

Islamic Banking: AN Empirical Study of Consumer Preferences in India

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Abstract

Purpose: The Islamic banking system is now present in more than 70 countries of the world. Apart from full-fledged Islamic banks many international conventional banks have started to open Islamic banking windows in their existing branches which operate in accordance with the Sharia'h principles. India is a home to over 200 million Muslim population in the world. It is necessary to understand the consumer's preferences towards the Islamic banking in India. The organizations which are planning to enter Indian Islamic banking market are required to know the preferences and motivations of Indian consumers. Marketers want to know that what is more important for consumers their faith or issues like security, risk minimization, profitability, etc.?

Design/methodology/approach: The objective of the research is to study the preferences and awareness of Indian consumers towards Islamic banking. For this purpose, a representative sample of 756 respondents, across 9 cities in northern India was surveyed with the help of a structured questionnaire developed for this purpose.

Findings: It has been found that in India, which has a minority of Muslims in its population, both Muslims and non-Muslims are not much aware about Islamic banking. Also the two separate groups have different preferences towards Islamic banking. These findings should be considered seriously by the Islamic banks in designing their marketing strategies for the Indian consumers.

Practical implications: This Study can help marketers to categorize the preferences of Indian customers towards Islamic banks. This should also be of some help to the management of commercial banks in devising appropriate marketing strategies.

Research limitations: This work is based on survey work with a structured questionnaire. Cities for data collection are selected on judgmental basis. Inclusion of cities from south, west, east and central parts of India may provide better results.

Key Words: Islamic Banking, Sharia'h, Customer Requirements, Islamic banking in India.

1. Introduction

The Islamic banking system growing worldwide. Currently Islamic banking is present in more than 75 countries worldwide. Globally, Islamic banking assets are said to be growing twice as fast as conventional banking assets and reached \$1.8

trillion (INR 110 trillion) in 2013, maintaining an average annual growth rate of 19% since 2010, and are estimated to grow beyond \$2 trillion by 2014, according to The World Islamic Banking Competitiveness Report 2012-13 by Ernst & Young. Today the spread of the Islamic banking system is not limited to the Islamic countries only. Many secular and non-Islamic countries had either adopted Islamic banking or are in the way to adopt Islamic Banking. Indian policy makers had shown their interest in Islamic banking and finance. India is a home to over 200 million Muslim population in the world and they are demanding for Islamic banking system in India. Many big international Islamic and conventional banks are waiting for government nod to provide Islamic banking services in India. It is necessary to understand the consumer's preferences towards the Islamic banking in India. The organizations which are planning to enter Indian Islamic banking market are required to know the preferences and motivations of Indian consumers. Marketers need to know that what is important for Indian consumers, faith or issues like security, risk minimization, profitability, etc.

Apart from full-fledged Islamic banks many international conventional banks have started to open branches or windows in existing branches which operate in accordance with the Sharia'h principles. For instance, HSBC had stated its Islamic banking services under the brand name HSBC Amanah, Citibank has established branches in countries like Bahrain and Sudan to operate in accordance with Islamic Sharia'h principles. The consequence of this is that Islamic banks are facing strong competition not only from Islamic banks but also from non-Islamic rivals (Naser and Moutinho, 1997). Though the Islamic banking system is different from the conventional banking system, there are some similarities between the two. For instance, an Islamic bank conducts its activities in accordance with the Islamic Sharia'h principles that strictly prohibit any payment or receipt of interest. However, the Islamic bank can also offer products and services which are similar to those offered by a conventional bank. When competition intensifies and when banks start to offer more or less similar products and services, it is the customer's satisfaction that can influence the performance of an Islamic bank and determines its competitiveness and success. Hence it is of paramount importance to assess the customer expectations and preferences from an Islamic banks. There are a range of matters which any local bank will have to consider in deciding whether to start up a local Islamic banking operation. In this context, a number of questions can be raised. For example, in a country like India where the majority of the population are non-Muslims and where conventional banks are operational for years. "what are the main factors that motivate customers to deal with either an Islamic bank; and "what are the factors which help Islamic banks to retain/acquire customers?" In this study, an attempt is made is to assess the degree of Indian consumers awareness and preferences for Islamic Banking. The paper also reports the reasons for banking with the Islamic bank in India. Furthermore, the paper reports on the extent to which consumers in India are aware of the Islamic banks, institutions, products and services.

The remainder of this paper is organised in five sections. Section 2 reviews the literature related to customer satisfaction in general, customer satisfaction and service quality, customer satisfaction and the banking sector. Section 3 describes the methodology adopted for the current study. Findings are reported in section 4 which is followed by a concluding section.

