



***CUSTOMER AWARENESS AND FACTORS INFLUENCING ISLAMIC
BANKING ADOPTION IN BINTULU, MALAYSIA***

MALISAH LATIP

GSM 2015 10



**CUSTOMER AWARENESS AND FACTORS INFLUENCING ISLAMIC
BANKING ADOPTION IN BINTULU, MALAYSIA**

MALISAH LATIP

**Thesis Submitted to Graduate School of Management, Universiti Putra Malaysia,
in Fulfilment of the Requirements for the Degree of Master of Science**

April 2015

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DEDICATION

This thesis is dedicated in loving memory of

my late grandfather

Hamid Bin Aba

for living by example to teach me the valuable lessons of life

and to my late aunt

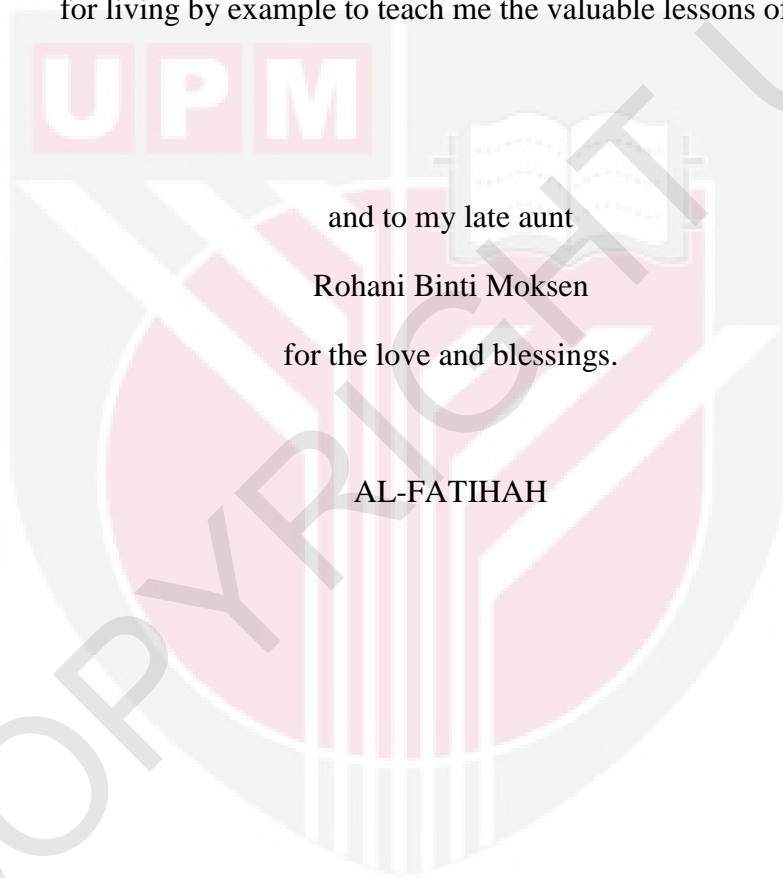
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for the love and blessings.

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Abstract of thesis presented to the Senate of Graduate School of Management in fulfilment of the requirements for the degree of Master of Science

CUSTOMER AWARENESS AND FACTORS INFLUENCING ISLAMIC BANKING ADOPTION IN BINTULU, MALAYSIA

By

**Malisah Latip
April 2015**

Chair : Mohamed Hisham Dato' Hj Yahya, PhD
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The emergence of Islamic banking system in the contemporary banking industry has made a huge impact on the financial industry across the world. Despite the enthusiasm to promote Islamic banking systems internationally, Malaysia has yet to achieve satisfactory level of awareness and adoption of Islamic banking from its national perspective. This research attempts 1) to examine the awareness of Islamic banking and 2) to identify the influential factors that are associated with Islamic banking adoption among the Muslims and non-Muslims population in Sarawak, Malaysia by extending the renowned framework of Diffusion of Innovation (DOI) theory with the “adoption of Islamic banking” being the dependent variable, this study comprises of seven independent variables. There are four attributes of innovation, namely; 1) relative advantage, 2) compatibility, 3) observability and 4) complexity and three additional variables, namely 5) perceived risk, 6) perceived trust and 7) customer innovativeness. The simple random sampling method is used whereby a questionnaire is administered to 436 respondents from Bintulu, Sarawak. The findings of descriptive analysis show that,

the awareness of Islamic banking products and services are relatively low among the respondents, regardless of their religious backgrounds. Initially, exploratory factor analysis has generated six factor solutions. By the filtration of the logistic regression equation, three factors, namely; 1) compatibility, 2) relative advantage and observability and 3) complexity are proven to have significant influence on customers' adoption of Islamic banking products and services in Bintulu. Thus, the study recommends that the banking industry gives serious attention on these attributes of innovation to increase the adoption level among customers. Banks need to enhance accessibility, profitability and service quality factors which are critical success factors that affect an organization's competitiveness. In addition, banks need to reduce the complexity of transactional procedure in order to raise the acceptance of Islamic products among the public and increase its usage.

