

## Awareness Level of Islamic Banking in Pakistan's Two Largest Cities

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### Abstract

*Islamic Banking in Pakistan has been growing steadily for the past ten years. Its market share in the overall banking industry has increased from 1 percent in the year 2001 to more than 7 percent by January 2011. What needs to be assessed is the level of awareness of Islamic Banking amongst customers in Pakistan's largest and second largest city, Karachi and Lahore. Their pattern of switching from conventional banking towards Islamic Banking has been studied. This study would try to present the findings of the research carried out mainly with the people who are currently banking with either Islamic or Conventional Banks and their awareness level regarding Islamic Banking. In this research, researchers have tried to highlight variables specific to the Islamic Banking industry and its impact on customers. Dependent variables may range from switching from other Islamic Banks, Customer Satisfaction and Recommendation by other customers. Researchers have selected a sample size of 150 banking customer (both male and female) and have used descriptive and correlation analysis to establish trends between awareness level and the growth of Islamic Banking in Pakistan. Researchers believe that this study would aim to measure the overall awareness level as well as the avenues through which this awareness is generated.*

**Keywords:** Banking, Islamic Banking, Karachi, Lahore

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## Introduction

With the comparison of conventional banking system, Islamic Banking is relatively a very new concept, but it has shown a spectacular growth in the past few years. Not only in the Islamic countries the Islamic banking has been recognized by the western countries as well, and it is giving very tough competition to the conventional banking system. The awareness of Islamic banking has been the key for its growth, but still many people around the world has questioned about the products of Islamic banking and compared it to the conventional banking system.

Through this study our main objective was to find out the level of awareness of Islamic Banking and try to find out the biggest factor that influenced people to switch from a conventional bank to Islamic Bank.

The limitation of this study is that, it was conducted with the Islamic Banking customers that have switched from a conventional banking to an Islamic banking or operates accounts in both conventional banking and Islamic banking simultaneously. So the awareness level of the entire population cannot be judged appropriately through our study, but it could be helpful as a reference for further studies done in future, and caution may be exercised in projecting these findings for any other studies.

## Significance

As indicated in the research interest factor comes out to be the main reason for the customers to switch to Islamic banking. However, the growth of Islamic banking has not created a balanced awareness level among the masses.

Further, Islamic banks needs to focus on the service quality which can boost the growth of the Islamic banking sector as a whole as Riba might not sustain in the long run as a single largest factor for growth. Also, Islamic banks need to focus on other factors as well to boost the awareness level at large.

## Research Methodology

Researchers have focused on both quantitative and qualitative research. For this, questionnaire was used with a sample size of around 150 (Males and Females). We made efforts to interview all the respondents in detail with regards to the outcome of the study.

## Hypothesis

- Awareness about Islamic Banking over the past 10 years has increased by 25% amongst the masses across Pakistan.

- Quality of service of Islamic Banks is better than conventional banks
- Riba or Interest factor is the main reason to switch towards Islamic Banking

### **Variables**

#### *Independent Variables*

- Riba or Interest
- Quality of Service
- Awareness

#### *Dependant Variables*

- Switching to Islamic or Conventional Bank
- Customer Satisfaction
- Recommendation to other customers

### **Literature Review (Service Quality & Customer Satisfaction)**

Islamic banks operating in Islamic countries are faced with strong competition not only from Islamic banks but also from non-Islamic rivals (Naser & 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 Shariah principles that strictly prohibit Riba in any forms. However, the Islamic bank can also offer products and services which are similar to those offered by a conventional bank. Hence it is of paramount importance to assess the degree of customer satisfaction towards Islamic banks operating in Islamic countries

In today's world, banking being the major stake bearer of service industry is getting an increased focus on research in customer satisfaction areas (Holliday 1996). Word of mouth works well with customers having favorable experiences and thus run through as a barometer of customer satisfaction (Richens 1983). Customer attitude towards Long-term strategy buy more and, if satisfied, may generate positive word-of-mouth promotion for the company. Additionally, long-term customers also take less of the company's time and are less sensitive to price changes (Reichheld 1996).

In contemporary marketing thought customer satisfaction has been a critical concept (Richens 1983). It is generally argued that if customers are satisfied with a particular product or service offering after its use, then they are likely to engage in a repeat purchase and try line

extensions as for the service industry it can be termed as the relationship building concept (East 1997).