2. Literature Review

A review of the literature established an ideal reference source of materials and research writings concerning Islamic Banking (Ali and Ali, 1994). 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). Despite the prohibition of interest by the world's major religions today's international economic system is based on interest. However efforts are going on to replace the conventional interest-based banking system with the interest free banking and finance. Apart from religious dimension, the case against interest has been examined by many researchers (Faisal *et. al*, 2012). The concept of interest-free financing was practiced by Arabs prior to the advent of Islam, and was later adopted by Muslims as an acceptable form of trade financing. This system has been used on a small scale for centuries, its commercial application began in the 1970s (Naser and Moutinho, 1997).

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).

The core system of the interest-free banking, widely termed as the Islamic Banking System, is developed by economists of the Indian subcontinent but it is a fact that the region especially India has gained nothing from it. In India, Islamic banking is facing hurdles. There are efforts being made to establish a full fledged Islamic bank for the financial inclusion of the second largest population of the country which is reluctant of interest based investments. Islamic financial institutions exist in India, in the form of Non-banking financial institutions and Muslim Funds (Bagsiraj, 2002). 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. 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, Shariah-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. Haron et al. (1994) likewise highlighted the differences in the patronage of Islamic and conventional banks in their study of Muslims and non-Muslims in Malaysia. Two subsequent studies also examined perceptions of Islamic banking in Malaysia – generally viewed as the largest center for Islamic finance outside the Middle East.

Hamid and Azmin (2001) focused on the awareness of Malaysian customers towards Islamic banking within the context of the wider promotion of Islamic education. They found that most Malaysians did not differentiate between Islamic and conventional bank products and services. Subsequently, Zainuddin *et al.* (2004) also surveyed Malaysian bank customers to illustrate the different perceptions of users and non-users of Islamic banking services. 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.

Ahmad and Haron (2002) examined the attitude of the corporate customers towards Islamic banking in Malaysia. They surveyed 100 respondents and found that average 55% of the respondents pointed religion as the premier reason behind selecting of Islamic banking. However, about 75% think that Malaysian government should promote Islamic banking through marketing channels.

The second study of note is the work on customer satisfaction with interest-free banking and bank selection criteria in Turkey by Okumkus (2005). The analysis itself focused on the degree of satisfaction and awareness of customers dealing with Special Finance Houses offering Islamic banking products services. Information on consumers' characteristics and behaviors is very important as one of the strategic efforts to develop Islamic banking. What is a consumer's characteristic and behavior? What factors are motivating this consumer to choose Islamic banking (Khoirunissa, 2003)? The existence of the relationship between economic and

religious preferences proves that, in making decision, consumers wish to attain two satisfaction levels, i.e. satisfaction in the world and in the hereafter (Khoirunissa, 2003). 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, 2007; Wilson, 1995; Ahmad and Haron, 2002; Kuehn and Bley, 2004, Owen and Othman, 2001; Metawa and Almossawi, 1998). 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.

Existing studies have focused on their respective countries or region. As a result, we lack a holistic view in understanding the factors in Indian context. Also there is a lack of study to gauge the prospective customer's attitude towards Islamic banking in India. When one talk about Islamic banking in India, an important question that remains to be answered is what would be the ultimate fate of these banks. Thus, the factors that affect the introduction and operations of Islamic Banking in India need consideration.

3. Methodology

3.1 Research Design

Since consumers are going to use Islamic banking services and invest their money into Islamic banks it. Therefore, an empirical study into consumer's attitude and willingness with respect Islamic banking is a prerequisite for marketing related activities. Consumer's preference towards Islamic Banking was assessed using a questionnaire developed by researcher for the study. For this research the sample was chosen in such a way so that that there would be adequate representation across all types of cities in India. The cities are selected by judgment of researcher on the basis of Muslim population, businesses owned by different communities, institutes of Islamic learning historical and political importance. Villages located near class B and other cities are also covered for the survey. Target population was those who are existing bank customers. Data was collected during the period between January 2013 and July 2013.

Though, all possible efforts were made by the researcher to personally administer the questionnaire on the respondents, due to time constraints on the part of respondents, sometimes the questionnaire was left with the respondents to be collected later. As a rule of thumb, data from at least 300 cases is considered comfortable, 500 is considered as very good and 1000 is considered excellent (Comrey & Lee, 1992 and Tabachnich *et al.*, 2001). Thus, it was decided to target at least 500 respondents. Keeping in mind the nature of the study, a response rate of 40-45% was anticipated and thus, it was decided to administer 1600 questionnaires on the respondents in proportion to their representation in the study. People in rural areas were approached for the purpose of administering questionnaires in their respective villages with reference person, local branches of gramin banks and places at districts headquarters like office of district Magistrate, district court, post office; while people in class A & B cities were contacted in banks, markets, and offices. For contacting people in metros, people were contacted in malls, banks, special events and university. An online version of questionnaire was also used to collect data using google docs. 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 Tabachnick *et al.*, 2001).