Abstrak tesis yang dikemukakan kepada Senat Universiti Putra Malaysia sebagai memenuhi keperluan untuk ijazah Master Sains

**KESEDARAN PELANGGAN DAN FAKTOR MEMPENGARUHI
PENGUNAAN PERBANKAN ISLAM DI BINTULU, MALAYSIA**

Oleh

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Kemunculan sistem perbankan Islam yang dipraktikkan ke dalam industri perbankan moden telah mencipta fenomena di seluruh dunia. Walaupun agresif mempromosikan sistem perbankan Islam di peringkat antarabangsa, Malaysia masih belum mencapai tahap kesedaran dan penggunaan produk perbankan Islam yang memuaskan dari perspektif tempatan. Berhubung dengan perkara tersebut, kajian ini cuba untuk 1) menilai tahap kesedaran pelanggan dan seterusnya 2) mengenalpasti faktor utama yang mempengaruhi penggunaan produk perbankan Islam dalam kalangan populasi Islam dan bukan Islam di Bintulu, Sarawak, dengan menjadikan teori Difusi Inovasi sebagai model rangka kajian. Pembolehubah bersandar untuk kajian ini ialah penggunaan perbankan Islam, manakala tujuh pembolehubah tidak bersandar terdiri daripada empat karakteristik inovasi iaitu 1) keuntungan relatif, 2) keserasian, 3) dapat dilihat dan 4) kerumitan dan tiga pembolehubah tambahan iaitu 5) persepsi risiko, 6) persepsi kepercayaan dan 7) “*customer innovativeness*”. Kajian ini menggunakan kaedah persampelan rawak di mana soal selidik telah diisi oleh 436 responden di Bintulu,

Sarawak. Hasil daripada analisa deskriptif menunjukkan yang tahap kesedaran dan penggunaan produk dan servis perbankan Islam adalah secara umumnya rendah dalam kalangan responden, tanpa melihat kepada latar belakang agama. Pada permulaannya, analisis faktor eksploratori telah menghasilkan enam faktor solusi. Setelah ditapis oleh persamaan regresi logistik, didapati tiga faktor iaitu 1) kesesuaian, 2) keuntungan relatif dan boleh dilihat dan 3) kerumitan dibuktikan mempunyai pengaruh signifikan ke atas penggunaan produk dan servis perbankan Islam di Bintulu, Sarawak. Dengan itu, bank perlu mengurangkan kerumitan dalam prosedur transaksi sebagai langkah untuk menaikkan tahap penerimaan dalam kalangan masyarakat awam dan seterusnya akan meningkatkan kadar penggunaan produk perbankan Islam. Kajian ini juga mencadangkan supaya industri perbankan memberi perhatian serius kepada karakteristik inovasi untuk melonjakkan tahap penggunaan produk perbankan Islam dalam kalangan pelanggan di Bintulu. Pihak bank juga perlu meningkatkan faktor kebolehcapaian, faktor keuntungan dan faktor kualiti servis, yang mana pada ketika ini merupakan faktor kritikal kejayaan yang mempengaruhi persaingan sesebuah organisasi.

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I certify that an Examination Committee met on 13 April 2015 to conduct the final examination of Malisah Latip on her Master of Science thesis entitled “**Customer Awareness And Factors Influencing Islamic Banking Adoption In Bintulu, Malaysia**” in accordance with the Universities and University Colleges Act 1971 and the Constitution of the Universiti Putra Malaysia [P.U.(A) 106] 15 March 1988. The Committee recommends that the student be awarded the Master of Science degree.

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CHAPTER 1

INTRODUCTION

1.0 Background of the Study

Islamic banking system has morphed from being a niche offering Islamic banking products to an important sector in the financial services industry. Historically, the introduction of Islamic banking has been motivated by the demands and needs of Muslim clients who are looking for alternatives in obtaining financing and investment products which comply with their religious beliefs. In the early years of Islamic banking, its products and services were not as competitive compared to the already established conventional banking system. This is especially true in the aspects of pricing and service offerings (Vayanos *et al.*, 2008). According to Zainol, Shaari and Ali (2008), Islamic banking is almost unheard of amongst the masses in 1970. However, by the early twenty-first century, Islamic banking has become a reality and is growing at steady pace. Iqbal and Molyneux (2005) reveal that the size of the industry in 1975 amounted to a meager few hundred thousand dollars. The worldwide Islamic banking assets were projected to reach the US\$1.8 trillion mark in 2014 (Global Islamic Finance Magazine).

Islamic banking in Malaysia do not obtain a satisfactory support and participation from the public mostly due to 1) poor awareness on Islamic banking products and services, 2) misunderstanding against the Islamic banking system, and 3) lacking in terms of brand recognition (Khan and Bhatti, 2008; Samat, 2009).

The Islamic Banking and Finance Institute of Malaysia (IBFIM) has highlighted that 1) lack of knowledge on Islamic banking, as well as, 2) the need for promotion, marketing and branding as the two major challenges or issues faced by Islamic banking in Malaysia (Veeriah, 2012). Thus, it is appropriate to study the customers' awareness and their perspectives on Islamic banking, as well as, ascertaining the factors influencing their decision to adopt Islamic banking that would provide a useful strategic direction and planning.

