Consumer trust and confidence in the compliance of Islamic banks

Abstract

Islamic banks compete with traditional (non-Islamic) banks for customers. This paper aims to provide insight into why some Muslims choose to bank with Islamic banks in Pakistan, while others do not. Specifically, it addresses the questions: to what extent are trust and confidence active influencers in the decision making process, are they differentiated or are they one of the same? Also how does the Pakistani collective cultural context further complicate the application of these concepts. For the purposes of this paper trust refers to people and their interpersonal or social relations whereas confidence concerns institutions such as banks. Drawing on interviews with Muslim consumers in Pakistan this study provides further insight into consumer behaviour within financial services and specifically Islamic banking and contributes to our theoretical understanding of the concepts of trust and confidence.

Key words

Confidence, trust, Islamic banking, religion, compliance, Pakistan.

Introduction

Islamic banking has witnessed substantial growth in recent years and is still expanding (Khattak *et al.*, 2011). In part, this success can be attributed to the size of the Muslim market, being the second largest population in the world (Desilver, 2013; Grim and Hsu, 2011). In addition, religious guidance encourages Muslims to use banks that comply with Shariah principles. Indeed many studies identify adherence to Islamic principles as among the main reasons for Muslims to choose an Islamic bank (Dusuki and Addullah, 2007; Omer, 1992; Metawa and Almossawi, 1988).

Islamic banks do not however operate in isolation and compete with traditional banks for customers (Naser & Moutinho, 1997). Within Islamic countries, Muslim customers are known to bank with both Islamic and traditional banks (Dusuki & Abdullah, 2007). Reasons for this may include low knowledge of Islamic banking principles and poor awareness of Islamic banks (Khan et al., 2008; Khattak & Rehman, 2003). In addition, some scholars have cast doubt on the importance of religion in the choice of an Islamic bank (Tamimi et al 2009; Erol et al., 1990) and yet others have questioned whether all Islamic banks comply with Shariah principles and are truly 'Islamic' (Khan, 2010).

This paper aims to provide insight into why some Muslims choose to bank with Islamic banks, while others do not. Specifically it seeks to answer this question using the concepts of trust and confidence. Trust and confidence, although different, are often used interchangeably in the extant literature. For the purposes of this paper trust refers to people and their interpersonal or social relations whereas confidence is something people have in institutions (Jackson and Bradford, 2010; Tilly, 2005; Luhmann, 1979).

The importance of trust and confidence has already been well established in the financial services and banking sectors (see for example, Ennew et al, 2011). In the context of Islamic banks, trust and confidence can be attached to the bank as a provider of financial services and also to the notion of religious compliance and whether Islamic banks adhere to Islamic principles.

The context for this study is Pakistan. Pakistan is an Islamic country. It has a dual banking system with both Islamic and traditional banks; however traditional banks have the greater market share (SBP, 2012). This paper addresses the following research questions: to what extent are trust and confidence active influencers in the decision making process, are they differentiated or are they one of the same? Also how does the Pakistani collective cultural context further complicate the application of these concepts.

Literature Review

Trust and confidence are often used interchangeably in the contemporaneous literature. As a result key differences and the relationship between the two are often difficult to distinguish. In this section, we draw on the psychology, sociology and marketing literature in order to define and distinguish between the two concepts. Trust and confidence are then considered in the context of financial services and finally Islamic banking.

Trust

Trust is a complex and multifaceted phenomenon (Dimitriadis et al., 2011; Flavian et al., 2005; Lewicki & Bunker, 1996). As such there exists a lack of consensus on the definition of trust among researchers (Ibrahim et al, 2009; McKnight & Chervany, 2002; Lewicki & Bunker, 1996). In part this confusion of definitions may arise as trust is known to be affected by context, personal and cultural factors respectively (Rachan and Satkunasingam 2009; McKnight and Chervany, 2002; Panagiota et al., 2002; Palmer et al., 2000). Trust in a banking context is therefore likely to differ from trust in other, non-financial, contexts and from one country to another.

