



CUSTOMERS' BANK SELECTION CRITERIA: THE
CASE OF MALDIVES

By

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ABSTRACT

Studies on bank selection criteria as well as knowledge level of banking principles and its effects on patronization have been done by numerous researchers in various countries. However, review of prior literature has turned up no evidence of such a study having been done in Maldives. Therefore, this study attempts to identify and rank the bank selection criteria perceived as significant by Maldivian banking customers. In addition to this, the study also attempts to categorize the level of awareness and understanding Maldivian banking customers possessed about Islamic banking, its principles and products. Furthermore, attempts are also made to determine whether there is any relationship between the level of Islamic banking knowledge and the decision to patronize Maldives Islamic Bank. The study involved a self-administered survey, with a sample of 398 respondents. Friedman's test, Pearson's chi-square test and factor analysis was carried out on the data. The results of the analysis show that Maldivian banking customers are able to differentiate between various bank selection criteria and have a perceived ranking of these factors according to its significance to them. The results further show that Maldivian banking customers value trustworthiness followed by availability of automated teller machines and cards above all the other criteria. Furthermore, evidence show that Maldivian banking customers are highly aware of existence of Islamic banking but possess an average level of understanding of its principles. This understanding is especially poor when it comes to specific products. Similarly, there is also evidence of a relationship between customers' Islamic banking knowledge level and their decision to patronize Maldives Islamic Bank.

ملخص البحث

لقد أجريتمن قبل العديد من الباحثين في مختلف البلدان، دراسات عن معايير اختيار البنك، فضلا عن مستوي المعرفة بمبادئ الخدمات المصرفية وأثره على تشجيع التعامل مع البنك. إلا أن مراجعة كتابات سابقة لم تقم الدليل على أن مثل هذه الدراسة تم إجرائها في المالديف. لذا تحاول هذه الدراسة تحديد وترتيب معايير اختيار البنك، ينظر إليها عملاء البنوك المالديفية على أنها هامة. بالإضافة إلى هذا فإن الدراسة تحاول أيضا تصنيف مستوي الوعي والفهم الذين يتمتع بهما عملاء البنوك المالديفية عن المصرفية الإسلامية ومبادئها ومنتجاتها. علاوة على ذلك، تحاول هذه الدراسة أيضا تحديد ما إذا كانت هناك أية علاقة بين درجة المعرفة عن المصرفية الإسلامية وبين قرار تعامل مع البنك الإسلامي المالديفي. هذا وشملت هذه الدراسة استطلاعا للرأي مع عينة بلغ 398 مشاركا. اختبار فريدمان، ونفذت بيرسون اختبار خي مربع وتحليل عامل خارج عن البيانات. وتشير نتائج الاستطلاع المذكور إلى أن عملاء البنوك المالديفيين قادرين على التمييز بين المعايير المختلفة لاختيار البنك كما يدركون ترتيب هذه العوامل طبقا لأهميتها بالنسبة لهم. والنتائج أيضا تشير إلى تقدير عملاء البنوك المالديفيين للثقة التي تمنحها لهم توافر ماكينات الصرف الآلي وبطاقات الائتمان أكثر من أية معايير أخرى. إضافة إلى ذلك تشير الدلائل إلى أن عملاء المصارف المالديفية يدركون تماما بوجود المصرفية الإسلامية، غير أن درجة فهمهم لمبادئها ومنتجاتها عادية، ولا سيما عندما يتعلق هذا الفهم بمبادئ ومنتجات معينة فإن درجته ضعيفة. كما أن هناك شواهد تدل على وجود علاقة بين مستوى المعرفة للمصرفية الإسلامية وبين قرار التعامل مع البنك الإسلامي المالديفي.

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 in Islamic Banking and Finance.

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DECLARATION

I hereby declare that this research paper is the result of my own investigations, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for my other degrees at IIUM or other institutions.

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□

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For my parents:

Moosa Didi and Mariyam Abdulla

And

My wife:

Aminath Mufeed

For their unconditional love, care, trust, encouragement, continuous support and sacrifices.

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In the Name of Allah, Most Gracious, Most Merciful.