In the Malaysian context, although there seems to be a growing awareness and understanding on the concept of Islamic banking operations among Muslims and non-Muslims community, this has not been translated into practice. After three decades of the establishment of Bank Islam Malaysia Berhad (BIMB), the public's knowledge on Islamic banking system has increased considerably. However, the customer's attitude change towards adopting Islamic banking products has yet to move at a rapid pace. Most of the Malaysian banking customers have not converted their Islamic banking knowledge into their daily financial practices. This is witnessed by low usage of Islamic banking products and services compared to conventional banking products among Malaysians (Raman, 2010; Doraisamy *et al.*, 2011; Thambiah *et al.*, 2012).

Since majority of Malaysians are aware of the basic concepts of Islamic banking operation, issues regarding public awareness and acceptance do not arise. On the contrary, the major issues rest on the providers of the services. According to Haron *et al.* (2005), even though Islamic financial institutions claim that their marketing

programs are wide-ranging (in promoting Islamic banking products and services), the outcomes are far from satisfactory. This statement is supported by Ahmad and Haron (2002) who discover that Islamic banks are ill prepared in marketing their products to the corporate sector. Aziz (2007) states the Islamic banking operation in Malaysia has not completely diffused or reached the entire ranks of the society compared to the matured conventional banking. Although there are increasing statistics on Malaysian banking clients utilizing Islamic banking products and services, most of them have not adopted the system.

According to Aziz (2007), it is the aspiration of the Malaysian government to have a strong Islamic banking industry; capturing 20 percent of the local market share of banking assets, financing and deposits by 2010. Even though the 20 percent of market share has been accomplished, the growth seems to be slow and insignificant in comparison to conventional assets, financing and deposits (Thambiah *et al.*, 2012). Although there are continuous opportunities for Islamic banking in this country, there is a need to create and develop products and services that are aligned with the varying needs and demands of customers in order to stay competitive (Sadiq and Shanmugam, 2002; Haron *et al.*, 2005). Malaysian banking customers take a longer time before deciding to adopt Islamic banking products and services, in spite of the fact that it has been operating for the past thirty years.

This study focuses on customer awareness and factors influencing Islamic banking adoption among banking customers in Malaysia, particularly in Sarawak. Some backgrounds and philosophies of the Islamic banking will be briefly discussed to better understand the practices of Islamic banking in the current financial systems.

1.1 Fundamentals of Islamic Banking

An Islamic bank can be defined as an interest-free based financial institution which acts in accordance with Islamic laws (also known as *Shariah*) and has a progressive and creative financial engineering to provide competent and competitive banking, trade finance, investment, real estate and commercial financial services (AbdulQawi and Owen, 2001). The system principally, a) adopts a profit sharing concept in its investment ventures, b) encourages entrepreneurships and c) disallows speculative behavior as well as, d) underlining the divinity of contracts (Hassan and Lewis, 2007; Kayadibi, 2011).

In Islam, there is no separation between religion and state. Likewise, business cannot be treated separately in Islam. The *Shariah* rules each element of a Muslim's religious practice, daily life, as well as, his economic activities. In theoretical perspective, Islamic banking is dissimilar from conventional banking in term of interest (*riba*), which is, strictly forbidden in Islam. For instance, banks are not permitted to offer a fixed rate of return on deposits and are not permitted to charge interest on loans. This seals the door to outset of interest and excludes the application of debt-based instruments. It is crucial to keep in mind that, what is prohibited by *Shariah* is the fixed or predetermined return on financial transactions, and not the uncertain rate of return represented by profits.

Gait and Worthington (2007) have listed the six fundamental principles of Islamic banking as follows:

- (i) the forbiddance of *riba*, (which is also known as *usury*) and the elimination of debt-based financing from the economy;
- (ii) the forbiddance of *gharar*, by the enclosing the full disclosure of information and deletion of any asymmetrical information in a contract;
- (iii) the exclusion of financing and dealing in sinful and socially irresponsible activities and commodities such as gambling and the production of alcohol;
- (iv) risk-sharing, wherein, the provider of financial funds and the entrepreneur shall share business risks in return for shares of profits and losses;
- (v) materiality, in which, a financial transaction needs to have a ‘material finality’, that is a direct or indirect link to a real economic transaction; and
- (vi) justice, with which, a financial transaction should not cause the exploitation of any party involved in the transaction.

Technically, Islamic banking is no different from conventional banking in the point that both banks collect funds from depositors and investors and then invest the funds to get higher returns (Kamarulzaman and Madun, 2013). The prominent features of the two banking systems are summarized in table 1.1.

