

# THE CONCEPT OF ISLAMIC BANKING IN SRI LANKA: PERSPECTIVE OF ISLAMIC BANK CUSTOMERS IN COLOMBO

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**ABSTRACT:** Islamic banking as an alternative banking and finance method is one of the fastest growing industries in the world. With double digit growth rate, the operations of Islamic Banks had been accepted and adopted in more than 75 countries. In Sri Lanka, Islamic Banking and Finance operations started in late 90`s. Since then this industry is growing in term of Islamic Financial Institutions, customer base as well as asset value. Even though the growth had been slow in Sri Lanka compared to other countries still the industry claims that their penetration in the market had been gradual and stable. The purpose of the study is to explore the concept of Islamic Banking among the Islamic Banking customers. The Objective of this paper is to explore whether the Islamic Banking customers are aware of the fundamentals of Islamic Banking. The methodology used is an exploratory descriptive study. Sample sizes of 150 Islamic Banking customers in Colombo district were selected for this study. Research findings show that the Islamic Banking customers are aware of the concept of Islamic Banking, and are positive and futuristic about the Islamic Banking in Sri Lanka. This study contribute significantly to understand the Islamic Banking customers and is the first study in this nature in Sri Lanka

**Key Words:** Islamic Banking, Shari`ah, Customer Perception, Islam

## 1. INTRODUCTION

Islamic banking, a branch of Islamic Finance is a financial system built on the principles of equity. The basis of operation in Islamic Banking is based on profit and loss sharing basis. The concept of Islamic Banking is fairly young compared to the mainstream conventional banking system. Nevertheless, the growth of Islamic Banking as an alternative financial system has been tremendous. Today, Islamic banking is practiced in more than 85 countries with over 700 Islamic Financial Institutions adopting and offering Islamic banking and Finance products and services (Siddiqui, n.d.). In Sri Lanka, Islamic banking was first introduced by Amana investment in year 1997 (KPMG 2011; Amana Bank, n.d.). Started primarily to cater for the Muslim community as a private operations, had become to be one of the growing financial sector in Sri Lanka. At present more than 19 financial institutions are offering Islamic finance services in Sri Lanka, including one fully fledged Islamic bank and seven Islamic banking window operation (Fawzer 2015; Kamil 2015). Overall the performance of Islamic banking services has been steady but slow (Senewiratne 2013; Kamil 2015). There is a huge potential for the Islamic banking and finance industry to grow and reap its full potential with proper regulatory and institutional support. There had been valid concerns over this burgeoning industry in Sri Lanka that need to analysed in detail. This paper examines the concept of Islamic banking with the Islamic Banking customers. The study is conducted through an empirical research to investigate the reasons and motives of choosing an Islamic banks. The findings of this study will benefit the Islamic banking operators, regulators in devising strategies to develop and sustain Islamic banks in Sri Lanka.

## 2. LITERATURE

The concept of Islamic Banking and Finance first started to be prevalent in early 60,s with the start of MitGhamr Savings Bank in Egypt and Pilgrims Saving Corporation of Malaysia (Ayub, 2007). In essence, Islamic banking operations are very similar to traditional banking

operations, except for the need to comply with the Islamic jurisprudential requirements on financial dealings known as *fiqmu`amalat* or *Shari`ah* (Sultan, 2013). Hence, the key difference between Islamic Banking and Conventional banking is the application and implementation of *Shari`ah* compliance. *Shari`ah* refers to a code of law that regulates the conduct of human beings in their individual and collective lives. Ayub (2007) states Islamic Finance strives for justice, fairness, trust, honesty, integrity and balanced society inspired by the objectives of the *Shari`ah* (ISRA, 2012)

Islamic Banking is prominently known as “interest-free banking”, however, Islamic banking denotes a broader concept which adhering to the *Shari`ah* principles not only avoids Interest or well known as Riba, It also needs to avoid Gharar a term used to describe uncertainty or avoiding risk as well as Maysir term used to delineate to Gambling are also prohibited. Islamic Finance promotes transparency, recording and moral values

Islamic Banking can be classified into two categories (ISRA, 2012): firstly, Islamic banks coexisting with interest-based banks (well known as Islamic Banking windows), as well as banks operating under a binding and all-embracing Islamic banking system.

Despite the fact many customer opt for Islamic banks due to their religious commitment and beliefs, according to a survey conducted in Singapore it was found that religious motivation does not play a primary role in banking selection (Gerrard and Cunningham, 1997; Akbar et al, 2012). People prefer banks based on the services and facility provided to the customers. The most important bank selection criteria were: the provision of a fast and efficient service; the bank's reputation and image, and; confidentiality of the bank.

### **Islamic Banking and Finance in Sri Lanka**

The concept of Islamic banking and Finance was first introduced by Amana Investment in 1997 which is converted into a fully-fledged Islamic Commercial Bank in 2011( AmanaBank,n.d). Through limited resources and lack of proper legal and regulatory framework, Amana Investment paved the way to the establishment of Islamic Finance sector in Sri Lanka. For last 15 years of existence, Islamic Banking and Finance industry in Sri Lanka has made their progress steadily. Presently there are 6 Islamic Banking windows and 1 full-fledged Islamic Bank operating out of 35 licensed commercial banks in Sri Lanka.

