

## **PERCEPTIONS OF MALAYSIAN CORPORATE CUSTOMERS TOWARDS ISLAMIC BANKING PRODUCTS & SERVICES**

**Norafifah Ahmad & Sudin Haron**

*Islamic banking system was established in Malaysia since 1983. To date, Islamic banking products are available at two full pledged Islamic banks and at all commercial and merchant banks in Malaysia. However, these products are still not fully accepted by customers. At the end of 2000, total deposit at conventional banks was RM381 billion while total deposit in Islamic system was RM31 billion. In the case of loans, RM416 billion was extended by conventional system, and RM21 billion was given by Islamic system. Since corporate customers are the key players in the economy, it is imperative that the reasons for them to choose or not to choose Islamic system be studied. This seminal study explores the perceptions of persons responsible in financial affairs of public listed companies in Malaysia. Among issues covered in this study were usage of conventional and Islamic banking facilities, respondents' understanding of Islamic banking system, and their personal opinion on various aspects of Islamic banking products.*

### **1. Introduction**

Malaysia is one of the Muslim countries that is committed in not only developing Islamic banking system but also a complete Islamic financial system. The Islamic banking system in Malaysia started in 1983 when the first Islamic bank, Bank Islam Malaysia Berhad (BIMB) commenced its operations. It was the objective of the Malaysian government to develop the Islamic banking system parallel to the conventional system. Instead of establishing many new Islamic banks, the government introduced a concept of 'Islamic window' which allows the existing conventional banks to introduce Islamic banking products of customers. The concept of Islamic window started in March 1993 when the Central Bank of Malaysia or Bank Negara Malaysia (BNM) introduced the "Interest-Free Banking Scheme". Twenty-one Islamic financial products were developed to cater for this scheme with only three major banks participated initially. By July of the same year, this scheme was extended to all financial institutions in Malaysia. As at end of 2000, the Islamic banking system was represented by two Islamic banks, 17 domestic commercial banks, five merchant banks and seven discount houses. There are also four foreign-owned banks providing Islamic banking products and services.

The step towards developing a complete Islamic financial system began with the fostering of both Islamic capital market and Islamic money market. The former started when the Malaysian government issued Islamic bonds in 1983. To further enhance the development in the capital market, Islamic private debt securities were introduced. At the end of 2000, a total of RM22,935 private debt securities were issued, out of which RM 6,278 were Islamic bonds (Hassan, 2001). The establishment of BIMB Securities in 1994, as Malaysia's first Islamic stockbroker, was the first step towards promoting Islamic equity market. Apart from providing Islamic broking houses and Islamic managed funds, a separate "Islamic Index" was established. This index comprises 179 permissible stocks on the Kuala Lumpur Stock Exchange (New Horizon, 1996). Muslim investors have been able to invest directly in *halal* (permitted) counters. Conventional securities firms also set up their own Islamic stockbroking windows to advise investors on *halal* stocks. As of July 1996, 364 stocks of the total 633 listed on the Kuala Lumpur Stock Exchange (KLSE) are considered *halal*. On 17 April 1999 KLSE *Sharia* Index was launched to facilitate public investment in instruments in line with the *Sharia* law.

The BNM further boosted the growth of Malaysian Islamic financial system by pioneering an Islamic inter-bank money market in January 1994. This market was the first Islamic money market in the world. In the year 2000, the volume of funds traded in this market was RM301.9 billion (BNM Annual Report, 2000).

Malaysia also plays a major role in developing an international Islamic financial system. The first step taken was realigning Labuan from being an offshore financial center to an international Islamic financial centre. The first international Islamic financial market will be established in Labuan at the end of 2001.

As a result of the financial turmoil in 1997 and liberalization of the world banking system, Malaysia has developed a ten-year plan known as 'Financial Sector Stability'. The aim of this plan is to create a more efficient and competitive, innovative, technology-driven, and strategically more focused financial system. The plan includes Islamic financial system as one of the components that can be further developed to become the key player in Malaysian and international banking sector.

