Chapter 3 – Review of Literature
3.1 Introduction

Researchers point out that by and large Islamic Banking is less exposed to serious business and financial risks, which otherwise is the problem in conventional banking. On the basis of this they opine that it is expected that stakeholders throughout the world may have positive attitude towards the use of Islamic banking products. They further point out that the attitudes, perceptions and awareness of market participants towards Islamic methods of finance forms an important consideration in its establishment and development. As such, it has been widely studied in Muslim and non-Muslim countries such as Malaysia, Pakistan, Saudi Arabia, Sudan, Egypt, Jordan, Iran, Singapore and the United Kingdom etc. The detailed review of the same literature is presented in the following section.

3.2 Review from related literature

Islamic banking, started on a modest scale in mid-1970’s, has witnessed a rapid expansion and evolution over the past four decades. It has emerged as one of the fastest growing industry at an estimated growth of 15 – 30 % per annum (Haque et al, 2007; Iqbal and Molyneux, 2005; Khan et al, 2008) and has spread to all corners of globe and received wide acceptance by both Muslims and Non-Muslims (Aziz, 2006). Islamic Financial Services Board (IFSB) (2008) stated that total assets were worth US $ 700 billion in 2005, which can grow up to US $ 2.8 trillion by 2015 due to the popularity of Islamic financial services among Non-Muslims in different countries (Knight, 2007). Observing the increasing demand for Islamic Banking Services, various multinational conventional banks have already started separate windows for Islamic banking that provide interest free services to the
widely scattered population (Hassan and Ahmad, 2001, Huda et al, 2007). It is not a coincidence that world-over Islamic banking system is making a rapid progress in many countries but it is because of the vision of the governments of those countries to develop a progressive and robust Islamic Banking Industry based on strong Islamic core values and principles that best serve the needs of the economy (Aziz, 2007).

However, today Islamic banks are struggling against conventional banking and non-banking financial institutions in terms of products, service quality and above all because of customer satisfaction. Therefore to survive in this strategic rivalry, Islamic Banks must understand and use the customer satisfaction issues under existing privileges given by the Islamic Shari’ah (McIver and Naylor, 1986). Various earlier studies pointed that religion (Islam) as the main reason for choosing Islamic banks, which has been grounded under the principles of the Qur’an and the Hadith. However, studies in Malaysia, UAE, Kuwait found non-religious factors like efficiency, cost-benefit etc. in conjunction with religion as the influential factors behind choosing an Islamic bank (Dusuki and Abdullah, 2006; Wilson, 1995; Ahmad and Haron, 2002; Kuehn and Bley, 2004, Owen and Othman, 2001; Metawa and Almossawi, 1998). While the opportunities for Islamic banking will continue to grow, there is an immediate need to develop products and services that are in line with the changing needs and demands of customers so as to remain competitive in the business. A feature of the banking industry across the globe has been that it is increasingly becoming turbulent and competitive (Sadiq & Shanmugham, 2002). The banking industry as a whole has seen paradigm shift in recent years due to globalisation and liberalization. Islamic
Banking System is no exception to this and they are also facing stiff competition from conventional banks. Today Islamic banking is no longer regarded as a banking service striving to fulfill only religious obligations of the Muslim community, but more significantly as an innovation in the whole banking industry, that ought to be, as competitive as conventional banking. This necessitates Islamic banks to understand the real needs of their stakeholders towards Islamic Banking Services. In countries like Malaysia, customers’ perception towards Islamic banking is far more crucial because Islamic banks have to compete with the dominant and long established conventional banks in dual banking system (Aziz 2006; Asyraf 2007).

