



**AN ANALYSIS OF PRODUCT KNOWLEDGE AND  
ISLAMIC BANKING CUSTOMER PRODUCT  
ACCEPTANCE IN MALAYSIA**

**BY**

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**A research paper submitted in fulfilment of the requirement  
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## **ABSTRACT**

Islamic banking is the fast growing industry serve financing products vis-à-vis conventional banking to the customers. Customer is an important agent in a product sale. They determine the product acceptance in a market. University students and working employee who are also act as customers need Islamic banking products in their daily life. Customers having insufficient product knowledge, religious practice and lower perception on competitive pricing of certain Islamic banking products lead to poor Islamic banking product acceptance. The objectives of this study were assessing the Islamic banking product knowledge, religious practice and perception on competitive pricing among students and working employees who lived in Klang valley. 300 respondents (144 males and 156 females) were participated in this study. The instrument used was a four-section questionnaire from previous studies and some were modified to suit the need of the study. The questionnaire consist twenty- five questions overall, and every section consists one factor to determine the product acceptance. SPSS Version 20.0 is adopted to measure the findings of the study. The results of this study confirmed that customer's product knowledge and religious practice are high thus resulted to Islamic banking product acceptance. On the other hand, customers have lower perception on competitive pricing rejects the product acceptance. The researchers recommend on strengthening the knowledge, religiosity and competitive pricing through Islamic banks as a medium.

**Key words: Islamic Banking, Customers Product Acceptance, University students, Malaysia.**

## خلاصة البحث

المصرفية الإسلامية هي صناعة سريعة النمو تخدم منتجات التمويل المصرفي التقليدي وجها لوجه للعملاء. العميل هو عامل مهم في بيع المنتج. أنها تحدد قبول المنتج في السوق. طلاب الجامعات والموظفين العاملين الذين هم أيضا بمثابة يحتاج العملاء المنتجات المصرفية الإسلامية في حياتهم اليومية. الزبائن وجود نقص معرفة المنتج، والممارسة الدينية وانخفاض الإدراك على أسعار تنافسية من بعض المنتجات المصرفية الإسلامية يؤدي إلى ضعف الإسلامي قبول المنتجات المصرفية. أهداف هذه الدراسة تم تقييم المعرفة الإسلامية المنتجات المصرفية والممارسة الدينية وتصور على أسعار تنافسية بين الطلاب والعاملين الذين عاشوا في وادي كلانج. وقد شارك 300 المستطلعين (144 ذكور و 156 إناث) في هذه الدراسة. كان الأداة المستخدمة أربع قسم استبيان من الدراسات السابقة وبعض وتعديلها لتناسب مع الحاجة للدراسة. الاستبيان يتكون عشرين خمسة أسئلة بشكل عام، ويتكون كل قسم عامل واحد لتحديد قبول المنتج. اعتمد SPSS النسخة 20.0 لقياس النتائج التي توصلت إليها الدراسة. وأكدت نتائج هذه الدراسة أن معرفة المنتج العميل وممارسة الشعائر الدينية مرتفعة مما أدى إلى قبول المنتجات المصرفية الإسلامية. من ناحية أخرى، العملاء لديهم أدنى تصور عن أسعار تنافسية يرفض قبول المنتج. يوصي الباحثون على تعزيز المعرفة والتدين وأسعار تنافسية من خلال البنوك الإسلامية باعتبارها وسيلة.

الكلمات الرئيسية: الصيرفة الإسلامية، قبول العملاء المنتج، طلاب جامعة، ماليزيا.

## **APPROVAL PAGE**

I certify that I have supervised and read this study and that in my opinion, it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a research paper for the degree of Master of Science (Islamic Banking and Finance).

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## DECLARATION

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# CHAPTER ONE

## INTRODUCTION

### 1.1 BACKGROUND OF THE STUDY

Malaysia is playing a significant role in the development of Islamic banking as pioneer and frontrunner in the global Islamic banking industry. There are currently five fully-fledged local and foreign Islamic banks in Malaysia and eleven Islamic subsidiary banks owned also by both local and foreign conventional banks.

Islamic banking operations are based according to the Shariah. Islam prohibits a number of things in banking in order to be Shariah compliant, some of which are the practice of interest (riba), uncertainty (gharar), gambling (maisir), and bribery. Trade (tijara) however is very much permitted in Islam. Accordingly, profits in Islamic banking operations are derived from the contract of trade (al-bai'). The al-bai' principle is manifested by an exchange of money with an underlying asset. Legitimizing profit in Islam is done through risk taking (ghorm), effort (kasb) and responsibility (daman). The objectives of Shariah (maqasid al-shariah) play a critical role in determining the legality of Islamic transactions, as all transactions must have positive impacts on the general welfare of the individual as well as the society as a whole. All transactions must be transparent based on mutual consent with offer and acceptance (ijab and qabul) and be free from duress.