Even with the support of the government in introducing various measures to develop the Islamic financial system, its success is very much influenced by the market players. The market share of Islamic banking assets, deposits and financing reflects public acceptance of this system. For example, the Islamic banking total assets in the banking system was 6.9% in 2000, whilst Islamic banking deposits and financing constituted 7.4% and 5.3% respectively. Malaysia is a country in which Muslims represent half of its population and which is governed by a coalition government led by a Muslim-based party. Total funds deposited in the Islamic system that remain insignificant compared to the total deposits in commercial banks, is an indicator of public unwillingness to use the system.

Haron et al (1994) who pioneered the research on bank patronage in Malaysia find that almost 100 percent of Muslims and 75% non-Muslims were aware of the existence of Islamic banks. Most of them wished to have a relationship with these banks if they had a complete understanding of this system. This study used retail customers as its samples. The findings showed that bankers considered retail customers as less important compared to corporate customers. The latter were considered as the ones who play a crucial role in generating profits to the banks. Therefore, it is impertinent that a study on the perceptions of corporate customers toward Islamic banks is carried out.

This study highlights the perceptions of corporate customers towards Islamic banking system in Malaysia. Aspects studied were the existing usage of Islamic banking facilities, level of understanding of Islamic banking features among corporate financial controllers, their roles in switching and using banking products, and their personal opinions towards Islamic banking products. While the government can use these findings in formulating additional strategies and policies, where appropriate, the Islamic bankers will be able to understand the needs of corporate customers, by providing the necessary services to fulfill these needs.

This paper is divided into five sections. Section two highlights findings of previous research which deal with corporate customers' perceptions on banking products and services, section three discusses the methodology of our research, section four presents the findings, and the concluding remarks and suggestion for future research are provided in section five.

## **2. Literature Review**

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 center".

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 showed that the corporate customers perceived that quality of service was the most important factor in establishing a relationship. 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 behavior 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.

The studies of Erol and El Bdour (1989) and Erol *et al.* (1990) are considered 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.

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. Gerrard and Cunningham's study however did not include any question that could measure the intention of their respondents to patronize Islamic banking.

Metawa and Almoosawi (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 Almoosawi 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).

### **3. Methodology**

The respondents participating in this exploratory study were the persons responsible for the financial affairs of the companies listed in the Kuala Lumpur Stock Exchange. Research assistants made initial telephone calls to selected companies for the purpose of identifying the person in charge of the financial affair of these companies. Once the person was identified, a call was made to explain the intention of this research and the types of assistance required from him/her. A total of 100 respondents were identified and willing to participate in this study. These respondents were financial directors, financial managers, general managers of finance, and accountants.

Out of the 100 questionnaires sent to all agreed participants, 45 were returned. No further attempt was made to increase the samples. The questionnaire contained five sections; the first section was designed to gather information about the respondent's personal background. The profiles of the respondents are shown in Table 1. About 80 per cent of the respondents were non-Muslims. This study therefore reported mostly the opinions of non-Muslims towards Islamic banking. Age wise, about 55 per cent of the respondents were less than 40 years old, with majority of them having professional qualifications such as CPA, CA and ACCA. About 60 per cent of the respondents had been working in the existing companies less than five years ago.

In the second section of the questionnaire, the respondents were asked to indicate the usage of common conventional and Islamic banking facilities and derivatives by their companies. The banking facilities and derivatives included overdraft, term and fixed loans, letters of credit, trusts receipts, bankers acceptances, export credit refinancing facilities, bank guarantees, notes issuance facilities, bonds, current accounts, fixed deposits and other facilities. With regard to Islamic banking, the respondents were asked when their company started using these facilities.

The third section of the questionnaire was designed to measure the overall knowledge of the respondents in Islamic banking system. The questions asked in this section included those that measured the respondents' level of understanding of the concepts and principles of Islamic banking. The questionnaire in the fourth section was designed to determine the role of respondents in the decision-making process of the bank selection. The final section of the questionnaire seek respondent's perceptions on some general matters of which answers could be used by Islamic banking product and service providers in their effort to win these customers.

Since this study is exploratory in nature, no rigorous statistical technique was used in analyzing the data.

## **4. Findings**

### **Usage of Banking Facilities:**

The banking facilities used by respondents are highlighted in the Table 2. All of the respondents used current account for their daily transactions, while 75 per cent had fixed deposit facility in the conventional system. Overdraft, followed by bank guarantee, was the most used facility for financing and trade facilities. Bond and note issuance facilities were unpopular among the respondents.