Most scholars identify three characteristics of trust: cognitive; affective and behavioural (see for example, Cummings and Bromiley, 1996; McAllister 1995). Cognitive trust is the rational element of trust and is based on the trustor's knowledge of the other party and their capabilities; it is a learning process (Castaldo, 2007). If knowledge is complete then trust is not required (Johnson and Grayson, 2005). Rempel et al. (1985) refer to this as predictability whereas Johnson-George and Swamp (1982) call it reliableness. Affective trust concerns the emotional aspect of trust, the establishing of an emotional bond (Lewis and Weigert, 1985) and is generated by a feeling that the trustee has concern for the trustor (Johnson-George and Swamp, 1982; Rempel et al., 1985). Finally, behavioural trust is the willingness to act (Morgan and Hunt, 1994). Behavioural trust flows from and is therefore a consequence of cognitive and affective trust (Lewis and Weigert, 1985; Johnson and Grayson, 2005).

However, most of these studies are conducted in a western context and may not be relevant in other cultural contexts where religion has a strong role as a cultural element (Ali, 2014; Khraim, 2010; Panagiota et al., 2002). Indeed, the roles of cultural dimensions of collectivism and individualism have gained attention in the operationalization of the trust concept (Gelfand et al., 2006). Collectivism shows higher sensitivity to contextual signs such as predictability and benevolence (Mohamed et al., 2011) which is integral for countries like Pakistan (Vohra et al., 2009). In addition the fundamental aspects of the Pakistani culture is kinship; the community and the collective self strongly influences decision making at all levels.

Confidence

As with trust, there also exists confusion over the definition of confidence and how it differs from trust (Sevenson, 2006; FSCP, 2005; Rousseau et al., 1998). Confidence may be a part of trust (Sevenson, 2006; Moorman et al., 1992) and trust may influence confidence (Scott, 2010).

In defining confidence, Sevenson (2006) discusses the expectations one possesses from the institutions in using the rules and routines in their practices and following procedures. Giddens (1990) defines confidence as a faceless commitment which relies on the fulfilment of professional knowledge and expertise. Yet others have defined it on the basis of an institution’s reputation without having experienced the service personally (Kramer and Tyler, 1997; Giddens, 1990). An individual’s perception plays a vital role in confidence formation (Elliot, 1997). This perception is formed through the experiences of others (Fineman 2000; Malin

2000), or media opinions, or both (Sevenson, 2006). Scott (2010) perhaps best summarises the difference when he explains that trust can inspire confidence but confidence relates more to an approval of performance and reliability.

Trust and confidence

There are three key differences between trust and confidence. First, trust refers to people and their interpersonal or social relations whereas confidence is something people have in institutions (Jackson and Bradford, 2010; Tilly, 2005; Luhmann, 1979). It is the human aspect that differentiates trust from confidence (Newton, 2007; Barber 1983). A consumer may have confidence in their bank but may not have trust, although they may trust individual bank employees through personal relations built with them.

Second, trust is defined as what you do and confidence is what one has (Roberts & Hough, 2005:30-31). Trust is therefore more action or behaviour based, for example, opening a bank account. Confidence relates to the reputation an organisation has in terms of its systems, procedures or compliance (Sevenson, 2006). Consumers can have confidence in an institution without necessarily holding an account. It is the reputation of that institution drawn from secondary sources such media reports.

Finally, trust is only required in uncertain, vulnerable and risky situations (Ennew and Sekhon, 2007; Luhmann, 1979) as trust provides stability (Ennew and Sekhon, 2007). Confidence, however, can exist independent of risk (Luhmann, 1979). This links to the preceding point, as trust exists in the context of consumer behaviour (where risk can be present when purchasing a financial service product) whereas confidence can be independent, for example, confidence in the banking sector or financial services industry as a whole.