Service quality is not a complete indicator of customer satisfaction but to somewhat a relative of the term (Yavas, Bigin, Shenwell 1997). Quality of service depends heavily on the quality of the personnel dealing with the customers. This is well documented in a study by (Leeds 1992) who documented that customers who switched banks because of poor service are considered to be approximately gauge at 40 percent (Leeds 1992). Two of the researchers (Levesque & McDougall 1996) investigated the determinants of the service quality on customer satisfaction in financial institutions being a major influencer. They found out that a substantial impact of service problems on customer satisfaction and their willingness to switch therefore it was suggested that service quality was rightly termed as an essential determinant of customer satisfaction (Levesque & McDougall 1996). Customer satisfaction often depends on the quality of product or service offering. In the context of services, some describe customer satisfaction as an antecedent of service quality (Al-Hawari & Ward 2006). Al-Hawari and Ward also came to the same notion that relationship between service quality and financial performance of the banks are directly related to the customer satisfaction. Financial performance of the banks plays inter-mediator role in the relationship between service qualities (Al-Hawari & Ward 2006). Further they also elaborated that organizations need to know how to keep good relationship standards with their customers, even if they appear to be fully satisfied (Al-Hawari & Ward 2006). In a consumer behavior research it was documented that a maximum points and a good relationship in the service industry will gauge from the quality of service received by the customer. This can also result in reduced customer erosion (Leeds 1992). It was reported that banking and financial services are the integral part of services industry and its contribution In the overall pie of the service industry is increasing with the passage of time (Mishkin; 2001).

Curry & Penman (2004) reported that differentiation that comes with service quality is inevitable for differentiation to compete in the banking sector. They suggested that customer retention through right kind of service can reap long-term benefits for the organization. So, Banks should maintain strict compliance checks on the level of services by proper allocation of resources to meet customer requirements.

Ioanna (2002) further proposed that product differentiation factor doesn't apply in a competitive environment like the banking industry. Banks globally are offering more or less the same products and the product suite. Thus, bank management tends to differentiate their firm

from competitors through improved standards of service quality. It is said that products derived out of the service industry have some unique characteristics that differentiates them from physical products (Zeithaml & Bitner1996). Services are often characterized by their impalpability, inseparability and non uniformity (Zeithaml & Bitner1996).

### **Literature Review (Islamic Banking Evolution)**

Pakistan was created on the basis of Islam as its religion. Since its creation, the people of Pakistan have held the demand for elimination of Riba (Usmani 2005) from the financial system of Pakistan. Quaid-e-Azam (Akhtar 2007), the father of the nation, in his speech at the occasion of the inauguration of State Bank of Pakistan, had expressed the desire for evolving an Islamic system of banking. Quaid-e-Azam said,

*'I shall watch with keenness the work of your Organization in evolving banking practices compatible with Islamic ideas of social and economic life. We must work our destiny in our own way and present to the world an economic system based on true Islamic concept of equality of manhood and social justice.'* (Akhtar 2007)

In an international conference of the world Muslim congress, Justice Mufti Taqi Usmani states that

*'the world is badly in need of third Economic system, the Muslim ummah can work on it. Economic system given by Quran and Sunnah is quite capable of solving the problem faced these days by this world. The basic problem in capitalism is the absence of the criteria for the difference between just and unjust earning. This creates a great distance between poor and rich, the gap is continuously increasing as the profit earns by the rich is not being shared with the poor.'* (Mufti Taqi Usmani)

Modern Islamic Banking pioneered by the thoughts presented by Muhammad Baqir Al Sadr(T.M Aziz ; Rashid, Hassan & Ahmad 2008) in early 1960's, in which he tries to revive the Islamic Economic system in place of Capitalistic and Socialistic economic system. This thought was taken forward and the Islamic Banking takes its origin in 1963 (T.M Aziz ; Rashid, Hassan & Ahmad 2008) when an Egyptian Mr Ahmad Elnaggar started a saving bank based on Islamic Shariah's rules of Profit and Loss sharing, whereas, the first commercial Islamic Bank was

established in the form of Dubai Islamic Bank in 1975 (Wikipedia, May 2009)

In Pakistan, Islamic Banking emerges in the regime of President Zia-ul-Haq in 1980's. Under the Zia's Islamization process, the first step taken was to convert the financial and economic sector under the laws on the basis of Islamic laws and principles (Sheikh 2007).