A significant milestone in Islamic banking industry in Sri Lanka is the amendment to the Banking Act No 30 of the 1988 in 2005. This opened a huge opportunity to many banks and finance companies to explore the avenues of Islamic finance. According to Seniwiratne(2013) Islamic Finance market has an estimated market of around Rupees 300 billion, with total deposit base of nearly Rupees 35 billion and the total loan base of Rupees 25 billion.

Sri Lanka has rightly taken steps to include diversity and flexibility in financial sector to unleash all the potential opportunities with more choices for customers. Nevertheless, according to Krishan Thilakaratne the growth is taking place very slowly compared to conventional counterparts (Dailymirror, 2014). As Islamic finance sector only accounts for less than 1% of the total banking and finance sector. There is a vast amount of industry potential where Sri Lanka can gain from. He further questioned whether opening windows in banks in Sri Lanka really committed to taking Islamic finance into grass root level.

## Challenges faced by Islamic Banking and Finance Industry in Sri Lanka

As highlighted by Krishan Thilakaratne (Dailymirror, 2014) “Sri Lanka’s Islamic finance sector has been growing at an unsustainable pace and thus failed to see its full potential”. Lack of Knowledgeable human resources is a key drawback of Islamic finance sector. Most employees are conventionally trained and experienced, thus, have the same mindset as the conventional banks.

Another major issue that curtailed the development and growth of Islamic banking and finance sector in Sri Lanka is the cultural perception that Islamic banks promote Islam and terrorism and implementing Shari`ah Law will lead to many religious conflicts (Dailymirror, 2014). Hence, the Central Bank of Sri Lanka is reluctant to encourage and develop Islamic Finance, thus it lacks proper regulatory and legal framework to sustain the growing industry.

One of the major issue that has pointed out is the lack of awareness in terms of Islamic Bank products and services (mirrorbusiness, 2014)

### 3. METHODOLOGY

This study is an exploratory descriptive study to understand the concept of Islamic Banking in Sri Lanka. A questionnaire survey was distributed to customers who has an account in an Islamic bank or an Islamic window in Sri Lanka. Questionnaire generally regarded as an important research tool in a primary research. Questionnaire was distributed to 150 customers in Colombo district. The sample was collected from Colombo 4 and 5 cities only using a convenient sampling method. Customers were selected randomly who were willing to fill in the questionnaire. The data were collected in 5 working days from 9am to 4 pm. Out of 150 questionnaires distributed, there were 121 valid questionnaires. Therefore, the response rate is 81% which is fairly a good response rate. The questionnaire was developed by the researcher that has been tested for reliability by the Cronbach’s Alpha with a score of .68. This score shows that the questionnaire fulfills the reliability requirement. The questionnaire comprised of 17 questions to assess the perception of Islamic banking customers. Out of this 7 questions were based on the demographic profile of the respondents. Rest of the questions was exploring customer preferences. Descriptive statistics are calculated using Statistical Package for Social Sciences (SPSS) version 19.

### 4. RESULTS AND DISCUSSION

*Table 1. Demographic Profile of Respondents*

No	Questions	Description	Percentage
1	Gender	Male	85%
		Female	15%
2	Age Group	Less than 20 years	10%
		20 years to 40 years	65%
		40 years to 60 years	22%

		60 years and above	3%
3	<b>Type of Deposit Account</b>	Islamic Current Account	28%
		Islamic Investment Account	53%
		Both	19%
4	<b>Religious Belief</b>	Muslims	91%
		Non-Muslims	9%
5	<b>Marital Status</b>	Single	37%
		Married	63%
6	<b>Academic Qualifications</b>	High School	36%
		Diploma	20%
		Bachelor/ Profession	34%
		Post graduate	8%
		Others	2%
7	<b>Occupation</b>	Public Sector	6%
		Private Sector	52%
		Self-employed	25%
		Student	11%
		Other	6%

Table 1 presents the demographic profile of all the respondents. Splitting the sample on the basis of gender revealed that 85% were male, whereas 15% were female participants. The majority of the respondents 65%, are from the age group 20-40 years, whereas 22%, are from the age group 40-60 years and 10% represents the age group of less than 20%. This shows that most customers are young adults. In addition 91% represents Muslim population and only 9% consist of non-Muslims. This reveals that the awareness among non-Muslim about Islamic Banking products and services are less. When looking at the educational qualification 36% have high school qualification, 20% are Diploma holders, and 34% possess professional qualification or bachelor's degree and 8% having post-graduate qualifications. On the basis of profession, it is revealed that majority 52% are private sector employees, 25% self-employed, 6% comprises of public sector and 11% consists of students. This shows a good mix of diverse professional. In terms of marital status majority of 63% is married and the rest 37% were un-married respondents.

When the sample is split on the basis of type of account, it revealed that 53% have investment account and 28% current account and 19% had both investment and current A/C.

