindsets of the regulators and policy makers. The various levels of determinants, are critical for better understanding and bear implications for the successful introduction of Islamic banking in India.

Islamic banking system can be introduced in India by developing factual ideology about Islamic Banking and its operational aspects. This can be further facilitated by a collaborative relationship with governmental policies and regulations. Proper awareness creation about Islamic banking is the primary issue which needs to be focused upon.

The government of India has recognized the benefits of products and services offered by Islamic banking to the large untapped Muslim population. Several initiatives were introduced to foster compatibility of the features like nomenclature and requirement of Sharia'h certification with Indian financial system. However, these developments are in their nascent stage at the moment.

For the purpose of financial inclusion of Muslims as well as non-Muslims, a marketing plan is required by the Islamic banks to offer modified banking products on the principles of Islamic banking. The issues of legal and regulatory factors need to be handled with care and proper gelling is required between the features of Islamic banking products and current financial regulations in India. In order to make Interest-free Islamic banking a reality in
India, a multi-dimensional plan of action is required. This action plan should comprise of awareness campaign, intervention of regulators, political will, development of knowledgeable manpower, financial inclusion and support to the efforts undertaken by various individuals and institutions.

Recommendations

I. Ideology has been found as the most important driving force for Islamic baking in India. It is necessary to educate people about the concept of Islamic banking. Consumers’ awareness programs and informative seminars should be organized, so that the larger audience is made aware of the benefits of Islamic banking products.

II. Government should make way for the full-fledged operationalization of Islamic banking by removing hurdles in the path of Islamic banking in India. It is a banking system which is likely to fully sanitize the banking sector and also reduce the socio-economic problems bedeviling the sector in India. Islamic banking will also contribute significantly to the overall development of the country by introducing micro credit schemes aimed at improving different communities, thereby drastically reducing unemployment rates.

III. Nomenclature of Islamic banking remains a point of concern for regulators and policy makers. A proper Indian name can be given to terminology of Islamic banking system. As most of the terms in Islamic banking are derived from Arabic sources, hence in a non-Arabic speaking country like India. It may pose difficulty in customers’ familiarity and recall of products. It may also hinder word-of-mouth publicity by the customers. Name should be given according to the secular character of India. Countries like Turkey, U.K. had adopted similar kind of names. Names may be like Bhartiya interest free bank, Samajik Banking, Social Banking Ethical Banking, Participatory Banking, Moral Banking, etc.

IV. A large number of consumers has shown readiness to open an account in an Islamic bank and they are not going to withdraw their money even if an Islamic bank does not distribute any profit for one year. This segment needs to be targeted even before the introduction of Islamic banking in India as this segment may help in pressurizing the
government to come up with the necessary changes in the legislation for the introduction of Islamic banking in India.

V. Islamic Banking offers an alternative paradigm for millions of needy people currently not catered by the conventional banking system. In order to provide access to sustainable services offered by Islamic banks on a large scale, it is imperative for the industry to adopt innovative and sound practices and prove that these models work.

VI. Islamic banks have to provide high level of customer services in comparison to the services offered by the commercial banks so that customer shifting from conventional to Islamic bank maintain the same level of satisfaction.

VII. Undoubtedly, under the present regulatory framework, Islamic banking is not possible in India. It has to be noted that Islamic banking is introduced without substantial changes in the financial regulations of other multicultural countries. In a large number of countries legislative changes in their banking and taxation law system without using religious terms Sharia’h or Islamic in their legislation have been made.

VIII. Profitability as well as religious principles remain at the heart of people’s preference for Islamic banks. This indicates that the banks should remain highly dedicated to Islamic principles. Introduction of any products/service (particularly the ones that have a fixed amount of profit upfront instead of a ratio of profit sharing) that may have substantial similarity with the traditional banking products/services should be thoroughly explained on the basis on Islamic principles and should be checked for consumers’ adaption.

IX. On its own part, government can allow some public sector banks to come out with a scheme under which, instead of paying interest to its depositors, it will agree to share profits earned out of actual investments in activities like trading in equities, financing infrastructural projects and other core business activities. Some filtering may be required in these sectors to keep out segments like financial companies, vulgar entertainment, tobacco, etc.; but there would still be a huge basket of investment opportunities left.
Implications

- Determinants of Islamic banking in India listed out by this study will help researchers in deciding key areas for future research.