3.2 Instrument

The questionnaire had two sections to it. The first section contained a series of statements/questions that were styled on those used Erol & El-Bdour (1989) and Gerrard & Cunningham (1997). There are some differences in Indian scenario to scenario in Jordan and Singapore. As a result of these differences, the statements/questions used by Erol and El-Bdour (1989) and Gerrard & Cunningham (1997) was reviewed. Rephrasing of some of the other questions/statements was needed to make them more appropriate for local people. The second section contained standard demographic questions, such as gender, age and religion.

3.3 The Sample

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 (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. Majority of the respondents are Muslims (64%). 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. For analyzing the data generated through questionnaire survey Man Whitney test is used to analyze the data.

4. Findings

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 response 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.

4.1 On Introduction of Islamic Banking in India

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 shown in table 1.

More than half (54%) of the consumers will go for Islamic bank only when it provides better profit than existing ones. So, for growth and sustainability Islamic

bank need to perform better than conventional ones, failing this they will not get a good no of customers even they may lose some from their existing customers. Less than 3% of consumers had responded that they will continue with their existing banks. So there is a big size of prospective customer base.

Table 1 : Reaction on opening of an Islamic banking branch (Mann-Whitney Test)

If an Islamic Bank opens its branch in India what will be your reaction to it?	Non-Muslim	Muslim	Total	Z-Value	Sig
Open an account immediately with such type of bank	41 (15.24%)	184 (37.78%)	225 (29.76%)	-3.894	0.000
Wait for market response and open an account with such a bank if it is providing more benefits than existing commercial banks	191 (71.00%)	218 (44.76%)	409 (54.10%)		
Will continue banking with the traditional commercial banks	16 (5.95%)	5 (1.03%)	21 (2.78%)		
Can't say	21 (7.81%)	80 (16.43%)	101 (13.36%)		

4.2 Non-distribution of profit by an Islamic bank

Table 2 shows 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.

Table 2: Reaction in case of non-distribution of profit (Mann-Whitney Test)

In case an Islamic bank announced that it had no profit to distribute on investment and savings deposits for any one year and if you were a depositor with this bank, would you:	Non-Muslims	Muslims	Total	Z-Value	Sig
Keep the deposit at the same or a different Islamic bank, because placing the deposit with a non-Islamic bank contravenes Islamic principles	0 (0%)	160 (32.85%)	160 (21.16%)	-3.056	0.000
Withdraw all deposits at once and switch them to one or more banks which guarantee a return	54 (20.07%)	37 (7.6%)	91 (12.03%)		
Remain a depositor at the Islamic bank because it could distribute high profits in subsequent years	81 (30.11%)	112 (23%)	193 (25.52%)		
Consult relatives and colleagues and then decide what to do	109 (40.52%)	51 (10.47%)	160 (21.16%)		
Can't Say	25 (9.29%)	127 (26.08%)	152 (20.11%)		

About 46% of the total respondents will remain depositors in Islamic bank even in case of zero profit because of different reasons. It shows that expectations from Islamic banks are very high even customers are ready to give some leverage to Islamic banks to survive in the financial market.

4.3 Main Reasons for Motivation to deposit in an Islamic Bank

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.

Table 3: Main Reasons for Motivation to deposit in an Islamic Bank (Mann-Whitney Test)

The reasons which motivate people to deposit their money in Islamic bank are	Non-Muslim	Muslim	Total	Z-Value	Sig
Religious reason solely	33 (12.27%)	81 (16.63%)	114 (15.08%)	-10.101	0.000
Profitability reason solely	124 (46.10%)	10 (2.05%)	134 (17.72%)		
Religious and profitability reasons combined	111 (41.26%)	297 (60.99%)	408 (52.97%)		
Can't say	1 0.37%	99 (20.33%)	100 (13.23)		

4.4 Investments of savings

Only 64.47% Muslim respondents were actually invest whereas 85.13% respondents were invest their savings. This shows that Muslims investment investments less as compared to their non-Muslim counterparts. This may be because of their religious believes.

Table 4: Investment of Savings

Do you invest?	Non-Muslim	%	Muslim	%	Total	%
Yes	229	85.13	314	64.47	543	71.82
No	40	14.87	173	35.53	213	28.18

4.5 Sharia Compliance Investment

Table 8 show that 70% Muslim respondents will care that there investment is sharia compliant or not. This may be because of reason that some people does not know that investment can sharia compliant.

Table 5: Sharia compliance of Investments

Do you care that your investment is Halal (Sharia compliant) or not?	Non-Muslim	%	Muslim	%	Total	%
Yes	0	0.00	341	70.02	341	45.11
No	269	100	146	29.98	415	54.89

4.6 Awareness about sharia compliant investment options in India

Table 4.87 shows that only about 30% respondents are about the sharia compliant investment options in India. Surprisingly 21.56% non-Muslim respondents are aware of sharia compliant invest opportunities.