Banks were set to start its operations, but the Ulemas at that time had some reservation over the principles on which those banks were transformed. The biggest breakthrough in the Islamic banking Industry was by the historical judgment of Supreme Court of Pakistan on Riba on November 14, 1991 Zaidi (2003). Under this Verdict, the government was asked to implement an interest free system by June 30, 2001. (Usmani 2005) But in year 1999, the government has filed a petition for reconsideration of the decision, which is still pending in Supreme Court (Usmani 2005).

The biggest milestone in the Islamic banking Industry of Pakistan was the introduction of Islamic Banking Policy in December 2001(Akhtar 2007). Under this policy, Islamic banking is being promoted in parallel to the development of conventional finance industry in an integrated, gradual and steady manner (Akhtar 2007). In addition, SBP allows conventional banks to set up Islamic banking subsidiaries or dedicated Islamic banking branches to offer range of financial services (Akhtar 2007).

In 2003, Meezan bank emerged as a first fully fledged Islamic commercial bank in Pakistan, and this started a new era of Islamic banking in Pakistan. Today 6 fully fledged Islamic banks (IBs) and 13 conventional banks are operating in Pakistan (World Database 2010). This has created a lot of awareness in the people of Pakistan, and the Islamic Banking industry started to grow at a very fast rate. State bank of Pakistan has also fully supported the spread of Islamic Banking Industry in Pakistan.

SBP is looking forward for a strategic plan for Islamic Banks so that by the end of 2012, Islamic banks would have a total share of 12% of the total banking Industry. (Hassan 2006). For this Islamic Banks have to do a massive expansion policy and have to achieve a 40-50% of annual growth rate (Akhtar 2007).

Worldwide Islamic Banking is growing at a rate of 10-15% per year and with signs of consistent future growth (Cihak & Hesse 2008) Islamic banks have more than 300 institutions spread over 51 countries (Economist 2009)

In his Book, Introduction to Islamic Finance (Usmani 2005) said:

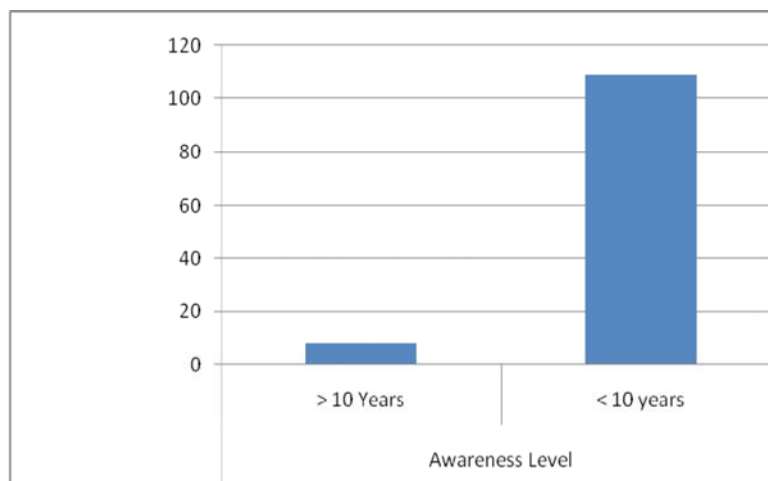
*'They have contributed a lot in a sense that Islamic banks have made a break-through in the banking system, it was once just a theory but now with a great supervision of Shariah boards it gave satisfactory solutions to the problem emerging. They have now asserted themselves in the international market and have distinguished themselves from conventional banking.'*

In a seminar Director Islamic Banking State Bank of Pakistan; Mr. Saleemullah (2010) said that "The biggest challenge to promote Islamic Banking in the country is the lack of awareness about Islamic Banking concepts among general public. He further stated that the stakeholders including bankers and practitioners must play their due role in promotion of Islamic Banking products. We need to remove confusion about some concepts of Islamic banking among masses for which awareness needs to be promoted.