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LIST OF ABBREVIATIONS

AAOIFI	Auditing and Accounting Organization for Islamic Financial Institutions
ACCA	Association of Certified Chartered Accountants
ANOVA	Analysis Of Variance
ATM	Automated Teller Machines
BBA	Bai Bithaman Ajil
BCE	Before Common Era
BML	Bank of Maldives Ltd
CFA	Chartered Financial Analyst
CIBAFI	General Council for Islamic Banks and Financial Institutions
CIMA	Chartered Institute of Management Accountants
CSR	Corporate Social Responsibility
d.f.	Degrees of freedom
et al.	(et alia): and others
GCE A' Level	General Certificate of Education Advanced Level
GCE O' Level	General Certificate of Education Ordinary Level
IBM	International Business Machines
ICD	Islamic Corporation for the Development of the Private Sector
IDB	Islamic Development Bank
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IILM	International Islamic Liquidity Management Corporation
IIRA	Islamic International Rating Agency
KMO	Kaiser-Meyer-Olkin
MIB	Maldives Islamic Bank
MNDF	Maldives National Defense Force
PCA	Principle Component Analysis
PLS	Profit-Loss Sharing
SDU	Savings-Deficit Unit
SPSS	Statistics Packages for the Social Sciences
SSU	Savings-Surplus Unit
UAE	United Arab Emirates
UK	United Kingdom

CHAPTER 1

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Modern Islamic banking and finance was established in the early 1960s and the few decades since then have witnessed rapid growth and development in them, leading to the mainstream acceptance of Islamic banking and finance by both Muslims and non-Muslims (Iqbal, 2007). Today it is one of the fastest growing segments of the financial industry with presence in all corners of the world. While the rapid and seemingly short-term success of Islamic banking and finance might lead a casual observer to conclude Islamic banking and finance as recent developments, however, the truth is far from it. In reality, Islamic banking and finance are not new concepts, although some of the operations of modern Islamic banking might seem unfamiliar. However, the basic principles behind these operations are not new at all but rather are applied unmodified, as prescribed in the Qur'an and the Sunnah of the Prophet since the time of the Prophet (Schoon, 2009).

Generally, Islamic banks perform similar functions as their conventional counterparts. Majority of the writings on Islamic banking and finance support this view but they differentiate these two forms of banking based on the approaches adopted as well as the values which guide the operations (Chapra, 2000a; Warde, 2000; Henry and Wilson, 2004; Iqbal and Molyneux, 2005; Iqbal and Mirakhor, 2007; Dusuki, 2008a). Among these writings, Dusuki (2008a) defined Islamic finance as approaches to banking and finance that conforms to the principles of Islamic *Shari'ah*. Although the writer discussed Islamic finance, the definition is equally applicable to

Islamic banking.

While Islamic banks are based on the principles of Islamic sharia, and observers such as Kuran (1997) might view them as being more than financial institutions, the inescapable truth is that they cannot be construed as purely charitable establishments. While the teachings of Islam with its application of morals to finance offer an alternative to the ‘profit-centric’ capitalistic ideals of conventional banking and finance (El-Ashker, 1987), it is not entirely against profit. This is also in line with the writings of Hassan (2008). According to El-Ashker (1987), Islam supports profit, but does not recognize profit maximization as the prime motive. Similarly, Hassan (2008) goes further to describe profit as a bounty from God. Although Islam does not recognize profit maximization as the prime motive, writers such as Rosly (2005) say that there is nothing wrong with profit maximization as long as *Shari’ah* principles are being properly observed. According to him the observation of *Shari’ah* principles will remove unethical practices associated with profit maximization and will put Islamic banking business in the “forefront of moral excellence”. In such an environment, Islamic banks cannot be viewed in a narrow one-dimensional sense, but rather should be viewed as multi-dimensional business entities, which face the same market conditions of demand and supply as their conventional counterparts, all the while fulfilling the religious needs of the community.

The importance of demand to business entities is not debatable, similarly, the significance of marketing and promotion as a means of influencing demand is also an established fact of the business world (Rosly, 2005). With the understanding that Islamic banks are also business entities comes the unavoidable fact that it also needs to increase the demand for its products if it wants to develop and flourish. To do this they need to attract new customers and retain their existing customers (Wilson, 1995).

This necessitates the banks to learn the behaviour of their customers particularly regarding the customers' bank selection criteria (Haron, Ahmed and Planisek, 1994; Gerrard and Cunningham, 1997; Metawa and Almosawi, 1998; Dusuki and Abdullah, 2007). Studies dedicated to researching the bank selection criteria in the context of both Islamic and conventional banks are significant in number, and nearly all of these studies provided the conclusion that customers do not choose banks merely for religious reasons. The studies provided a multitude of factors, which customers considered before choosing a bank, and not surprisingly, profitability is indicated as a significant factor (Erol and El-Bdour, 1989; Erol, Kaynak and El-Bdour, 1990; Haron et al., 1994; Hegazy, 1995; Rohimah, 2006; Dusuki and Abdullah, 2007; Awan and Bukhari, 2011). Understanding the results of these studies would allow Islamic banks to streamline their operations and improve customer satisfaction and loyalty by improving the key areas identified by the customers. This would save considerable resources that might otherwise be used inefficiently in non-essential areas of the operation. For example, Islamic banks might feel that the fact that they offer *Shari'ah* compliant products and services might be enough to attract customers, however, with the results of the study they can understand that being labelled Islamic is not enough, and that there are other factors that customers perceive as being equally important.