Trust and Confidence in financial services

The importance of trust in the financial services sector is widely accepted (see for example, Sekhon et al., 2014; Sekhon et al., 2013; Ennew et al., 2011; Becket and Hewer, 2000; Bejou et al., 1998). Financial services are intangible and therefore difficult to evaluate prior to purchase or even consumption. The products are often complex and infrequently purchased. Ownership is not transferred and the product, or promise, is not realised until a future date, often a year or decades later (Farquhar and Robson, 2014). Consumer trust, in some form, in the financial services provider is therefore essential for transactions to take place (Ennew et al., 2011).

Much work has been conducted to measure trust in financial services. Indeed, Ennew and Sekhon (2007; 2011) work in a western context proposed a framework to measure organisational trustworthiness which they define as the extent to which consumers perceive that a financial institution is worthy of their trust. This they suggest can be determined by communications, shared values, integrity, ability/expertise and benevolence (Ennew and Sekhon, 2007). They define low level (or cognitive) trust or trustworthiness as the extent to which an organisation can be relied on to do what it says it will do. Higher level (affective) trust or trustworthiness relates to the extent to which the organisation is concerned about the interests of its customers (Ennew and Sekhon 2007). Notably, Ennew and Sekhon (2003) conclude that trust is an attribute of consumers and is not something that a financial service institution can directly manage.

Confidence has increased in frequency in the financial services literature in recent years following the financial crisis. Scholars have sought to measure consumer confidence as part of the recovery of the banking sector, often without defining confidence or phrasing questions in terms of trust rather than confidence. Measures of confidence have included, confidence in the people running the banks (Owens, 2012), the institutions themselves (Owens, 2012; Gritten, 2011) and in financial services industry in general (Owens, 2012).

Trust and confidence in Islamic Banking

Within the Islamic banking context, trust and confidence are important in consumer choice. Previous studies suggest that it is not only confidence in the provider as a bank that is relevant, but also confidence in terms of compliance and that the bank adheres to Shariah principles (Hoq et al., 2010; Amin and Isa, 2008).

In terms of the confidence in the bank as a financial institution, previous studies have identified financial stability by means of assets and financial position as important (Hussein, 2010; Rashid and Hassan, 2009) as well as corporate efficiency (Rashid and Hassan 2009) and trust in the bank management (Rashid and Hassan, 2009; Erol et al., 1990; Erol and El-Badour, 1989) as a key factors. Whereas trust is more precisely defined as a fulfilment of a promise and expectation that the bank will act to protect customers' long term interests (Hassan et al 2008). In the context of Islamic banking in Pakistan, trust is defined as the attainment of positive feeling after fulfilling one's expectations regarding any product or service (Rizwan et al 2014). Within a collectivist culture like Pakistan predictability and benevolence are particularly important (Vohra et al 2009).

Shariah compliance is also known to be of importance to Muslim customers when choosing their bank. Many studies have found Islamic reputation and adherence to Islamic principles to be the main reasons for choosing an Islamic bank (see for example, Yahya et al 2012; Thambiah et al., 2011; Dusuki and Addullah, 2007; Jabnoun and Khalifa 2005; Metawa & Almossawi, 1998; Omer, 1992). However, others have called this assumption into question as religion has not always been identified as an important factor in choosing an Islamic bank. Erol and El-Bdour (1989) and Erol et al. (1990), for example, found that religion was not listed in the top criteria when choosing a bank. In addition, Tamimi et al (2009) report that the most important factor in choosing a bank was the bank products followed by service quality and then religious factors. Indeed, many factors other than religion have been found to be important when choosing an Islamic bank account including fast and efficient service (Gerrard and Cunningham, 1997; Hegazy, 1995; Erol and El-Bdour, 1989) bank reputation and image (Naser et al 1999; Gerrard and Cunningham 1997; Erol et al., 1990; Erol and El-Bdour, 1989) confidentiality (Erol et al., 1990; Erol and El-Bdour, 1989); and profitability (Metawa and Almossawi, 1998).