### Hypothesis Testing

Ho: Awareness About Islamic Banking has increased significantly over the past 10 years  
 H1: Awareness about Islamic Banking has not increased significantly over the past 10 years  
 Level of Significance: 95%  
 Confidence Interval

Awareness Level	
> 10 Years	< 10 years
8	109



Null hypothesis  $p = 93\%$   
 Alternate Hypothesis  $p_0 = 90\%$   
 $n = 117$

Level of Significance  $0.05$   
 Tail  $= 2$

Test Statistics  $z = \frac{\hat{p} - p_0}{\sqrt{\frac{p_0(1-p_0)}{n}}}$

Calculated Value  $= 1.082$

Tabulated Value  $= -1.96$

Decision **Accept**

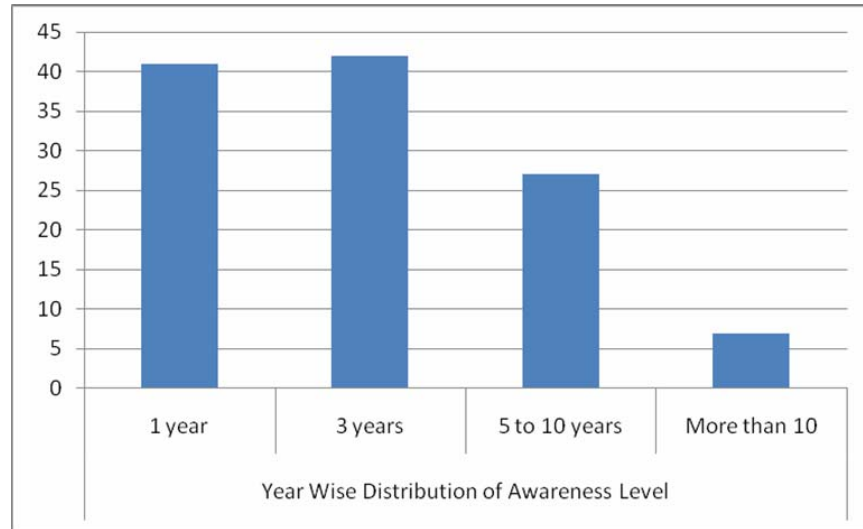
For our calculation we have assumed that atleast 90% of our sample should be aware of the Islamic Banking product for the past 10 years , Otherwise it would be assumed that the people living in Pakistan were aware of Islamic Banking for more than 10 years.

Since the Calculated Value falls in the acceptance region, therefore at the 5% significance level we don't have enough data to conclude that, the awareness of Islamic Banking has significantly increased over the past 10 years. Therefore we will accept the Hypothesis.

From the result we can conclude that awareness level among masses was bare minimum or none 10 years ago.

Year Wise Distribution of Awareness Level			
1 year	3 years	5 to 10 years	More than 10
41	42	27	7





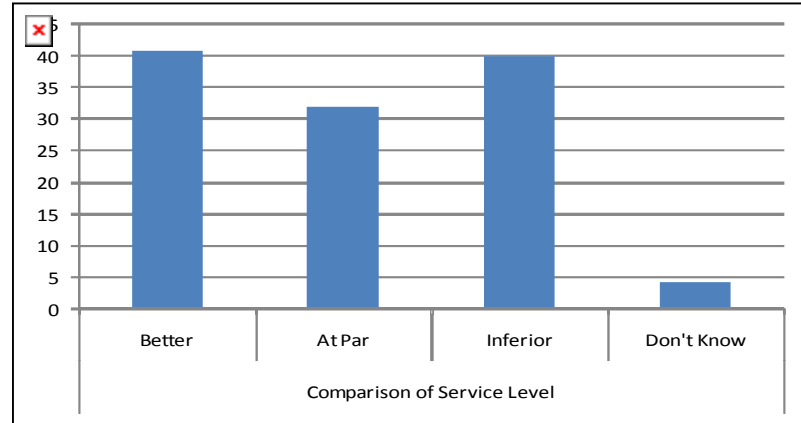
From the above year wise distribution it is evident that majority among the sample size falls within the last three years with sporadic instances in the five or more years column. We can also say that Islamic Banks need to expand more and certainly need to market themselves to the indifferent customers who will certainly opt out for Islamic Banks if offered.