Conventional banking has made its way into Malaysia much earlier than Islamic banking. In Malaysia, while remaining dominated by conventional banks, Islamic banks account for roughly one-fifth of the banking industry. Islamic banks under subsidiaries of conventional banks however are numerous in comparison to fully-developed Islamic banks. Hence, there has not really been a level playing field

for Islamic banking in Malaysia to date. This is because conventional banks are able to offer what Islamic banks do (through their Islamic subsidiaries), but Islamic banks are unable to offer what conventional banks can. For instance, it is against the *Shariah* for a fully-fledged Islamic bank to own conventional subsidiaries or windows as it contradicts underlying operations and activities. As of now, even after three decades, Islamic banking is still in the initial stage of product differentiation.

Therefore, conventional banks continue to play a big role in the Malaysian economy, although lose some market share to Islamic banks especially during and after the 2007-2008 financial crisis. The share of conventional banking in total deposits has fallen from 92.5% in 2007 to 80.4% in 2012, while its share of total financing has also declined from 93.4% to 78.0% between the 2007 and 2012. However, their Islamic subsidiaries have been growing, as the latter's share of assets in the Islamic banking industry has grown from 48.7% in 2007 to 79.5% in 2012. Islamic subsidiaries of conventional banks have accounted for 77.2% of Islamic deposits and 83.1% of Islamic financing in 2012 (Monthly Statistical Bulletin, June 2016).

In comparison, the performance of fully-developed Islamic banks are not as great as the Islamic subsidiaries of conventional banks. According to Bank Negara Malaysia's website, their market share of the Islamic banking business has declined gradually over the years. Their share of total Islamic deposits has decreased from 53.4% to 22.8% between 2007 and 2012, while their share of Islamic financing has also declined from 48.9% to 16.9%. In terms of total Islamic banking assets, the share of fully-fledged Islamic banks has also fallen from 51.8% in 2007 to 20.3% in 2012.

With conventional banks having an overwhelming stronghold as stakeholders in the Islamic banking industry, the chances that Islamic banks owned by conventional

banks will continue to copy their parents' products with *Shariah* compliance are high. Therefore, the fully-developed Islamic banks, which compete with conventional banks and their Islamic subsidiaries, are likely to simply follow suit. This means that Islamic banks may stay focused on producing '*Shariah-compliant*' products rather than '*Shariah-based*' products.

### **1.1.1 PRODUCTS DEVELOPMENT IN GENERAL**

Many people perceive that Islamic products are no different from conventional ones due to their strong resemblance with each other. However, Islamic banking products indeed differ from their conventional counterparts in terms of their theory and practice. Nevertheless, the problem lies in the fact that Islamic banking products are modelled after existing conventional bank products. For every conventional product, there is a corresponding Islamic substitute that adheres to *Shariah* compliance. In the first stage of product development, Islamic banks offer 'differentiated' products by simply adopting conventional risk and return profile but subject to some *Shariah* constraints. For example, while the deposit product of savings accounts in conventional banks are based on interest, Islamic banks will have the same product named as savings account-i (i denotes Islamic in Malaysia's case) under the contract of either *wadiah* (safe keeping) or *mudharabah* (profit sharing). This is said to satisfy the *Shariah* and at the same time the customers' needs. Thus, in the first stage of the Islamic banking evolution, the products offered by Islamic banks are very similar but not identical to conventional banks.

In the second stage, Islamic banking products would move away from 'differentiated' (*Shariah-compliant*) to distinctively 'different' or 'dissimilar' (*Shariah-based*) products that will not mimic conventional products. While in the third

stage, 'home grown' products will be produced based on research and development (R&D) efforts. To be at this mature stage, Islamic banks will have to leap into a new developmental path, with risk and reward sharing modes of finance to be in sync with Islamic ideals.

### **1.1.2 THE PRODUCT DEVELOPMENT IN MALAYSIA**

The first Islamic bank in Malaysia was established in 1983, the first of which was Bank Islam Malaysia Berhad (BIMB) which had not represented the whole financial system. It was only until 1993 that Bank Negara Malaysia (BNM) began to introduce the Islamic Banking Scheme (IBS). The scheme allowed conventional banking institutions to offer Islamic banking products and services using their existing infrastructure, including staff and different branches. Since then, commercial banks, merchant banks and finance companies began to offer Islamic banking products and services under the Islamic Banking Scheme. IBS banks had to separate the funds and activities of the Islamic banking transactions from the non- Islamic banking transactions (conventional banking).