*Table 2. Perception of Islamic Banking Products and Services*

No	Questions	Description	Percentage
8	Knowing Haram to receive interest	Yes	97%
		No	1%

		Not sure	2%
9	Knowledge about Islamic Finance	Not much	21%
		Sufficient Knowledge	70%
		Very Well	9%
10	How did you get to know about Islamic Banks	Bank Employees	31%
		Media	21%
		Internet	6%
		Friends/Family	42%
11	Reasons to choose Islamic Banking	Religion	92%
		Convenient locations	2%
		Family/Friends	2.50%
		Ethical	2.50%
		Cheap Product	1%
12	Important Aspect of Islamic Banks	Shari`ah compliant	92%
		Cost	1%
		Convenience	3%
		Service offered	4%
13	Knowledge about how deposits are invested	Yes	35%
		No	45%
		Not sure	20%
14	Switch to other Islamic bank in the future	Yes	26%
		No	74%
15	How do you differentiate banking services	Interest/Profit rate	40%
		Convenience	24%
		Cost of Banking	6%
		Service provided	30%
16	Do you feel that the cost of Islamic Banking products and services are costly	Yes	35%
		No	35%
		Not sure	30%
17	If products and services of Islamic banking is costlier will you consider being a customer of Islamic banking	Yes	70%
		No	30%

The outcome of questions 8-17 are highlighted in Table 2. The table exhibits that vast majority 97% knows that it is haram to receive interest. With regard to the knowledge about Islamic Banking 70% revealed that they have sufficient knowledge and 21% does not have adequate knowledge pertaining to Islamic Banking products and services, while 9% states that they have very good knowledge. This is a positive outcome for the Islamic Finance industry in Sri Lanka.

For the question how they got to know about Islamic Banks 42% stated through friends and relatives, 31% through bank employees, whereas, media and interest only contributed to 21% and 6% respectively. This shows evident that the marketing initiatives undertaken by Islamic Banks needs to give more importance and emphasis to marketing activities through mass media and social media. When posed the question the reason why they opted for Islamic Bank, 92% stated it's because of religion. Other factors like convenience, ethical, relative influence, and cheap only constituted for 8%. The same outcome was presented to the question as to what is the important aspect of Islamic Banks, 92% said it's the Shari'ah compliant. Only 8% feel cost, convenience, and service offered as important aspect of Islamic Banks. When inquiring about the knowledge about how their deposits are been invested, 45% said that they have no knowledge about it and 35% said that they are aware of how the deposits are invested, and 20% were not sure about this. This indicates that Islamic Banks customers are not fully aware how their money is utilized, shows the transparency and disclosure aspect of the Islamic Banks should improve.

When asked whether they will switch to other Islamic Bank in the future 74% said no and 26% said yes. For the question how they differentiate banking services, 40% stated through interest/ profit rate, while 24%, 6%, and 30%, said based on convenience, cost of banking and services provided respectively. 35% feel that the cost of Islamic Banking products and services are costlier, whereas 35% said otherwise that they do not feel that Islamic Banking products and services are costly, however, 30% is not sure regarding the cost. When asked whether they will switch to another Islamic Bank if the products and services is costlier 70% said yes and 30% said no. This is a good indicator that customers in the Islamic Banking sector are influenced by cost factor.

## **5. CONCLUSION**

The main purpose of this study was to explore customers understanding of the concept of Islamic Banking in Sri Lanka. To achieve this purpose the researcher provided empirical evidence about the real nature of Islamic banking products and services. Questionnaire survey was conducted sampling 121 individuals in the Colombo district of 4 and 5. The aim was to gauge their understandings about Islamic banking. The results reveal that the majority of the respondents have selected Islamic Banks due to their religious beliefs, and Shari'ah aspect is the most important aspect of Islamic banks. It is also revealed that most customers are sensitive towards costs associated with Islamic Bank products and services. This study also shed light to the fact Islamic Banks in Sri Lanka lacks marketing initiatives in creating awareness and promoting Islamic Banks products and services as well as awareness among non-Muslim has not been utilized. Another significant fact about the demographic profile of customers is mostly young adult which indicates long relationship with Islamic Banks as well. Overall the findings show that the Islamic Banking customers are

aware of the Islamic Banking concept. However, this research does not give in-depth analysis into the operationalize perspective of Islamic banking compare to the conventional banking applicable in Sri Lanka.

## **6. LIMITATIONS AND FUTURE RESEARCH**

The research scope of this study is limited by sample size and sample area. Only Colombo district were taken into consideration, in that only two main cities were surveyed. If this study is expanded to other areas it will give a comprehensive insight into the application of the concept of Islamic Banking in Sri Lanka. Further the study was only limited to few Islamic Banking operators in Sri Lanka, which can challenge the reliability of the research. Future research into more Islamic operators and wider geographical area will be encouraged and will benefit the Islamic Banking industry in Sri Lanka. This is study is also limited to descriptive analysis only. More advance analysis will invariably give a better understanding of Islamic Banking customers in Sri Lanka.

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