Ho: The Services of Islamic Banking is better than the Conventional Banking

H1: The Services of Islamic Banking is not better than the Conventional Banking

Level of Significance: 95% Confidence Interval

Comparison of Service Level			
Better	At Par	Inferior	Don't Know
41	32	40	4



Null hypothesis is  $p = 35\%$   
 Alternate Hypothesis is  $p_0 = 67\%$   
 $n = 117$

Level of Significance  $0.05$   
 Tail  $= 2$

Test Statistics 
$$z = \frac{\hat{p} - p_0}{\sqrt{\frac{p_0(1-p_0)}{n}}}$$

Calculated Value  $= -7.361$

Tabulated Value  $= -1.96$

Decision **Reject**

For our calculation we have assumed that 2/3<sup>rd</sup> of our sample should believe that the quality of services of Islamic Banking is better than the services of the Conventional Banking, Otherwise it would be assumed that the Quality of Services of Conventional Banking is at par or Better than the Islamic Banking.

Since the Calculated Value falls in the rejection area, so we can say that the test results are statistically significant at the 5% level; i.e. at

the 5% significance level we have enough data to conclude that, the services of Islamic Banking are not better as compared to the Services of the Conventional Banking; therefore we will reject the hypothesis.

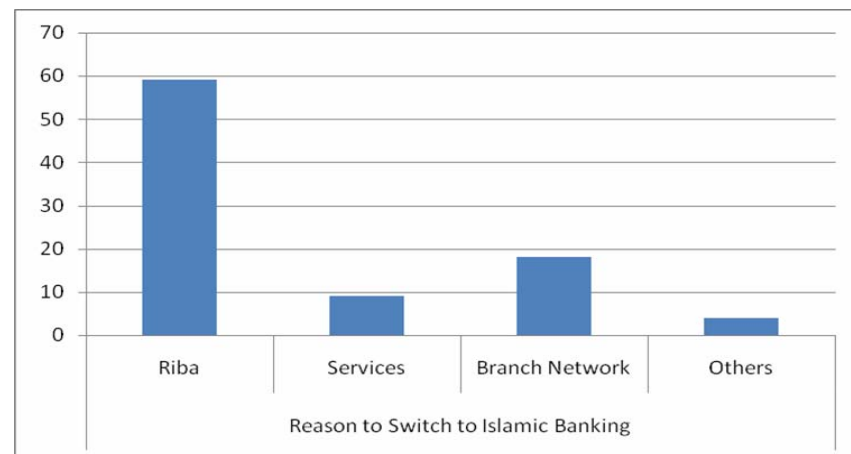
From the result it is concluded that Islamic Banks need to drastically revamp their service quality level to meet the minimum criteria of customer satisfaction.

Ho: Riba is the significant reason for a person to switch to an Islamic Bank

H1: Riba is not the significant reason for a person to switch to an Islamic

Bank Level of Significance: 95% Confidence Interval

Reason to Switch to Islamic Banking			
Riba	Services	Branch Network	Others
59	9	18	4



Null hypothesis  $p = 65\%$   
 Alternate Hypothesis  $p_0 = 67\%$   
 $n = 89$

Level of Significance  $0.05$   
 Tail  $= 2$

Test Statistics  $z = \frac{\hat{p} - p_0}{\sqrt{\frac{p_0(1-p_0)}{n}}}$

Calculated Value  $= -0.401$

Tabulated Value  $= -1.96$

Decision **Accept**

For our calculation we have assumed that 2/3<sup>rd</sup> of our sample should believe that they have switched from conventional Banking to Islamic Banking due to Riba factor, Otherwise it would be assumed that the Riba is not the primary reason for a person to switch from conventional Banking to Islamic Banking

Since the Calculated Value falls in the acceptance region, therefore at the 5% significance level we don't have enough data to conclude that Riba is the significant reason for a person to switch to an Islamic Bank. Therefore we will accept the Hypothesis.

From the above graphical presentation it can be concluded that more than 67% of the sample size have switched from conventional banking to Islamic banking due to the Riba/ Interest factor.