Later in 2007, Bank Negara Malaysia (BNM) issued guidelines on the introduction of new products. A new product is defined as a product that is offered by a financial institution in Malaysia for the first time or a combination of or a variation to an existing product that results in a material change to the risk profile of the existing product (Bank Negara Malaysia, 2014). Bank Negara Malaysia (BNM) also indicates that the new product must also have the element of consumer protection to ensure that risk is managed properly for the sake of justice for all. This is in line with the Islamic teaching in which Islamic banks should be built based on a societal

foundation or upon religious principles that may help institutions introduce products designed and price-based on the principle of societal equality (Kwon, 2007), as well as brotherhood and solidarity (Imady & Siebel, 2006). These new products must also adhere to the *Shariah* as per the guidelines of Bank Negara Malaysia (BNM). One of the initial requirements to submit new products for approval is that the product must be endorsed by the Islamic Financial Institutions (IFIs) *Shariah* Advisory Board (SAB). *Shariah* members appointed by the financial institution must first and foremost be recognized by BNM. This is to ensure that only those qualified can advise on the compliance of a product to the *Shariah* principles.

Other than that, Islamic banking products are recognized based on contracts instead of commercial orientation. The current Islamic banking products can be categorized as shown in Table 1.1 below:

Table 1.1 Current Islamic banking products

CONSUMER SEGMENT	PRODUCT NAME	CONTRACT USED
Deposit	Current account	<ul style="list-style-type: none"> <li>• <i>Wadiah</i> (safe keeping)</li> </ul>
	Saving account	<ul style="list-style-type: none"> <li>• <i>Mudharabah</i> (profit sharing)</li> </ul>
	Staff deposit account	<i>Qard Hassan</i> (benevolent)
Credit	Credit card	<i>Tawarruq</i> (cost plus sale)
Financing	House financing	<ul style="list-style-type: none"> <li>• <i>Bai Bithaman Ajil - BBA</i> (deferred payment sale)</li> <li>• <i>Musharakah Mutanaqisah</i> (diminishing partnership)</li> </ul>
	Personal financing	<ul style="list-style-type: none"> <li>• <i>Murabahah</i> (cost plus)</li> <li>• BBA (deferred payment sale)</li> <li>• <i>Bai Inah</i> (immediate cash)</li> </ul>
	Vehicle financing	<ul style="list-style-type: none"> <li>• BBA (deferred payment sale)</li> </ul>
	Staff financing	<i>Qard Hassan</i> (benevolent)
CORPORATE SEGMENT	PRODUCT TYPE	CONTRACT USED
	Trade financing	<ul style="list-style-type: none"> <li>• <i>Wakalah</i> (agency)</li> <li>• <i>Mudharabah</i> (profit sharing)</li> <li>• <i>Murabahah</i> (cost plus)</li> </ul>
	Asset based financing	<ul style="list-style-type: none"> <li>• <i>Ijarah</i> (leasing),</li> <li>• <i>Istisna</i> (purchase order)</li> </ul>
	Corporate investment	<ul style="list-style-type: none"> <li>• BBA (deferred payment)</li> <li>• <i>Ijarah</i> (leasing)</li> <li>• <i>Istisna</i> (purchase order)</li> <li>• <i>Murabahah</i> (cost plus)</li> <li>• <i>Mudharabah</i> (profit sharing)</li> <li>• <i>Musharakah</i> (profit and loss sharing)</li> </ul>

(Source: Abdul Aris, N., Othman, R., Mohd Azli, R., Sahri, M., Abdul Razak, D., & Abdul Rahman, Z., 2013).



## 1.2 STATEMENT OF THE PROBLEM

A review of literature suggests that the acceptance of Islamic banking products is based on several factors. In this study, the researcher focuses only on three factors which are: product knowledge, religious factor and competitive pricing.

At present, there exists many Islamic banks offering the same Islamic banking products in Malaysia. However, a few problems arise especially in product knowledge and also understanding of the terms and product features offered by Islamic banks as Islamic banking is still new and quite complex. Many customers seem also to be unfamiliar with the principles such as *Mudharabah*, *Bai Muajjal*, *Rahn*, *Musharakah*, *al Ijarah*, *al Istisna* and others. Thus, the researcher is of the opinion that the higher the product knowledge, the higher the customer acceptance. Haron et al. (1994) conducted a study among Muslim and non-Muslim customers. They found that the source of knowledge in Islamic banking products among the Muslims are mainly from television, newspapers, family members, magazine and radio. Their review found that 63% of respondents were aware of the differences between Islamic and conventional banking.