However, in Maldives, the idea of Islamic banking is entirely new. Maldives, a small country of about 300,000 people with an even smaller financial sector comprised of six commercial banks, three insurance companies, one *Takaful* operator and two specialized finance companies, welcomed its first Islamic bank in early 2011. Although the market is limited and has no knowledge or understanding of Islamic banking principles, infrastructure is under-developed, and legal framework is non-

existent, Maldives Islamic Bank (MIB), a joint venture between the Islamic Corporation for the Development of the Private Sector (ICD), an arm of the Islamic Development Bank (IDB), and the Maldivian government, started its operations on 8th March 2011 with the aim of capturing at least 25% of the market within the first 3 years of operations. They hoped the demand for *Shari'ah* compliant financing from the small and medium enterprises and the fisheries sector of the 100% Muslim country would help them achieve this target.

While it is reasonable to assume that the Muslim population of Maldives would have demand for a *Shari'ah* compliant alternative to the conventional banks operating in Maldives, it would be naïve to base their strategy on this element alone. It is perfectly reasonable to question whether, after a lifetime of being in a conventional financial system, Maldivians would be ready and willing to convert to Islamic banking based on religious motivations alone. It is vital to study the perception of the Maldivians regarding various issues related to Islamic banking such as their level of knowledge, their level of acceptance and their bank selection criteria to provide Maldives Islamic Bank with information that they can use to fine-tune their policies and strategies. Similarly, such information would be of vital importance to government decision makers as a tool to develop guidelines and regulations to help establish and develop Islamic banking and finance as an economically viable alternative to the current system.

The level of importance of a bank customer perception study to the Maldivian banking sector is further highlighted by the lack of any literature on the topic related to Maldives. The results of the available researches on the topic cannot be applied, as the situation and circumstances in Maldives is entirely new. Therefore, this study is an attempt to fill this gap in the literature.

1.2 MOTIVATIONS OF THE STUDY

Islamic banking and finance is often described to be value-laden due to the influence of religious doctrines that prohibits many of the bases of conventional banking and finance. Kuran (1997) describes Islamic banks as being more than just financial institutions. According to him, “Islamic banking defies the separation between economics and religion. It invokes religious authority in a domain that modern civilization has secularized”. Such writings coupled with the use of the term “interest-free” by Islamic financial institutions might conjure ideas of Islamic banking as being “profit-free” in some people. However, this is not true. The same religious principles that prohibited interest, treats profit as a bounty from God and supports trade as an occupation (Hassan, 2008). Furthermore, while writers accept Islamic banks as being more than just financial institutions, they are also of the view that Islamic banks are not religious institutions. Kahf (2002) is of the opinion that Islamic banks are ultimately civic institutions that choose to abide by *Shari'ah* principles.

The significance of profit to Islamic banking and finance is highlighted by various researches done on Islamic banks and their customers. Studies by Erol and El-Bdour (1989) in Jordan, Erol et al. (1990) in Jordan, Haron et al. (1994) in Malaysia, Hegazy (1995) in Egypt, Karim and Afiff (2006) and Rohimah (2006) in Indonesia, Dusuki and Abdullah (2007) in Malaysia, Lateh (2009) in Thailand, Awan and Bukhari (2011) in Pakistan, all reached the conclusion that Islamic banking customers did not choose Islamic banks merely for religious reasons. These researches showed that bank selection depended on a multitude of factors and often religion came behind factors such as profitability. The studies showed that in order to increase the customer base and retain customer loyalty, Islamic banks needed to recognize what customers really wanted out of their relationship with banks. They

cannot depend upon their label of being “Islamic” alone to attract and retain customers.