Based on the findings in Table 2, it seems that Islamic banking products were not popular among Malaysian corporate customers. Only 11 respondents maintained banking relationship under the Islamic banking system. Despite of the Islamic banking having been established in Malaysia more than 15 years ago, most of the respondents started patronizing Islamic banks less than five years ago.

### **Knowledge in Islamic Banking:**

As indicated in Table 3, the respondents indicated that they had knowledge in Islamic banking system. However, more than 65 per cent indicated that their knowledge in this system was limited. Although the majority of the respondents were non-Muslims, they knew that Muslims were not allowed from patronizing conventional banks due to the interest that was prohibited in Islam. This Table also indicated that there was misconception among the respondents about the objective and philosophy of the establishment of

Islamic banks. About 65 per cent of the respondents believed that Islamic banks must adopt profit-maximization principle in order to survive in the competitive business environment. This perception however is contradictory with the objective of Islamic banks, i.e. combination of moral and profit motives. The lack of knowledge among the respondents in Islamic banking system was further confirmed when questions about the principles used in Islamic banking system were posed. While 38.1 per cent of the respondents were unsure of the nature of profit-sharing principle in Islamic banking system, about 50 per cent believed that this principle was the only principle used by Islamic banks in replacement of interest. They were unfamiliar with other principles such as *mudarabah*, *bai-muazzal*, *ijarah*, *istisna*, *bai-salam* and others used in Islamic banking. The general inadequate knowledge among the respondents is to be expected since 80 percent of them were non-Muslims.

### **Roles of Respondents:**

The findings in Table 4 indicate that only one respondent had no authority at all, while 16 per cent had no influential power. The rest of the respondents were those who had either made recommendation with influential power, took part in decision-making process, or were authorized to make decisions. In most cases the respondents were those who had the power to determine relationship with banks.

In the case of applying new financing or additional facilities, and ceasing relationship with the bank, similar results appeared. In both cases about 70 per cent of the respondents had either made recommendation with influential power, taken part in decision making process, or were authorized to make decision

### **Potentiality of Islamic Banking:**

As indicated by Table 5, few respondents believed that religious were the only reason for customers selecting Islamic banks. More than 55 per cent perceived that both religion and economics were the patronage factors in this system. About 50 percent of the respondents believed that Islamic banking products and services had a good potential to be accepted by customers. About 75 per cent of the respondents indicated that Islamic banks in Malaysia however have not done enough marketing in promoting their products and services to corporate customers.

Table 6 shows the factors perceived as important in selection of bank. The most important one was cost and benefit to the company, followed by service delivery (fast and efficient), size and reputation of the bank, convenience (location and ample parking), and friendliness of bank personnel. This finding was inconsistent with previous research whereby size of bank is considered the most important criterion perceived by corporate customers in bank selection.

## **5. Concluding Remarks**

This study though exploratory in nature, provides useful information to both policy makers in the government and also those who manage Islamic banks in Malaysia.

Firstly, it is a great possibility that the dream had come true for the late Tan Sri Jaafar Mohammed, the former Governor of the Central Bank of Malaysia. He wished to see Islamic banking system operated parallel to the conventional system. Almost half of the individuals surveyed who had financial decision-making authority in the Malaysian corporate sectors believed that the Islamic banking system had a good potential as an alternative to the conventional system.

Secondly, this study serves as an indicator showing that providers of Islamic banking products and services have not done enough in educating customers and marketing their products. For example, more than 65 per cent of the respondents indicated that they had limited knowledge in Islamic banking system. Similarly, despite the fact that the Bank Islam Malaysia Bhd had gained footing since 1984 and that the Interest-Free Banking Scheme was launched since 1993, the majority of the respondents started having banking relationship with this system only four years ago. This lack of marketing effort among the providers could be the contributory factor towards the smaller market share of Islamic deposits and loans against total loans and deposits of Malaysian banking system.

Finally, this study also highlights that the most important factor perceived by corporate customers in selecting their banks is the cost of the services and products. This means that Islamic bank products will not be attractive to this market unless and until its costs are lower than those of the products of the conventional banks.

## Notes

\*Professor Sudin Haron is the Dean and Norafifah Ahmad is a senior lecturer of the School of Finance and Banking, Universiti Utara Malaysia. The authors wish to thank Badariah Mohd Zahir and hairul Anuar Adnan for their administrative assistant. The grant from Universiti Utara Malaysia is acknowledged.