The studies of Erol and El Bdour (1989) and Erol et al. (1990) are considered to be as the earliest patronage studies on ‘Islamic Banking’. Using both conventional and Islamic bank customers, they found that customers who patronized Islamic banks perceived that the three most important criteria in bank selection were the provision of a fast and efficient service, bank’s reputation and image, and confidentiality. Islamic banking in its contemporary form is the newer of the two and not many in-depth empirical researches are available in this regard. Zineldin (1990) compares the two types of banking and put forth his arguments, using the theory and practice of Islamic banking, and concluded the superiority of Islamic banking. The empirical studies extended to various other Islamic countries like Egypt and Malaysia, and almost all of them, have concluded that Islamic banking performance is relatively better than its conventional counterparts. While Kazarian (1993) compares the two types in Egypt. Samad (1999) compares the efficiency of the two types of banks in Malaysia with empirical analysis of four years. Samad (1999) gives opinion that Islamic Banks in Malaysia had superior managerial skills
than conventional banks. **Samad and Hassan (1999)** focus on liquidity ratios of Islamic banks and also on popularity of Islamic lending. They test the hypothesis that the liquidity ratios of Islamic banks are higher in the initial years and lower later due to learning curve. **Zaher and Hassan (2001)** have documented comprehensively the working and structure of Islamic finance and banking, and have explained the theory behind the growth of Islamic finance. They have also articulated the difference between profit and loss sharing (PLS) that exists in Islamic banks vis-à-vis interest payment in conventional banks. **Iqbal (2001)** examines ratios for 8 years of Islamic and conventional banks across various Islamic countries. The paper compares the performance of Islamic banks with conventional banks as “control group”, and concludes that Islamic banks have done better than conventional banks. **Samad (2004)** examines the two types of banking in Bahrain for a period of 10 years from 1991 to 2001. He argued that there is no major difference with respect to profitability and liquidity, but finds that credit risk is much less in Islamic banks coupled with superior credit performance. **Qorchi (2005)** discusses the rise of Islamic finance not only in the Muslim countries but also in Europe and the U.S. He discusses the unique features of Islamic financial instruments that are more contract based between the savers and the seekers of funds and the various contracts in vogue in Islamic banks. Based on the study of Malaysian banks, **Choong and Ming (2006)** argue that distinguishing feature of Islamic banking, that is the PLS, is merely in theory and that Islamic banking deposits are not interest-free, but are very much dependent on actual interest rates in the market. They do not find much difference between the structure of the two
banking types and opine that a very negligible proportion of banks actually practice Profit / loss Sharing.

Notwithstanding the general soundness of GCC banks, Abdullah et.al. (2010) find some weaknesses associated with the operational aspects of GCC banks. The rapid credit growth, concentration risk, and low liquidity levels by international comparison are seen as the three major operational weaknesses of GCC banks. Beck et al. (2010) have compared the two types of banking and their performance across many countries, during recent crisis and conclude that though both types of banking were affected by the crisis, Islamic banks had higher capitalization coupled with higher liquidity reserves, resulted in better performance of Islamic banks. There is a growing body of literature that compares the Islamic and conventional banks. If majority of the literature has found Islamic banks, performed well most of the times, then it should reflect the same during the crisis. Hence, while comparing the two types before the recent global financial crisis and during the crisis, in order to examine the shock Islamic banks had vis-à-vis conventional banks and the superiority or otherwise of performance of Islamic banks during crisis, it was found that despite shock in terms of certain ratios during crisis period, Islamic banks have performed better than conventional banks during four year period of 2006-2009.

With the exception of a few studies that used individual and small business customers as samples, no attempt has been made in the area of corporate customers’ understanding of Islamic banking in the mainstream publications. Similarly, there are only a few published works that relate to corporate customers’ perceptions on conventional banking service quality.
**Turnbull (1983)** was among the first researcher who studied the perceptions of corporate customers towards their banks. He examined the relationship between 44 corporate customers in United Kingdom and their bankers and found that size played an important role in maintaining split banking practices. Another important finding of Turnbull (1983) was that large corporations tend to prefer foreign banks than the local banks.

**Rosenblatt, et al. (1988)** sampled 423 Canadian corporate treasury personnel in their study to determine the responsible person(s) in selecting bank(s) for their organization, factors attributed to the selection of the bank(s), and perceptions of these personnel on the bank’s service quality. They found that almost half of these corporate treasurers were solely responsible in the selection of the bank(s). The two factors that influenced their decision-making were banks with better branching networks and which offer quality services. Half of the respondents in this survey also preferred the bank to assign special officer who had the most knowledge about the customers’ business operations. The corporate treasurers were also more concerned about quality products and services than innovative products. They also were not keen on the concept of “one-stop banking centre”.

**Turnbull and Gibbs (1989)** conducted a study using ‘large’ and ‘very large’ companies in South Africa. The objectives of their study were to find factors that were considered important among corporate customers in selecting their banks and to find information whether companies have single or split banking relationship. The finding generally highlighted that the corporate customers perceived that quality of service was the most important factor in establishing a relationship with
Islamic Banks. Other influential factors were quality of staff, bank manager’s attitude, and price of service. Although very large companies considered quality of service as the most important factor, both price and quality of staff were equally important. Split banking relationship practice was common among the corporate customers. Almost all of the treasurers agreed that physically appearance of the banks had no impact on their selection process.

Chan and Ma’s (1990) study in Hong Kong aimed at understanding corporate customers’ behaviour on split-banking, bank-switching, factors that attribute to patronage, level of awareness, and the usage of banking product and services. They found that corporate customers preferred to use big and reputable banks, and split banking. Corporate customers would only switch their banks if the new bank were able to show that the quality of its products and services were more superior to others’. Tyler and Stanley (1999) used orthodox grounded theory in their study with the objective of identifying key elements of perceived service quality by large corporations. They found that elements considered important were reliability, assurance, empathy, responsiveness and pro-activity.