Table 1.1: Summary of Different Features of Islamic and Conventional Bank

	Islamic Bank	Conventional Bank
Function	Custodian Entrepreneur Financier Capital Provider	Lender and borrower
Deposit	Safe custody Investment	Interest-based deposit
Loan	Debt financing Equity financing	Interest-based loan
Asset	The asset, <i>e.g.</i> , the house, is the subject matter and major element	The asset, <i>e.g.</i> the house, becomes the security

Source: Adopted from Kamarulzaman and Madun (2013)

The establishment of Islamic banks is associated with the growing awareness of the Muslim community in implementing Islam as the way of life, not only in aspect of finance and banking, but also in other aspects of life. Even though the emergence of Islamic banking is to satisfy the demands of the Muslim society, it should be clear that these Islamic banks are not religious institutions. This is because Islamic banks do not only provide the banking services for Muslims, but for the non-Muslims customers as well.

This system does not have any religious implication. It endeavors to put the foundations of an ethical and fair financial system, which consequently have an effect on the socio-economic settings on the market. Islamic banking provides services to everybody regardless of their religious beliefs, ethnicity, wealth, caste or creed (Faisal *et al.*, 2012). As stated by Usman (2003), the role and functions within the banking system in a modern economy are very crucial, and actually, it is at the heart of every robust economy. Therefore, the emergences of Islamic financial

activities are synchronized with the needs of Muslims to live all aspects of their lives in line with the philosophies of the *Quran* and the *Sunnah* (Ahmed, 2009).

1.2 The Growth of Islamic Banking

Islamic banking, maintains to be part of the mainstream financial services landscape as portrayed by strong macro outlook of core Islamic financial markets and assets. It increasingly obtains acceptance, especially in high growth emerging markets, as an alternative to construct a comprehensive financial system. The market is positioned to develop extensively in the years to come. At the present rate of growth, the industry could top US\$2 trillion in assets by the end of 2014 (Andrea, 2014).

The worldwide industry for Islamic financial services ‘*Shariah* compliant’ assets is projected to boost up by a fifth in 2012, to a record US\$1,460 billion (Table 1.2 and Figure 1.1). According to Maslakovi (2013), Islamic finance has revealed resilience at a period during the world economy has sluggish and Western countries facing difficulty in their conventional banking operations. Worldwide assets of Islamic finance have doubled since the 2008 economic downturn.

Table 1.2: Global Islamic Finance Assets by Sector

Sharia compliant assets, \$bn					
	2008	2009	2010	2011	2012
Banks	720	777	943	1,105	1,326
Funds	51	54	58	62	74
Takaful	8	13	21	26	31
Other	1	3	3	26	28
Total	781	847	1,025	1,219	1,460

Source: The Banker, Ernst & Young (2013)

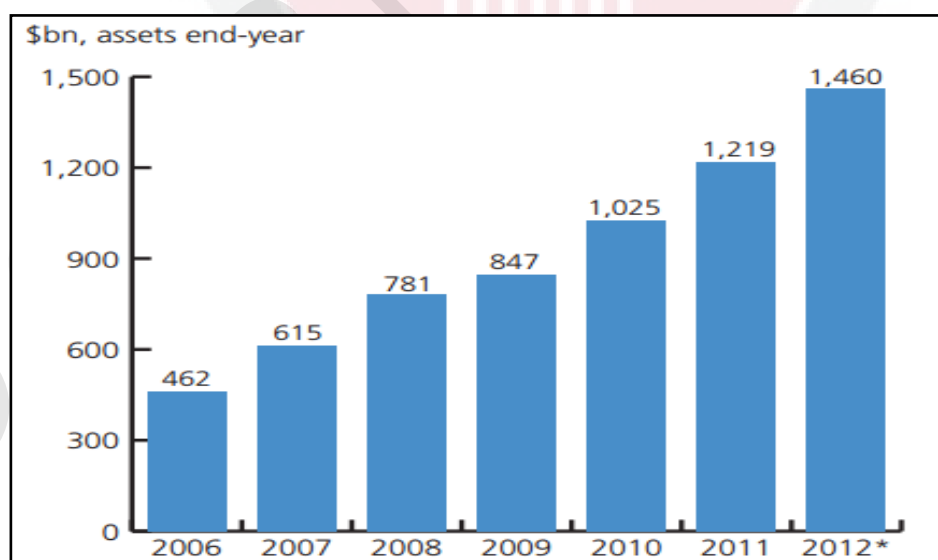


Figure 1.1: Global Assets of Islamic Finance
(Source: The Banker, 2013; Ernst & Young, 2013)

The potential for expansion exists since less than a fifth of Muslims consumer utilize Islamic products, even though the scale is narrower in certain countries where Muslims are a minority. The magnitude of the industry’s penetration differs considerably. As exhibited in Figure 1.2, Islamic banking recorded for 65 percent of total banking assets in Bangladesh; whereas in Bahrain 46 percent and Saudi Arabia 35 percent. In contrary, the penetration in other countries is relatively limited with Islamic banking reporting for only 4 to 5 percent of total banking assets in Turkey, Egypt and Indonesia (The Banker, 2013). In Malaysia, Islamic financial institutions hold 21.2 percent of total domestic banking system assets as at year-end 2013.