Alternatively, a research conducted by Hamid and Nordin (2001) found that although 96.7% of respondents were aware of Islamic banking in Malaysia, they scored a low percentage in the knowledge of Islamic banking products. On the other hand, Osman and Ali (2008) conducted a study on Muslim entrepreneur knowledge and usage of Islamic finance. Their study focused on the level of knowledge among entrepreneurs towards Islamic financing to the Small and Medium Enterprises (SMEs). Their findings reveal that Muslim entrepreneurs' understanding towards

Islamic SME's financing are considerably adequate and they understand the importance of practicing and applying Islamic financing in their business.

As far as religion is concerned, according to Ab. Ghani and Kamri (2008), Islam is a religion that provides guidance for the welfare of all human life in this world and the hereafter. Islam is not only confined to performing religious rituals as most perceive but stresses on all aspects of life; Islam is the way of life—*Ad-Din* (Alam et al., 2012). This means that Islam concerns all parts of human life from the spiritual to the social, political and economic matters of one's life. Thus, for example, engaging in *haram* (forbidden activities) in banking matters is totally prohibited as mentioned in numerous places in the Holy *Quran*. According to Abdul Rahim (2012), the duty to comply with religious obligations in Islam is expected to have a significant effect on the intention to use Islamic banking products. This is supported by Conroy and Emerson (2004) where they defined religiosity as something which is signified that can influence people's ethical beliefs and can reflect human daily conduct and commitment. Interestingly, Haron et al. (1994) claimed that religion was not the main factor in attracting customers, therefore Islamic banks need to recognise that customers may view them just like any other commercial banks. Due to the mixed findings on the religious factor, this gives motivation for the researcher to study these aspects further.

Competitive pricing is another factor which differentiates Islamic banking with its counterpart; conventional banking. Lower pricings will most likely result to more customer acceptance and vice versa. As an instance, Khazeh and Decker (1992) identified interest rates as one of the top five determining factors that influenced the

choice of banking among 1198 business school alumni of Salisbury state university in Maryland.

All in all, this research studies the level of customers' acceptance towards the Islamic banking products among students and working employees and their relationship with three factors which are: product knowledge, religious practice and competitive pricing. This study hopes to assist the growth of comprehensive Islamic banking in the future by providing a basis of customers' needs and wants.

### **1.3 RESEARCH GAP**

The availability of homogeneous Islamic banking products offered by different Islamic banks in Malaysia makes them readily accessible products to all. However, there are a few problems which arise especially in product knowledge and in the understanding of the terms as well as product features. Firstly, many of the customers themselves may find difficulty in understanding the terms, comprehending the complexity of the products and are lacking in familiarity of the principles such as *al-Mudarabah*, *al Ijarah*, *al Istisna* and *Bai' Salam*.

In terms of religious background, there is lack of religious motivation by some Muslim customers, this may cause lower product acceptance due to the lack of product knowledge. However, even though religion motivates them to select an Islamic banking product, the lack of knowledge may make the customer hesitant in accepting the product. As found in the study by Haron et al. (1994), the religious factor could no longer be a driving factor for Muslims to choose Islamic banks as they see Islamic banks as the same as other commercial banks. However, some other studies have shown that this is the opposite. As an instance, Metawa and Almassawi (1998) found that religion is the ruling factor that influenced customer perception in

the selection of Islamic banking system. In United Kingdom, the volume of deposits of Muslims in Islamic financial institutions is primarily influenced by religious reasons (Omer, 1992). Presently, religion is seen as the basis of all kind acts. People today seem to be more concerned and keen to invest in the hereafter. Thus, the mixed findings of this factor has driven the researcher to study further on the influence of religion in accepting Islamic banking.

Competitive pricing is also another the factor that influences customer product acceptance. It is assumed that higher pricing of a product will result to a lower level of customer acceptance towards Islamic banking products and vice versa. Gerrad and Cunningham (1997) also found that profit or interest rate served as one of the main reasons for people maintaining their relationship with Islamic banks.