Haron et al. (1994) sought to establish the selection criteria used by Muslim customers in Malaysia when selecting their banks. The three most important criteria perceived by Muslims in Malaysia were the provision of a fast and efficient service, the speed of transaction, and friendly bank personnel. Another important contribution from this study was the potentiality of individual customers in patronizing an Islamic bank when they had knowledge of this new system. 80 per cent of Muslim and 53 percent of non-Muslim respondents indicated that they
would consider establishing a relationship with an Islamic bank if they had substantial understanding of its operations.

While applying Haron et al’s study, Gerrard and Cunningham (1997) found that just like their Malaysian counterparts, Singaporean Muslims were more aware of the existence of Islamic banking than the non-Muslims. Similarly, this study found no evidence of Muslims and non-Muslims differing in their bank’s selection criteria. This study however did not include any question that could measure the intention of their respondents to patronize Islamic banking. Metawa and Almossawi (1998) focused their study to customers of Bahrain Islamic Bank and Faisal Islamic Bank of Bahrain. They found that customers of these two Islamic banks perceived Islamic principle as the most important factor while selecting Islamic banks. The second important factor was reward extended by the banks, followed by influence of family and friends, and convenient location. The study of Metawa and Almossawi also indicate that socio-demographic factors such as age, income and education were important criteria in bank selection. This finding indicating religion as the most important reason for customers patronizing Islamic banks contradict those findings by Haron et al. (1994), and Gerrard and Cunningham (1997).

In recent past, there has been paradigm shift in Islamic banking research. The development and shift in Islamic Banking seems to have taken note of Dar and Presley’s (1999) suggestions for adopting the empirical approach of western economic literature. In their article, “Islamic Finance: A Western Perspective”, authors argued that
a) Islamic writers have implicitly assumed that prohibition of interest is unique to Islamic Literature,

b) Islamic scholars should exploit the wealth of supportive argument in western literature rather than develop their literature in isolation, and

c) Islamic writers need an empirical approach like their western counterparts.

Interest free loans were practised 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 economic brotherhood (Maloney, 1971). The Old Testament was the key influence on Jewish and Christian opposition to interest, and may have been the original reason for the Qur’an’s dismissal of usury since the three religions share the same belief in the God of Abraham (Dar & Presley, 1999).

Apart from religion, socialists condemned interest as encouraging a “parasitical existence” (Brunner, 1937). There is a wealth of supportive argument in Western literature for Islamic scholars to exploit as western economists have identified linkages between interest rates and macroeconomic instabilities which afflict most capitalist economies, such as, inflation, unemployment and negative growth (Mill, 1826; Smith, 1904; Keynes, 1931; Fisher, 1933; Wicksell, 1935; Hayek, 1933, 1939; Minsky, 1977; Bernante and Gertler, 1990).

The abundant western literature that supports interest free loans should encourage Islamic scholars to take an empirical approach. Western economies have their
foundation in classical economics based on a perfect world but they have progressed by accepting uncertainty and imperfection, and testing empirically economic theories. Islamic theory describes “how people, groups or governments should act in a perfect Islamic community” and the reality is that people do not act in this manner, and empirical testing is needed to understand how Muslims behave in the real world towards Islamic Banking. Islamic banking studies are largely conducted among Muslims and to a little extent among non-Muslims. Erol and El-Bdour (1989) and Erol, Kaynak and El-Bdour (1990) are among the earliest known researchers who identified three key selection criteria for Islamic banks: fast and efficient services, reputation and confidentiality. Moreover, religious motivation was not a primary criterion.

However, Metawa and Almossawi (1998) and Naser, Jamal and Al-Khatib (1999) found adherence to Islamic tenets the primary criterion for selecting Islamic banks in Bahrain and Jordan. Likewise Kader (1993, 1995) and Osman et al. (2009), Othman and Owen (2001, 2002), and Wakhid and Efrita (2007) share the same findings in their studies in Malaysia, Kuwait and Indonesia respectively. Dusuki and Abdullah (2006) explained that Islamic bankers can no longer depend on promoting the Islamic factor but also have to improve service quality. Their survey among 750 respondents found the three most important factors were competence, friendliness and customer service quality.