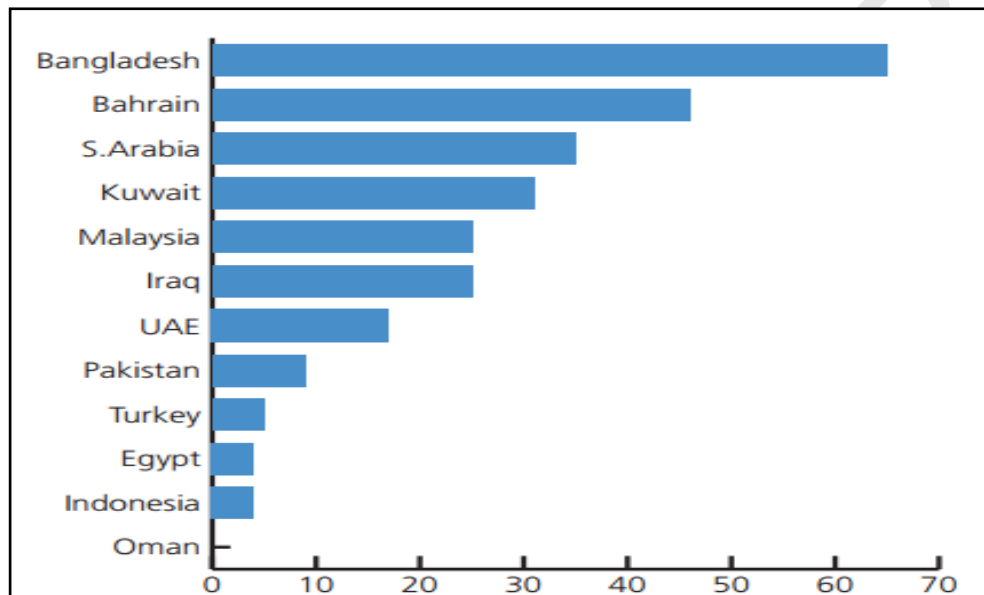


Figure 1.2: Islamic Finance Penetration in Selected Countries
(Source: The Banker, 2013)

The demographic and economic growth in most part of Muslim nations has stimulated the demand for *Shariah* compliant solutions. Despite the rise in financial services institutions offering Islamic banking products that lead to the increasing level of customers’ awareness, it has also increased the competitive pressure in the market (Al-Salem, 2009). For this reason, the providers of Islamic financial services should differentiate their products more but still be *Shariah* compliant. Product innovation has appeared not only as a reaction to the progressively competitive surroundings, but also to deal with up-and-coming customer demands.

1.3 Overview of Islamic Banking in Malaysia

In Malaysia, the expansion phase of Islamic financial operation begins with the formation of Lembaga Tabung Haji (LTH) or Pilgrimage Fund Board by Malaysian government after five years of independence in 1957. It is the first premiere Islamic savings institution that aims to facilitates the Muslims society to save for pilgrimage with no apprehension of the money being ‘contaminated’ by *riba* (Mohamad Akram, 2008). LTH is also responsible for the management of depositors’ funds in business activities and investment. The establishment of Islamic banking can be attributed to the increase in Islamic awareness among Muslims communities in Malaysia. Prosperity has facilitated more pilgrimages to Mecca and financed Muslim students

to take up Islamic studies in the Middle East. As the students come back from their study, they desire to practice all aspects of Muslim lifestyle, including Islamic banking (Loo, 2010).

Encouraged by the tremendous success of LTH, several organizations and individuals have facilitated the development and implementation of Islamic financial services. In 1983, Malaysia's cabinet has authorized the establishment of the first Islamic bank in Malaysia, namely Bank Islam Malaysia Berhad (BIMB) (Nor Ermawati *et al.*, 2012). Haque *et al.* (2009) states that the process of introducing and implementing the Islamic financial system in Malaysia can be categorized into three stages. The first stage is the era of familiarization (1983-1992). This is the era when BIMB started Islamic banking operation in accordance with *Shariah* principles. BIMB was listed on the main board of the Kuala Lumpur Stock Exchange (KLSE) in January 1992. BIMB has emerged and developed into one of the most reputable Islamic financial institutions with its activity rapidly expanding throughout the country.

The second stage (from 1993-2003) is focused on generating a more conducive atmosphere for competition among the banks. The objective is to provide banks sufficient time to capture market share and build knowledge among the public regarding the advantages of Islamic banking system. Besides, this is also the phase when conventional banks are permitted to offer Islamic banking services by establishing "Islamic windows" or also known as Islamic Banking Scheme (IBS).

The third stage, which began in the 2004, is the era of advanced financial liberalization. During this stage, the Central Bank opens the door to new foreign Islamic banks to commence their business operation in Malaysia. In fact, Malaysia was the first country in the world to put into practice a dual banking system, where the Islamic banking system operates side-by-side with the conventional banking system.

According to Sole (2007), the increasing enthusiasm to promote and offer Islamic banking products is attributable to the banks' aspiration to provide Islamic services to the huge Muslim community in Malaysia. In addition, the banks also aspire to capture the growing interest of international investors who are interested to gain the benefits of *Shariah* compliant products. The RHB Group was the first local based banking group that initiated Islamic subsidiary, namely, RHB Islamic Bank Berhad. The second was Commerce Tjari Bank Berhad which was established by the Commerce group. Hong Leong Group was the third banking group, which launched the Hong Leong Islamic Bank. In October 1999, Bank Muamalat Malaysia Berhad (BMMB) was set up as the second full-fledged Islamic bank in Malaysia (Abdul Rahim *et al.*, 2013).