Table 6 : Awareness about sharia compliant investment options in India

Are you aware of some firms providing Halal investment opportunities in India?	Non-Muslim	%	Muslim	%	Total	%
Yes	58	21.56	166	34.09	224	29.63
No	211	78.44	321	65.91	532	70.37

4.7 Awareness about Sharia Index in India

As of now only sharia compliant financial service available in India is the sharia index of Bombay Stock Exchange. Table 10 shows that 21% respondents are aware of this Indian Sharia index. Interestingly non-Muslim respondents are more aware than Muslim respondents.

Table 7 : Awareness about Sharia Index in India

Are you aware of Sharia index in India?	Non-Muslim	%	Muslim	%	Total	%
Yes	81	30.11	78	16.02	159	21.03
No	188	69.89	409	83.98	597	78.97

4.8 Referring Islamic Banking to a Friend

Many people had said that they will consult their friends when they are choosing a bank or other financial matters. To check this when it is asked that would they recommend Islamic banking to a friend more than half (55%) responded that they will recommend while percentage in case of Muslims is greater than that of non-Muslims.

Table 8 : Referring Islamic Banking to a Friend

Would you suggest your friends to switch over to Islamic banks from the conventional banking?	Non-Muslim	%	Muslim	%	Total	%
Yes	114	42.38	306	62.83	420	55.56
No	155	57.62	181	37.17	336	44.44

5. Conclusions and Implications

The results indicate a very interesting outlook on attitude Indian consumers towards Islamic banking. First discuss their Investment pattern only two out of every five respondents are presently investing. Interestingly 60% of non-investors are ready to invest if they found a Halal or Sharia compliant option. About the awareness and scope of Islamic banking in India, awareness about the existing Sharia certified product is very low but inclination towards Sharia compliant options is very high. Majority of respondents said that they will transfer their accounts if an Islamic bank opens its branch in India. Significant difference is found on responses of Muslims and non-Muslims about the investment in a purely Halal or Sharia compliant options. Opinion differs significantly for awareness about the Islamic finance, future of Islamic finance in India and acceptance of Islamic banking with religion.

As observed in the study, some of the companies had tried to understand and fulfil the requirements of the Shariah compliant financial products, but awareness about the products is not low or maybe they are not living up to the expectations of the Indian Muslims. This study is an attempt to understand the need and attitude of Indian Muslims towards Sharia certified financial products and available options to cater to their needs. On further exploration, this has been found that most of the respondents agreed that the products of their choice are not available in the existing retail options. Alternatively, they have to go for available substitutes.

It is important to understand the context of the findings, where even though this study specifically looks at Muslims, there is an element of ethnicity and ethics is involved. India is a combination of race and religion where values are more important and above all. Islamic finance is all basically ethics guided by the Sharia laws so there is a great chance of Acceptance of Islamic finance in India as a whole.

If Indian organizations can build on their experience and reputation in the financial world, and can provide Islamic banking services in India, they can aim to gain a growing customer base of the Muslim population, especially those who abstain from interest based transactions of the traditional commercial banks. Furthermore, awareness about the Islamic banking is found to be very low. Therefore, not only the banks but other people involved in promoting the cause of Interest free banking have to work in the direction of increasing awareness about Islamic banking through appropriate communication channels.

Similarities in the findings of this study with the studies conducted at Singapore and United Kingdom imply that the model adopted for introduction of Islamic banking in these countries may be adopted in India. Like Opening of special Islamic banking windows in existing commercial banks by accommodating some minor regulatory changes.

The findings of the present study are in line with previous studies by Omer (1992) and Gerrard and Cunningham (1997) but deviate from the findings of Erol and El-Bdour (1989) and Bley and Kuehn (2004). This is may be because Erol and El-Bdour (1989) and Bley and Kuehn (2004) conducted their studies in Islamic nations Jordan and Qatar with a Muslims majority whereas Omer (1992) and Gerrard and Cunningham (1997) conducted their study in United Kingdom and Singapore where Muslims are in minority. Thus, in Indian context the model of Islamic banking adopted in U.K., Singapore and other non-Islamic countries are more suitable.

6. Limitations

The sample population of this study has been drawn from North India, which represents a different culture and high concentration of middle class. The findings of this study therefore need to be generalized with care. While it could be of use for understanding possible future trends in customer preferences in other areas, it would be necessary carry out local studies using the model presented in this study for taking into account the cultural and demographic differences.

This study also treats Indian Muslims as part of a single cultural entity. While this could be so at the macro level of retailing, cultural differences among the Indian Muslims could become an important variable at the micro level. More researches would be needed for generalizing the findings of the study at the micro level.

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