#### **1.4 RESEARCH SCOPE**

This study will only emphasize on the acceptance of Islamic banking products and exclude the issues attached to it. More focus will put on Islamic banking rather than conventional banking. The survey of this study will be carried out around the Klang valley focusing on the participation of 300 respondents which include students as well as working employees. This study will focus on consumer products designed for retail customers which are not corporate-based. The top five Islamic banking products chosen are based on the most popular consumption which are savings, fixed deposit, investment, financing and Islamic credit card. These are chosen based on the Bank Negara Malaysia (BNM) Monthly Statistical Bulletin website in which it states that all of these products are among the highest in demand. To illustrate, personal financing itself recorded RM 2,652 Million at the end of 2006 compared to RM 27,295 Million

in 2015. While Islamic credit card recorded RM547 Million in 2006 compared to RM 2,285 Million in 2015 (Bank Negara Malaysia Monthly Statistical Bulletin, 2016).

### **1.5 RESEARCH OBJECTIVES**

In order to continue the efforts of other researchers, the objectives of this study are:

- RO1. To examine the level of customer knowledge, religion and competitive pricing on Islamic banking products.
- RO2. To analyse factors of customer acceptance of Islamic banking products.
- RO3. To recommend measures to enhance customer knowledge, religion and competitive pricing on Islamic banking products.

### **1.6 RESEARCH QUESTIONS**

In this study, the researcher needs to know the factors that influence customers' acceptance towards Islamic banking products. There are several questions that have been developed pertaining to the problem statement. The research questions are:

- RQ1. What is the level of customer knowledge, religious practices and competitive pricing on Islamic banking products?
- RQ2. What are the contributing factors for customer acceptance of Islamic banking products?
- RQ3. What are some of the measures that need to be taken to enhance customer knowledge on Islamic banking products?

## **1.7 SIGNIFICANCE OF THE STUDY**

The Islamic banking industry has been selected for this study as it shows a tremendous significant growth in the global financial market. Furthermore, despite a lot of past research covering this issue, there is still room for improvement regarding the time movement and method used. In addition, the researcher is trying to compare the views of both students and working employees in this study. Knowledge, religious practices and competitive pricing are at its best when to measure with students and working employees because they are at the level of seeking the truth and active subscriber of Islamic banking products. Most of them also have the knowledge, religiosity and willingness to compare Islamic banking products price with conventionals which make the study even more significance. Moreover, with the exception of a few studies that used Muslims and non-Muslims, different ethnic groups as well as a urbans and rurals as samples, no attempt has been made in mainstream publication in the area of Islamic banking product acceptance among working employees and students.

On top of that, this study will also benefit banking institutions specifically the Islamic banking sector as it could speed up the process of Islamic financial product development and could help practitioners to come up with more preferable financial products to both customers and key players. It is also one of the ways to improve any weaknesses they may have in the form of targeting customers, budgeting and to forecast their future undertakings.

As for the benefit to the customers, this study will help to sharpen the customers' knowledge and at the same time provide a better understanding towards the products that they wish to consume. They will be more familiar with the terms of personal financing based on *Tawarruq*, *Wadiah Yad Dhamanah* savings account and even *Bai Bithaman Ajil (BBA)* home financing.

Finally, this study will also bring benefit to academicians as well as students as it will enrich the existing literature of Islamic banking product acceptance as well as expanding the related contribution factors in Islamic banking product acceptance.

## **1.8 LIMITATIONS OF THE STUDY**

There are several key limitations to this study.

1. The Islamic banking product acceptance factor in this study is limited to three factors only which are customer knowledge, religious practice and competitive pricing. It must be acknowledged however that the acceptance of Islamic banking products may also come from other various factors.
2. The age group of the respondents captured in the study mostly fall between 25 to 39 years old. It must be acknowledged that other age group also brings effects to Islamic banking product acceptance.
3. The feedback rate for the questionnaire of this study which were distributed during the holy months of Ramadhan and Syawal was significantly low thus limiting the respondents' feedback

## **1.9 CHAPTER SUMMARY**

The research chapterisation is organized in five chapters as follows:

**Chapter One** provides a general introduction to Islamic banking products and states the objectives of the research, research questions, its significance and the scope of the research.

**Chapter Two** provides a literature review that comprises a brief concept and theory of Islamic banking features which will bring effects to the product principle and

therefore will bring about the selection criteria of Islamic banking products. The findings provided in this chapter work as a basis for the research.

**Chapter Three** clarifies the methodology used to address the various research questions of the study. This chapter is also concerned with explaining each variable of the research.

**Chapter Four** presents the discussion and findings of the produced questionnaire with the help of Statistical Package for Social Sciences (SPSS).

**Chapter Five** being the last chapter provides a summary of the entire study and offers recommendations for this study. In addition to that, it discusses the possible limitations experienced by the researcher and potential research area for future research.