#### Product Differentiation of Islamic Banking with Conventional Banking

Similar to Conventional	Different from Conventional	Don't Know
3	7	6

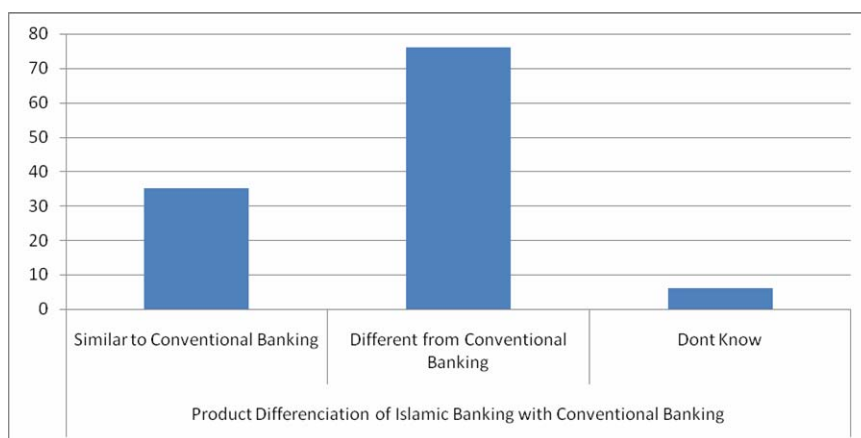
#### Description

Product Differentiation is not a significant factor when we are analyzing a product in a Service Industry and especially in a Banking Industry. But when we are comparing Islamic Banking Products with the Conventional

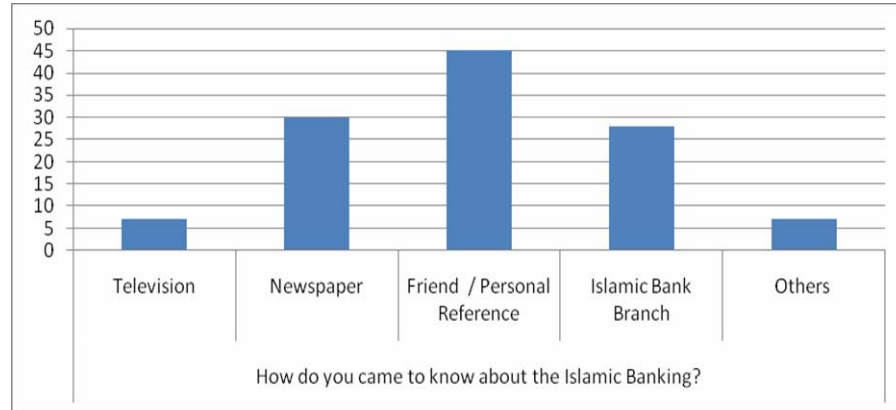
Banking Products, the consumers perception changes entirely. The customer always assumes that there must be a product differentiation when we are comparing Islamic Banking products with the Conventional Banking Products. But in reality the only thing that differentiates Islamic Banking from the Conventional Banking is 'RIBA' whereas all the basic products of Islamic and Conventional Banking are similar to each other.

If we analyze from our survey we can see that it is quite evident that a major lot of people perceive that the products offered by the Islamic Banks are different from the Conventional Banking, whereas only a small number of people agree that the products of both are similar to each other.

One of the reasons why the growth of the Islamic Banking has become stagnant is because they have failed to realize the general public that the products offering by Islamic Banking cannot be different from Conventional Banking in practical, the only factor that differentiate them is the Raba factor. Once the general consumers have learnt this thing they can have more trust and faith in the Islamic Banking systems and practices.

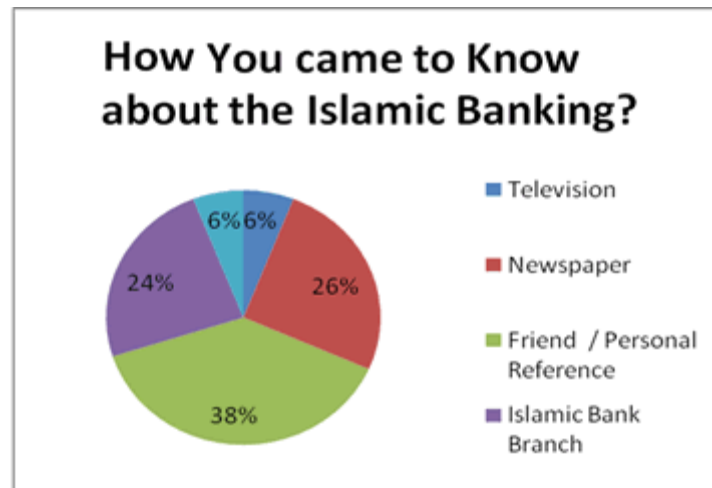


How do you come to know about the Islamic Banking?				
Television	Newspaper	Friend / Personal Reference	Islamic Bank Branch	Others
7	3	4	2	



### Description

In a service Industry 'Words of Mouth' and personal references considered to be an important growth factor. Even in a Banking Industry, Personal References and Branch Availability is an important factor for the growth and Stability of that bank, that's why branch location is considered to be one of the most important factors in banking industry.