## References

- Bank Negara Malaysia (1999), *The Central Bank and the Financial System in Malaysia*, Kuala Lumpur (Malaysia).
- Bank Negara Malaysia, *Monthly Bulletin*, various issues, Kuala Lumpur (Malaysia).
- Gerrard, P., and Cunningham, J.B. (1997), "Islamic banking: a study in Singapore", *International Journal of Bank Marketing*, Vol. 15, NO 6, pp. 204-216.
- Hassan, M. Z. (2001), *Challenges Towards Deepening of the Islamic Bond Market and Islamic Multi-Investment Funds*. A paper presented at Kuala Lumpur International Summit of Islamic Banking & Finance, 19-21 February, Kuala Lumpur.
- Haron, S., Ahmad, N., and Planisek, S. (1994), "Bank patronage factors of Muslim and non-Muslim customers", *International Journal of Bank Marketing*, Vol. 12, No. 1, pp. 32-40.
- Khan, M. Fahim (1983), 'Islamic Banking as Practised Now in the World.' in *Money and Banking in Islam*, Zaiauddin Ahmed et. al (eds), Islamabad (Pakistan), Institute of Policy Studies, pp. 259-276.
- Metawa, S.A., and Almosawi, M. (1998), "Banking behaviour of Islamic bank customers: perspectives and implications", *International Journal of Bank Marketing*, Vol. 16, No. 7, pp. 299-313.
- New Horizon, 1996, "News monitor: Malaysia to establish Islamic Index", *New Horizon* 52, 19.
- Rosenblatt, J., Laroche, M., Hochstein, A., Mctavish, R., and Sheahan, M. (1988), "Commercial banking in Canada: a study of the selection criteria and service expectations of treasury officers", *International Journal of Bank Marketing*, Vol. 6, No. 4, pp. 20-30.

Tyler, K., and Stanley, E. (1999), "UK bank-corporate relationships: large corporates' expectations of service", *International Journal of Bank Marketing*, Vol. 17, No. 4, pp. 158-172.

Turnbull, P.W. (1983), "Corporate attitudes towards bank services", *International Journal of Bank Marketing*, Vol. 1, No. 1, pp. 53-68.

Turnbull, P.W., and Gibbs, M.J. (1989), "The selections of banks and banking services among corporate customers in South Africa," *International Journal of Bank Marketing*, Vol. 7, No. 5, pp. 36-39.

**Table 1**

**Profile of Respondents**

	<b>N</b>	<b>%</b>
<b>1. Religion</b>		
Muslim	9	20.0
Non Muslim	35	77.7
Missing Value	1	2.3
	45	100.0
<b>2. Age</b>		
<30 years	4	8.8
30-39 years	21	46.7
40-49 years	14	31.1
50 and above	5	11.1
Missing Value	1	2.3
	45	100.0
<b>3. Qualifications</b>		
University / College	12	26.7
Professional	20	44.4
Both University / Professional	13	28.9
	45	100.0
<b>4. Years in the present position</b>		
<1 years	7	15.6
1-5 years	14	31.1
6-10 years	11	24.4
more than 10 years	13	28.9
	45	100.0
<b>5. Years with the present organization</b>		
< 1 years	7	15.5
1-5 years	21	46.7
6-10 years	7	15.6
more than 10 years	10	22.2
	45	100.0

**Table 2****Usage of Conventional / Islamic Banking Facilities / Derivatives**

Types of Facilities	Conventional		Islamic	
	<u>N</u>	<u>%</u>	<u>N</u>	<u>%</u>
1. Overdraft	42	93.3	3	6.7
2. Term / Fixed loan	33	73.3	5	11.1
3. Letters of Credit	21	46.7	3	6.7
4. Trusts receipts	15	33.3	2	4.4
5. Bankers acceptance	25	55.6	5	11.1
6. ECR	3	6.7	1	2.2
7. Bank guarantee	38	84.4	3	6.7
8. Note Issuance Facility	5	11.1	1	2.2
9. Bond	8	17.8	1	2.2
10. Current Account	45	100.0	11	24.2
11. Fixed deposit	34	75.6	4	8.9
12. Others	6	13.3	2	4.4