In Malaysia, banks that offer Islamic banking products must have their own *Shariah* committee (SC). The responsibility of the SC is to ensure that the products and services offered by the bank are in line with *Shariah*. In the bigger perspective, the *Shariah* Advisory Council of Bank Negara Malaysia (SAC) is established as the highest authoritative body in *Shariah* matters with regard to Islamic finance in Malaysia. The SAC is responsible for validating all Islamic banking and *Takaful* products to ensure their compatibility with *Shariah* principles (BNM, 2010^b).

To date, various banking products have been developed in accordance with the concepts of *Shariah* (see Appendix 1). These Islamic products and services are offered by banking institutions, whether by full-fledged Islamic banks/Islamic subsidiaries or by conventional banks via Islamic windows. In Malaysia, the Islamic banks have been part of the important players in the banking service industry. Currently, there is a significant number of full-fledged Islamic banks in Malaysia. BNM has issued 16 Islamic banking licenses, 10 licenses to local banks and 6 to foreign banks (see table 2.1). The rationale for BNM to issue separate licenses for Islamic banking is mainly driven by the *Shariah* requirement for greater compliance. Operating an interest bearing together with an Islamic banking business under one roof may invite ambiguities (*gharar*) concerning the legitimacy of profits that are generated from the business (Abdul Hamid *et al.*, 2011).

Table 1.3: List of Licensed Islamic Banking Institutions in Malaysia

NO.	NAME	OWNERSHIP
1.	Affin Islamic Bank Berhad	L
2.	Al Rajhi Banking & Investment Corporation (M) Berhad	F
3.	Alliance Islamic Bank Berhad	L
4.	AmIslamic Bank Berhad	L
5.	Asian Finance Bank Berhad	F
6.	Bank Islam Malaysia Berhad	L
7.	Bank Muamalat Malaysia Berhad	L
8.	CIMB Islamic Bank Berhad	L
9.	HSBC Amanah Malaysia Berhad	F
10.	Hong Leong Islamic Bank Berhad	L
11.	Kuwait Finance House (M) Berhad	F
12.	Maybank Islamic Berhad	L
13.	OCBC Al-Amin Bank Berhad	F
14.	Public Islamic Bank Berhad	L
15.	RHB Islamic Bank Berhad	L
16.	Standard Chartered SaadiqBerhad	F

Source: Central Bank of Malaysia (BNM)

1.4 Overview of Innovation in Islamic Banking Products

The first modern practice of Islamic banking was initiated in 1963 with the formulation of the MitGhamr Savings Bank in Egypt (Chong and Liu, 2009). Throughout the fruitful five decades, Islamic banking has developed briskly in aspects of the number of players and size. As a result, Islamic banking is presently operating in over 50 nations globally. In some Islamic countries such as Sudan, Iran and Pakistan, only Islamic banking is permitted to operate. In other countries, for example Malaysia, Indonesia, Jordan, Egypt and Bangladesh, Islamic banking is operating alongside with conventional banking (Chong and Liu, 2009).

The growth of Islamic banking has created a tremendous demand for rightfully skilled and trained professionals, principally those with profound knowledge of financial markets and *Shariah* principles. Islamic education must adapt to the modern finance industry. Higher learning institutions need to establish curriculums that generate dynamic persons to work with Islamic fundamentals in the commercial arena (Raja Nazrin, 2013).

As a result of new structures of distribution of financial services, numerous innovations have been introduced in retail banking (Sweeney and Morrison, 2004). Retail banking is one of the most aggressive markets and the banks are under pressure to sustain customer loyalty and satisfaction so as to attain competitive advantage (Sirohi *et al.*, 1998). New products and services that are introduced to the market are vital instruments, even if they have certain risks (Littler and Melanthiou, 2006). Bobat (2007) underlines that building a brand new Islamic financial products in conformity with the *Shariah* principles is relatively a challenging task. For that reason, failure to offer the complete package and the accurate quality of products and services as per the requirement of the consumers may overwhelm the rationale behind the establishment of Islamic banks and to remain competitive in the banking industry.

From the Islamic banking point of view, the main challenge is establishing products that are in fulfillment with *Shariah*. As Islamic finance and banking is viewed as a new activity, it is crucial that its products and services are developed on a constant basis. Given that customer needs and desires, and competitive offerings are continually changing, the institutions need to innovate continuously to remain viable or to stay even with competition (Govindarajan and Trimble, 2005). There are several financial instruments that have been developed and are acknowledged as innovations in Islamic finance. Table 2.2 has listed a number of products that have been tailored to meet the requirements of customers which can be considered as innovation (see Appendix 2).