If we analyze the results of our Survey, it is quite evident that most of the people got to know about the Islamic Banking through their Friends / Personal Reference or through the branch i.e. opened in their area. Around 38% of the people surveyed came to know about Islamic Banking through their friend or Personal Reference, whereas 24% of the

people surveyed got to know about Islamic Banking through the Branches opened in their Areas.

Another important aspect for the promotion of Islamic Banking came out through our survey was the Print Media especially the Newspaper. As 26% of people claimed that they came to know about Islamic Banking through either Newspaper Advertisements or the articles published in them. So it is suggested that Islamic Banks should continue their promotions through their Newspaper Advertisements, and from time to time it is advised to have their promotions through Television and other sources of Communication.

### **Conclusion**

From the result of our findings it follows that till the next decade Islamic banks will not be able to overshadow the conventional banking system. We can expect Islamic banks to stand at 20% of market share by 2020, and if it continues to grow with the same pace it would give tough time to conventional banks.

People are more satisfied by the methodology, performance and services/products offered by the conventional banks. On the other hand they are not fully aware about the products of the Islamic banks and they are still skeptical about their being fully Shariah compliant.

Many of the conventional banks customers are maintaining second account in Islamic banks as they are inspired by the product of the Islamic banks, still they are not fully aware that how these products are working.

We have seen from that the above discussion that Islamic banking is not a negligible or merely temporary phenomenon. Islamic banks are here to stay and there are signs that they will continue to grow and expand. Even if one does not subscribe to the Islamic injunction against the institution of interest, one may find in Islamic banking some innovative ideas which could add more variety to the existing financial network.

### **Recommendations**

In the light of the afore mentioned; following recommendations may be offered:

- Findings of the report may not be considered in isolation; Due consideration may be given to other avenues for increase in the awareness level; especially through Masajid. Other steps in this regard should be initiated at the industry level
- To remain competitive, service level needs to be improved to supersede the conventional banking standards.

- Product offerings should also be targeted towards the indifferent customers who if offered; would certainly come towards Islamic Banking and would in turn increase the market share of the Islamic Banking industry as a whole.



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**Appendix:**

## Survey Questionnaire

Dear Respondent

We are conducting a survey pertaining to Service Quality and Islamic Banking among male and female customers. In this regard you are requested to kindly spare some moments of your precious time and enlighten us with your views through the following questions:

Q1)	Were you aware about Islamic Banking 10 Years back?		
a) Yes	b) No		
Q2)	Since how long do you have known about Islamic banking in Pakistan?		
a) 1 Years	b) 3 Year s to 4 Years	c) 5 Years to 10 Years	d) More than 10 Years
Q3)	What is you perception about the awareness of Islamic banking industry during the last 10Years?		
a) Has Increased	b) Remained the same	c) Has Decreased	
Q4)	How do youometo know about thIslamic Banking?		
a) Television	b) Newspape r	c) Friend / Personal Referenced)	d) Islamic Bank Branch
e) Masjid	f) Internet	h) Others	
Q5)	How do you compare the services of Islamic Banks with the Conventional Banks?		
a) Better Standards	b) Similar to Conventional Banks	c) Inferior Standards	d) Dont Know
Q6)	How do you perceive Islamic Banking products are at par with the Conventional Banking Products?		
a) Similar to Conventional Banking	b) Different from Conventional Banking	c) Dont Know	
Q7)	Are you Satisfied with the service standards of Islamic Banks as compared to Conventional Banks?		
a) Yes	b) No		
Q8)	What do you think that should be improved in Islamic Banking?		
a) Trained Staff	b) Branch Housekeeping	c) Service Standards	d) IT Infrastructure
e) Product Portfolio	f) Other (Please Specify):		
Q9)	Have you switched to an Islamic Bank from a Conventional Bank?		
a) Yes	b) No		
If Yes:	What was the main reason to switch?		
a) Riba or Interest Factor	b) Quality of Services	c) Convenience w.r.t Branch Availability	
d) Other (Please Specify)			
Q10)	Would you recommend anyone to switch to Islamic Bank?		
a) Yes	b) No		
Other Information:			
Name:			
Age:			