Against this backdrop, Maldives Islamic Bank would be naïve to rely upon the fact that Maldives is a 100% Muslim country alone as a means to attract customers as can be inferred from the quote of Khaled Al-Aboodi, the chairman of Maldives Islamic Bank, in the Star newspaper, where he was quoted saying that “with a 100% Muslim population of some 330,000 individuals, it is expected that strong demand for *Shari’ah* compliant products will drive the bank’s future growth” (Star Online, 2010). In order to attract customers to Maldives Islamic Bank and develop Islamic finance as an economically viable alternative in Maldives, it is crucial to discover factors that Maldivian banking customers perceive to be important in patronizing a particular bank. However, there is a lack of any research in this field in Maldives.

This research paper is the result of the motivation to fill this gap in the literature by studying the factors that Maldivian banking customers consider as being important in selecting a bank to patronize. Furthermore, attempts are made to understand the level of knowledge customers possess about Islamic banking and whether there is any relationship between that level of knowledge and the decision to patronize Maldives Islamic Bank.

1.3 RESEARCH OBJECTIVES AND RESEARCH QUESTIONS

While the primary aim of this research is to identify bank selection criteria, level of Islamic banking knowledge and their relationship, to begin with, it is important to pinpoint specific research objectives that will help achieve the primary aim of the study (Bryman, 2008). Furthermore, according to Bryman (2008), research questions

that will guide the research towards its objectives need to be developed. The specific research objectives of this study are as follows:

1. To understand the level of knowledge Maldivian banking customers possess regarding Islamic banking.
2. To find out if there is any relationship between the levels of knowledge a customer possesses regarding Islamic banking and his decision to patronize Maldives Islamic Bank.
3. To identify the factors that Maldivian banking customers consider while selecting a particular bank to bank with.
4. To rank the identified factors according to their level of importance as perceived by the customers.

In order to achieve these research objectives the following research questions will guide the research.

1. What is the level of knowledge possessed by a Maldivian banking customer regarding Islamic banking?
2. Does the level of knowledge regarding Islamic banking affect the decision to patronize Maldives Islamic Bank?
3. What factors do Maldivian banking customers consider before choosing a bank to bank with?
4. Do customers consider a particular factor to be more important and another factor to be less important?

1.4 ORGANIZATION OF THE STUDY

The study is organized into five chapters: Chapter one acts as a brief introduction to the study and provides the background and motivation of the study, the research

objectives and the research questions that guided the study as well as the organization of the study.

Chapter two provides a review of the literature forming the theoretical foundation of this study. This literature review is organized under two major headings. Banking, which includes a review of literature on conventional banking and Islamic banking as well as the differences between the two. The other major heading in this literature review is bank selection criteria. Under this, detailed reviews of literature on bank selection, from both conventional and Islamic perspectives, are included. Similarly, literature on the effect of awareness and knowledge on Islamic bank patronization is also reviewed in this section.

Chapter three is dedicated to hypothesis development and research methodology. This chapter presents in detail the hypothesis development process and the research methodology employed by this study. It includes a description of the research instrument used, pilot testing, sample selection, and data collection procedures. In addition, it also explains the tools used by the study to analyse the data collected.

Chapter four presents the analysis and findings of this study. To begin with, it discusses the response rate followed by a descriptive analysis including a demographic profile as well as an Islamic banking knowledge profile of the respondents. Subsequently, the results of the Friedman test and the factor analysis on bank selection criteria are also presented in this chapter.

Finally, chapter five concludes this study with a look at the major findings of the study and their implications. In addition to this, the limitations of the study and suggestions for further research are also discussed in this chapter.

CHAPTER 2

LITERATURE REVIEW

2.0 INTRODUCTION

This chapter reviews literature available on Islamic banking. This review found out that the available literature is generally in agreement that from a humble beginning as a simple alternative to conventional banking and finance, Islamic banking and finance has grown in leaps and bounds to emerge as an integral component of the global financial scene, attracting mainstream attention from both Muslims and non-Muslims from all corners of the world (Iqbal, 2007).

The main focus of this review is literature on customers' perception on bank selection. These studies generally indicate that religion alone is not reason enough for customers to patronize banks. Although bank selection criteria is the main focus of this review other key areas will also be examined, including a brief look at conventional banking, background and objectives of Islamic banking, key transactions and instruments used in Islamic banking as well as the major differences between Islamic banking and its conventional counterpart.

This chapter is structured as follows: Section 2.1, with the heading of banking, discusses the literature available on general concepts of banking, both Islamic and conventional. This section is further divided into sub-sections where, the first sub-section is a brief discussion of conventional banking and the second sub-section a discussion on Islamic banking, including its general concepts, historical development, objectives, and major contracts. The third and final sub-section is a look at the

differences between Islamic banking and conventional banking. Section 2.2, with the heading of bank selection criteria, is divided into three sub-sections. The first sub-section deals with literature on bank selection in the context of conventional banking while the second sub-section deals with the same in the context of Islamic banking, and the final sub-section deals with literature on Islamic banking knowledge and its effects on Islamic bank patronization. Finally, Section 2.3 concludes this chapter.