- This study has given four dimensions and instrument for measuring the attitude of consumers towards Islamic banking.

- Ideology has been found as the single most important determinant to focus by the supporters of Islamic banking in India.

- Financial inclusion is found to be at top level of the model which implies that by introducing and successfully operating Islamic banks in India, the financially marginalized class could be brought into the financial mainstream.

- The attitude towards Islamic Banking is influenced greatly by educational qualification of consumer. The marketers can educate the investors by organizing some programs like seminars, and workshops to educate the customers about Islamic banking.

- Ideology has the highest driving power and lowest dependence; hence it appears at the bottom level of ISM hierarchy. Since Islamic banking is routed through lawmakers and regulators, marketers should focus on this aspect in developing appropriate strategies so that benefits of Islamic banking can be distributed equally among all the stakeholders.

- ISM model developed in this study explains the hierarchy and interaction among the determinants is likely to help marketers of Islamic banking in India in prioritizing their marketing related activities.

- Sharia’h certification, marketing of the products, manpower requirement, and modification in existing products are important determinants but need focus at later stages. Initially ideological, political, social and global development are the most important ones.

- The study shows that males and females do not have significantly different attitude towards Islamic banking, although females are slightly more inclined towards Islamic
banking. The marketers or advisors can focus more on other demographic factors than
gender of the consumers.

- It has been found that young consumer are very optimistic about Islamic banking
  in India. This implies that generation Y can be a prospective customer of Islamic banking.
  Marketers should focus on offering different products for different age groups.

- The present study shows that high income group consumers have a higher positive
  attitude than those with less income. The marketer can tap high income individual by
  offering them customized products. Consumers’ segmentation on the basis of income is
  very common for financial products.

- Consumers from different type of cities have shown different attitude towards
  Islamic banking. Most of the NRI customers are living in countries where Islamic banking
  is operational. Hence they are already aware of working of Islamic banks. There is not
  much attitudinal difference between people living in metros and class A cities with respect
  to Islamic banking.

- People already have faith in Islamic banking system as the study shows that a
  majority will not withdraw their money in case of non-distribution of profit by an Islamic
  bank. This indicates that Islamic banks, can take risk and can invest in long term profit
  making ventures.

- Muslim customer are ready to pay some premium for dealing with Islamic banking
  system. Maintaining the rates at par with the existing commercial banking system will even
  attract a good number of non-Muslim customers.

Limitations

- Limitations of time, funds and willingness of the respondents dictated that the
  sample could not be larger than the present one. Although this limits the generalizability
  of results, it is believed that it represents a necessary and economical first step in identifying
  useful concepts and relationships which could be later tested in more elaborate research
  designs and representative samples.
• There is a lack of extensive prior research in this field in India. This limitation affected the present research as there did not appear to be a strong foundation upon which this research could be built.

• The twelve determinants of Islamic banking were identified on the basis of extant literature and experts’ opinion. If more literature is searched and a new set of experts is interviewed, perhaps more determinants of Islamic banking in India can be identified.

• The study is limited by the constructs measured. The fact that all surveys were applied with the same polarity of the response scales might have also generated or strengthened a one-sided response effect. A self-report questionnaire was the primary measurement instrument, although every respondent received the same examples as part of the instructions for the survey, their imaginary processes may have led to different interpretations of the proposed collaborations, possibly creating inconsistent results.

• There may be a fundamental difference in the manner in which the respondent makes a hypothetical decision as compared to an actual decision which one may need to take later, when Islamic banking is actually introduced in India.

Directions for Future Research

• Further research is recommended in several areas. First, a follow-up study should be conducted to confirm the results of the present study.

• Additional studies could also expand the geographic coverage in data collection because residents in other parts of the country may have different opinions and attitude with respect to Islamic banking.

• Aspiring researchers may replicate this study in other countries and culture on respondents with varied demographic backgrounds to validate the findings of the present study so as to improve the generalizability.