Vayanos *et al.* (2008) have suggest five key necessities that have to be prepared to launch a differentiated product: (i) a robust methodology for quick development and deployment of products; (ii) a market intelligence process that in line to customers' needs; (iii) automated monitoring and compliance tool that assure compliance of increasingly complex products with the relevant *fatwa* or religion ruling, in a lucrative conduct; (iv) a mechanism to engage the *Shariah* board early on to request approval for the proposed product or service and (v) a management information system to track performance and fine-tune the product or service as needed.

Apart from that, Al-Salem (2009) states that Islamic financial product innovation is the formation of new *Shariah* compliant products that will capture the adoption of customers. He concludes that there is a requirement to innovate and practice new ideas which upholds Islamic fundamentals, and at the same time, is synchronized with the wants and demands of present markets. In addition, Al Rais (2013) affirms that "*there is an imperative need for diversity of products which should cover the same depth and comprehensiveness that conventional banking can deliver. Innovation must accelerate in the industry*". Therefore, Islamic institutions should be well-equipped for advanced development by continuously developing, refining and marketing innovative financial instruments (El Qorchi, 2005).

The evolution of Islamic banking has generated a competitive market atmosphere, which will impact on customer behavior. The banks should focus to enhance their understanding of the customers, as well as, their attitudes toward Islamic banking on the whole. Understanding customers' behavior will further be able to influence their adoption of Islamic banking.

1.5 Motivation of the Study

In the era of globalization and liberalization, Islamic banking faces intense challenges that can potentially affect the overall Islamic banking system. There is competition from the conventional banking system that grows rapidly and offers new products and services, which are more attractive and competitive. Even though Islamic banks have expanded rapidly, their expansion has been restrained by the lack of innovation (Bobat, 2007; Asyraf *et al.*, 2007). Presently, the concept of innovation has been one of the most attention-drawing topics by business practitioners and researchers because of its broad recognition as a powerful determinant of competitive advantage for the firms in the market (Rogers, 2003; Im *et al.*, 2003).

Although, Muslim customers are the minority in Sarawak, the demand for *Shariah* compliant banking products is expected to rise with the increase of knowledge regarding Islamic teachings and the Muslim's desire to conduct their life in accordance to Islam. This study focuses on the aspect of awareness and factors influencing Islamic banking adoption among customers in Bintulu, Sarawak. The motivation for this study is due to the fact that, no study regarding this topic has been done in Sarawak, particularly in Bintulu.

Islamic banking is not only offered to Muslims, but also to non-Muslims customers as well. For this reason, the non-Muslim market is equally important to the survival of the Islamic banking industry. The non-Muslims market is enormous and has huge potential for the Islamic banking industry. If non-Muslims customers keep on ignoring the existence of Islamic banking products and services, Islamic banking operations will have difficulties competing with conventional banking systems. By attracting non-Muslims customers, Islamic banks can ensure its long term survival.

It will be beneficial to local Islamic banking industry if it can capture both, Muslims and non-Muslims banking customers. The Malaysian government aspires to construct a progressive and strong Islamic banking industry ingrained with the Islamic core values and principles (Aziz, 2007). For that reason, great effort has been taken by the government to build the Islamic banking industry into a well functioning and competent banking system. Continuous research in this area is vital in order to attain deeper insights on the awareness and adoption behavior of banking customers towards Islamic banking products and services.

1.6 Problem Statement

There is a recent increase in the customers' demand for Islamic banking and financial products from customers all over the world. The Islamic Financial Service Board (IFSB) estimates that the global Islamic finance assets will reach the US\$2 trillion level by the year 2014, with Islamic banking projected to remain the major contributor at more than 80 percent share. Islamic banking institutions are not only located in the Muslims countries, but in other countries as well, where Muslims are the minority (*e.g.*, the Australia, Great Britain, USA, France and China). Apparently, the Islamic banking products and services are not exclusively adopted by Muslims, but also adopted by people from other religious backgrounds. The compliance with the principles that prohibit exploitation, deceit and fraud are attractive to many non-Muslims as well (Venardos, 2006).

According to the literature, several studies have been conducted to investigate the awareness and level of adoption of Islamic banking among customers in Muslims minority countries such as Australia, India and Singapore (Rammal and Zurbruegg, 2006; Srivatsa and Srinivasan, 2008; Gerrard and Cunningham, 1997). Their findings are crucial as they reflect the level of awareness and adoption of banking customers where the majority of the population is non-Muslims. Besides, the findings are valuable to the authority or banks in order to promote Islamic banking products and can further be used to determine the potential of Islamic banking in those countries. If Islamic banks are to accomplish their mission and objectives, they will have to understand their customers' perceptions (Metawa, 1998; Dusuki and Abdullah, 2007).

In Malaysia, many studies have been done in several states where Muslims are majority, such as, Kuala Lumpur, Selangor, Kedah, Johor and Pulau Pinang (Haron *et al.*, 1994; Dusuki and Abdullah, 2007; Haque *et al.*, 2009; Raman, 2010; Thambiah *et al.*, 2013). However, such research is scarce and limited in Sarawak. Sarawak which is the largest state in Malaysia has approximately 30% Muslims population. There are a few studies that have been undertaken in Sarawak, such as, study by Baba and Land (2012) that tries to examine the perception of non-Muslims towards Islamic banking in Kuching, Sarawak; De Run and Dick Yoe (2008) conducts a case study to investigate the awareness, understanding and behavior of Islamic banking; and Ho *et al.* (2007) who explores the determinants of Islamic banking service quality in Kuching and Samarahan.