Gerrard and Cunningham’s (1997) study in Singapore found 41.4% of Muslim respondents would deposit an unexpectedly acquired substantial sum of money in Islamic banks, but half of them would withdraw and transfer all deposits to another
bank if no profit is announced, much like non-Muslims who deposit with banks that guarantee a return. **Gerrard and Cunningham’s (1997)** study stressed the significance of customer awareness, product knowledge and informative advertising campaigns. The need to create awareness, enhance product knowledge and improve promotional campaigns is supported by **Haron et al. (1994), Bley and Kuehn (2004), Dusuki and Abdullah (2006) and Thambiah et al. (2007)** to combat growing competition from both Islamic and conventional banking products.

**Bley and Kuehn (2004)** studied 667 business graduate and undergraduate students’ knowledge and perception of conventional and Islamic finance in the United Arab Emirates (UAE). Non-Muslim students viewed Islamic finance as inherently appealing to Muslims, and did not perceive Islamic finance as provider of superior products. Overall, studies related to Islamic banking in Malaysia have largely focused on patronage factors (**Thambiah et al., 2008**). Recent studies indicate a deeper need to investigate the importance of marketing Islamic banking, reinforcing **Al-Haran’s (1995)** proposition for market research to determine a viable Islamic economic system. Islamic banking should no longer be regarded as a business entity striving to fulfil the religious obligations but as a viable business that can win over customers (**Dusuki & Abdullah, 2006**). **Bley and Kuehn’s (2004)** study in UAE showed although Muslim students indicated better knowledge and deeper interest in Islamic banking, they preferred conventional banking concurring with **Omer’s (1992)** study among Muslims in UK.

From the above literature review, it is inferred that most of the stakeholders are inclined towards Islamic banking because they feel **Riba is not Halal** as per Islamic
principles. However, some of the studies have shown that Muslims are more inclined to Islamic banking system not only because of religious belief but they also feel that conventional banking products lack innovation in terms of risk measurement and management. Because of Riba, Islamic banks have had to develop financial products which are not in conflict with the Sharia’h. The task has been achieved by creating a number of special financial products (Ali and Ali, 1994).

The excessive use of credit facilities by Islamic banks globally has drawn the ire of scholars such as Ahmad (1989) and El-Naggar (1994). Conventional futures are very controversial with the Ulema - religious scholars (Kamali, 1999). It should be noted that certain Ulema such as Justice Taqi Usamani have given their verdict allowing contracts with embedded options (Khan, 1999). The study of Erol and El-Bdour (1989), conducted in Jordan, aimed at establishing the attitude of local people towards Islamic banking. The results suggest that religious motivation did not appear to play a primary role in bank selection; the opening of new branches was not an important factor in increasing the utilization of financial services provided by Islamic banks; while 39.4 per cent of respondents would withdraw their deposits if an Islamic bank did not generate sufficient profit to make a distribution in any one year, 30.4 per cent would retain their deposits because the Islamic bank could distribute a higher dividend the following year.

The approaches of Islamic banking are distinctly different from the ones of conventional banks. The basic principle beneath Islamic financial system is development based on partnership (Ahmed, 2000; Chapra, 2000; Hassan and
Ahmed, 2001; Wilson, 1995). Under this principle, Islamic banks operate various deposit, loans and other commercial services for the retail and corporate customers.

3.3 Research Gap

It is evident from the literature review presented in this chapter, that no major study has been undertaken to analyse the attitudes and perception of Muslims towards ‘Islamic Banking’ in India in general and no such study has been made in the State of Jammu and Kashmir where Muslim Population is more than 1.50 Crores, Kashmir in particular. Even though in the year 2011 only, RBI gave nod to certain interest free Non-Banking Financial Institution in Kerala, yet the full gloomed interest free banking system is still a dream. Hence, in absence of this alternative Muslims of India in general and of Jammu and Kashmir State in particular are deprived off the facility of Islamic banking system. However, a lot of work has been carried out on the working of Islamic Banks in the places where Islamic banks are operating along with the Conventional Banks. Therefore, in order to establish the Islamic Banking as an alternative way of banking in India, an empirical study to evaluate the perception and attitudes of stake holders towards Islamic banking is a multi-dollar question to explore.

Against this backdrop, the present study has been undertaken to study the attitudes and perceptions of various stakeholders towards Islamic banking for establishing or not establishing the Islamic Banks in India with special reference to the state of Jammu and Kashmir. The study is conducted in the light of studies of Gerrard and Cunningham (1997); Ahmad and Haron (2002) and Loo (2010) with some minor
modifications to the research instrument in order to fit into the situation where Islamic Banking does not exist as an institution.

The literature review generated curiosity to dwell upon in the subject i.e., whether stakeholders in India in general and in the state of Jammu and Kashmir in particular are of the opinion that it should be started in this part of world or not? In order to study this curiosity of stakeholders and to fill this research gap, a complete research approach has been devised. Hence, next chapter is devoted to materials and methods used for analysing stakeholders’ perception and attitude.