2.1 BANKING

Banking is not a phenomenon of modern times. It has in one form or the other existed since the beginning of civilization according to scholars. Klein and Lambert (1987) posit that the earliest banks go back to the biblical times. These scholars point to the Code of Hammurabi, a comprehensive set of laws believed to be written around 1760 BCE, which contained laws governing banking operations in ancient Mesopotamia, as evidence (Schoon, 2009). In addition to this, they also point out various evidences from the civilizations of Rome, Greece, Babylon, China, and Egypt.

The existence of financial systems through out history maybe unquestionable, however, the financial system as we know it is descended from the Florentine bankers of the 14th – 17th century. It is widely believed that the word bank is derived from the Italian word *Banco* (desk or bench), which referred to the desks and benches used by merchants of Florence to conduct their dealings (Schoon, 2009).

While it maybe hard to imagine modern banking institutions as being related to the crude practices of the early moneylenders, the truth is that in its most basic form banking remains unchanged overtime. According to Obaidullah (2005), the role of banking is that of an intermediary, which he described as facilitating the flow of funds from saving-surplus units (SSU) to saving-deficit units (SDU) in the economy. In

simpler terms, the basic service of a bank is the safekeeping of depositors' money and lending money to borrowers (Klein and Lambert, 1987). This elementary function remains unchanged, even though with the development in commerce and technology, banking institutions may have taken on additional functions.

2.1.1 Conventional Banking

The term “conventional” according to the Oxford Dictionaries, means “based on or in accordance with what is generally done or believed”. Although, the same term is also quite commonly associated with being conservative and low-risk, in the context of Islamic banking, it is used by default to mean banking practices and institutions that are based on generally accepted practices and have been a part of the well-established financial infrastructure for a long time (Schoon, 2009). Another far simpler definition of conventional banking in the context of Islamic banking could be banking systems, principles and institutions and infrastructure, which are not based on Islamic principles.

Conventional banking is essentially a debtor-creditor system between the depositors and the bank on one hand and the bank and the borrowers on the other. In both these relationships, interest is considered the price of the transaction to reflect the opportunity cost of money (Haron and Wan Azmi, 2009). While the spread between the cost of funds and the loan interest rate is the major source of revenue for a conventional bank, it can also generate revenue in a variety of different ways including transaction fees and financial advice.

2.1.2 Islamic Banking

While there is no standardized definition found in the literature, it is a recurring premise that Islamic banking refers to a system of banking, which is governed by the principles laid down by Islamic law, also known as *Shari'ah*, and guided by the concepts of Islamic Economics (Haron and Shanmugam, 1997; Kahf, 2004; Iqbal and Molyneux, 2005; Rosly, 2005; Dusuki and Abdullah, 2007; Dusuki and Abozaid, 2008; Haron and Wan Azmi, 2009; Schoon, 2009; Visser, 2009; International Shari'ah Research Academy for Islamic Finance [ISRA], 2011). These principles come from the sources of the Holy Qur'an, Hadith, Sunnah, *Ijma*, *Qiyas* and *Ijtihad* (Gait and Worthington, 2007). According to the principles of *Shari'ah*, Islamic banks have to abide by the following governing principles, (a) avoidance of *Riba*, *Gharar* and *Mysir*, (b) avoidance of goods and services that contradict Islamic values, (c) and involvement with zakat.

Riba is an Arabic word which stands for excess, increase, addition, expansion or growth. Any interest or predetermined payment above and over the actual amount of principle is equivalent to *Riba* and is strongly prohibited by the Qur'an and the Sunnah. Chapra (2000b) is of the opinion that the main rationale behind the prohibition of *Riba* is its tendency to act as a means of accumulating wealth in the hands of a few, diminishing the natural concern towards their fellow man. The prohibition of *Riba* is almost universally accepted as a part of Islamic *Shari'ah*.

However, there is disagreement as to the interpretation of its scope and coverage. Similarly, there has been disputes among Muslim scholars as to whether *Riba* as discussed by Muslims is equivalent to interest or usury (Haron and Wan Azmi, 2009). However, despite these disputes there is consensus among Muslim scholars that the word *Riba* embodies both interest and usury (Mirakhor, 1987b). This