However, no research has been done to examine the customer awareness and to identify the influential factors in determining the customers' decision whether to adopt or not Islamic banking products and services in Bintulu, Sarawak. The population composition in Bintulu is representative of most cities in Sarawak. Besides, Bintulu is one of the cities that is seeing rapid development and escalating foreign investment in diverse industry from local and international companies. According to Borneo Post (2011), Bintulu's most recent investors include Japan's Tokuyama Corporation with RM6.5 billion for two polycrystalline silicon plants, Press Metal Berhad with a US\$1.6 billion aluminium smelting plant, and Hong Kong-based Asia Minerals with US\$200 million manganese ore processing plants in the new industrial park at Samalaju. These projects have commenced construction works in 2010 and their plants have currently (2014) begun operations. These projects have generated thousands of job opportunities to the local community in Bintulu and attracted job seekers from all over Malaysia as well as the expatriates. Therefore, it will generate more business prospects not only for the related industries in Bintulu but also to Islamic banking sectors as the financial service providers that may benefit from the increasing demand of financial products from retail or corporate customers.

In response to this problem, the question whether awareness of Islamic banking products and services affects Sarawakians' decision to adopt Islamic banking should be examined. To understand this, the first endeavor is to explore the awareness of banking customers in Bintulu, Sarawak with regards to Islamic banking products and services. It is probable that the level of awareness on such products in Bintulu, Sarawak be dissimilar to the previous studies that have been conducted in Peninsular Malaysia where the majority of the population are Muslims.

By recognizing the level of awareness and factors influencing Islamic banking adoption where Muslims are minority (such as, Bintulu), banks could design or set up different approaches in promoting Islamic banking products and services. Haron *et al.* (1994) emphasizes that the success and survival of the Islamic banking depends on the bankers' ability, 1) to understand customers' needs and 2) to find effective approaches to satisfy these needs. Once this awareness has been explored, it is important to develop some basis for understanding, regarding the effect of attributes of innovation towards customers' Islamic banking adoption. Rogers' *Diffusion of Innovation* model is used to explain the reason behind the motivation of customers in their decision of whether to adopt or not Islamic banking products and services. This decision may be influenced by various factors such as relative advantage, compatibility, observability, complexity, perceived risk, perceived trust and customer innovativeness.

1.7 Objectives of the Study

This study attempts to identify the factors that influence customers' adoption of Islamic banking products and services offered by banks in Bintulu, Sarawak. Specifically, this study aims:

- 1) to investigate customer awareness on Islamic banking products and services in Bintulu.
- 2) to identify the factors that significantly influence customers' adoption of Islamic banking products and services in Bintulu.

1.8 Research Question

- 1) Are the customers in Bintulu aware of Islamic banking products and services?
- 2) What are the factors that significantly influence the customers' adoption of Islamic banking products and services in Bintulu?

1.9 Significance of the Study

The results from this study would offer valuable inputs to the authority and local banks regarding the adoption level of Islamic banking products and services in Bintulu, Sarawak. It will give an insight on the weaknesses that need to be improved in the Islamic banking system. On top of that, for banks that are planning to introduce Islamic banking products (especially in Sarawak) the findings of this study could provide them with the perceptions of Muslim and non-Muslims respondents towards Islamic banking practice. The information can be used by the banks for the purpose of marketing and promoting Islamic banking products and services to customers, especially to non-Muslims, which is the largest population in Sarawak. Last but not least, from the academic point of view, this research could enrich the academic literature on the awareness and adoption level of Islamic banking in Sarawak.

1.10 Organization of the Thesis

The followings are the organizational structure of this study, which consists of six chapters:

Chapter 1 introduces the background of the study with a brief overview of Islamic banking operations. This chapter also includes the motivation of the study, problem statement, research objectives, research questions as well as the significance of the study.

Chapter 2 presents the synthesis of previous literatures on the innovation of Islamic banking products and services, awareness on Islamic banking and studies of customers' adoption.

Chapter 3 explains the theoretical framework, including the detail discussion on Diffusion of Innovation (DOI) Theory, attributes of innovations, research model and hypotheses development.

Chapter 4 focuses on the research methodology adopted to undertake this study. This chapter mainly discusses on the research design, sampling design, research variables, research hypothesis, data collection methods, research instruments as well as elaborating in detail the data analysis procedures.

Chapter 5 discusses in depth the results from the data analysis. This chapter begins with details on descriptive analysis, followed by results from factor analysis and logistic regression analysis. Then, the analysis and results for each research objective are presented and discussed.

Chapter 6 provides the conclusion and recommendation based on the findings of this study. The theoretical and policy/practices implications of the study as well as the limitations and future research suggestions are presented.

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