**Table 3****Salient Features of Islamic Banking System**

	<u>N</u>	<u>%</u>
1. Islamic banking system was introduced because Muslims are prohibited from associating themselves with the element of interest practice by conventional banking system.		
Absolutely untrue	2	4.8
Untrue	5	11.9
Not sure	4	9.5
True	-	-
Absolutely true	10	23.8
	21	50.0
2. Both Islamic and conventional banks must adopt profit maximization principle in order to survive in this competitive business environment.		
Absolutely untrue	2	4.7
Untrue	10	23.3
Not sure	3	7.0
True	19	44.2
Absolutely true	9	20.9
	43	100.1
3. The profit-sharing principle is the only principle that can replace the element of interest in the operations of Islamic banking system.		
Absolutely untrue	-	-
Untrue	5	11.9
Not sure	16	38.1
True	15	35.7
Absolutely true	6	14.3
	42	100.0
4. How do you rate your level of overall knowledge in the Islamic banking system?		
Very knowledgeable	-	-
Knowledgeable	4	9.1
Understand partially	11	25.0
Limited knowledge	29	65.9
No knowledge at all	-	-
	44	100.0

**Table 4****Administrative Matters**

	<u>N</u>	<u>%</u>
Under normal circumstances, what is your role in the following?		
1. Opening an account with new bank.		
Recommendation with influential power.	19	42.2
Recommendation with no influential power.	7	15.6
Authorize to make decision.	5	11.1
Take part in decision-making.	13	28.9
No authority at all.	1	2.2
	45	100.0
2. Applying new financing facilities.		
Recommendation with influential power.	14	31.1
Recommendation with no influential power.	11	24.4
Authorize to make decision.	2	4.4
Take part in decision-making.	16	35.6
No authority at all.	2	4.4
	45	99.9
3. Applying additional financing facilities.		
Recommendation with influential power.	14	31.1
Recommendation with no influential power.	13	28.9
Authorize to make decision.	2	4.4
Take part in decision-making.	14	31.1
No authority at all	2	4.4
	45	99.9
4. Terminating a relationship with the existing bank.		
Recommendation with influential power.	17	37.8
Recommendation with no influential power.	10	22.2
Authorize to make decision.	3	6.7
Take part in decision-making.	13	28.9
No authority at all.	2	4.4
	45	100.0

**Table 5****Personal Opinions**

	<u>N</u>	<u>%</u>
1. The main reason why people select Islamic banking products.		
Strictly religion	5	11.1
Economics (profit & cost elements)	8	17.8
Both religion and economics	25	55.6
Other reasons	-	-
No idea.	7	15.6
	45	100.1
2. The potentially of Islamic banking products in the Malaysian corporate sector.		
A very good potential	3	6.8
A good potential	19	43.2
Some potential	5	11.4
No potential	11	25.0
No potential at all	1	2.3
No idea	5	11.4
	44	100.1
3. Is it true the Islamic banking products available in Malaysia are similar to the products of conventional banks except that the banks use different names in highlighting those products?		
Absolutely true	2	4.5
True	12	27.3
Partly true	22	50.0
Untrue	6	13.6
Absolutely untrue	2	4.5
	44	99.9
4. Do you think that Islamic banks have done enough in marketing their products to corporate sector?		
More than enough	-	-
Enough	1	2.3
Just Enough	4	9.3
Not enough	32	74.4
Not enough at all	6	14.0
	43	100.0

**Table 6****Selection Criteria of Banks (%)**

Factors	Very Important	Important	Moderately Important	Of little Important	Least Important	Total
1. Cost / Benefit	73.3	11.1	11.1	-	4.4	100.0
2. Service Delivery	13.6	29.5	31.8	13.6	11.4	100.0
3. Size and Reputation	13.6	52.3	18.2	13.6	2.3	100.0
4. Convenience (location & ample parking)	2.3	9.1	22.7	29.5	36.4	100.0
5. Friendliness of Bank Personnel	2.3	9.1	13.6	36.4	38.6	100.0





\*Professor Sudin Haron is the Dean and Norafifah Ahmad is a senior lecturer of the School of Finance and Banking, Universiti Utara Malaysia. The authors wish to thank Badariah Mohd Zahir and Khairul Anuar Adnan for their administrative assistant. The grant from Universiti Utara Malaysia is acknowledged.