All these studies reflect the uncertainty about why consumers choose to bank with an Islamic bank and the need for the bank to be Shariah compliant. This study provides further insight into whether trust or confidence in an Islamic bank's compliance affects consumer banking behaviour.

Islamic Banking

Islamic banking is based on Islamic, or Shariah, principles (SBP, 2014). Islamic banks provide essentially the same products and services as traditional banks but by different means (Iqbal and Mirakhor, 2007; Warde, 2000; Naser et al 1999; Metwally, 1996). Notably, interest and the crediting or debiting of interest (i.e Riba), does not take place (Ongena & Yuncu, 2011; Khan, 2010; Chong & Liu, 2009; Glaeser & Scheinkman, 1998). Moreover Islamic banks forbid the investment of money in companies which deal with interest (Ray 1995) and contracts which involve risk or speculation (Khan and Mirakhor 1990).

There is, however, debate in the literature about the extent to which Islamic banks are truly Islamic and whether they do differ from traditional banks. Some writers argue that Islamic banks mimic traditional banks (Khan, 2010) and differ only in terms of the terminology they use (Kuran, 2007; El Gamal, 2001; Kuran, 2004). Indeed, occasionally Islamic banks have been found to be non-Shariah compliant, for example, as the Faisal bank of Egypt and Al Baraka Islamic bank of Pakistan (Khan, 2010).

This study looks to build on the work of Butt *et al.* (2011) who cast doubt on the assumed belief that consumer's trust Islamic banks to adhere to Shariah principles and to provide further insight into whether Pakistani Muslim consumers trust Islamic banks to comply with the Shariah requirements and how this trust affects their banking behaviour. This article explores the factors influencing choices made with regards to banking, to what extent are trust and confidence active influencers in the decision making process, are they differentiated or are they one of the same? Also how does the Pakistani collective cultural context further complicate the application of these concepts. Is it simply a case of consumers who trust and have confidence in Islamic banks, bank with them, and those that don't, choose traditional banks?

Methodology

Qualitative semi structured interviews were undertaken in order to gain insight into consumer confidence in the Islamic banks' compliance with Shariah principles. For this purpose, 15 semi structured interviews were conducted. Snowballing was used to identify interviewees. The interviews lasted between 45 minutes -1 hour. All interviews were recoded and transcribed. Data was analysed manually and key themes identified and coded. The transcripts and themes were analysed, discussed and the interpretation compared by the individual authors (Morse 1994).

Findings

Interviewees were predominantly male (2 females and 13 males) reflecting the social setting where males are predominantly the head of the household and responsible for financial and other decisions in Pakistan (Siddiqui, 2011). The gender imbalance did not however skew the results, males are the dominant decisions makers and so this sample fits in with the cultural norms and values in Pakistan. Over half (8) of the respondents were aged between 31 and 40, three were between 25 and 30 and three were between 45 and 50 and one was 51 years old. All but one was in full time employment. All respondents were Muslim.

Consumer knowledge, trust and confidence

Echoing previous studies, we found that consumer understanding of the workings of Islamic banking was not strong (Khan et al., 2008 ; Okumus, 2005; Khattak and Rehman, 2003). Most respondents were aware that interest was not paid and were familiar with some of the common terms associated with Islamic banking (e.g.Ijarah, and Morabha), however, more detailed knowledge was lacking.

> *I don't know much about it except the fact that it is interest free banking.*

This lack of knowledge resulted in the consumer questioning the banks compliance with Shariah principles and this uncertainty led them to have doubts about the bank's compliance. However, such consumers nonetheless continued to be a customer of the bank as they were simply not sure. This shows that faith in the religion is strong and influences decision making. The strength of religious ties impacts the choices made, so supporting previous studies (Naser et al., 1999; Metwally, 1996).

> *For me, although I have some doubts if the banks are doing what they say to us, like my bank is an Islamic bank (at least its name says it is), but still I have got a TDR (term deposit certificate) and I don't understand how this is not an interest based certificate.*

Where customers' understand the banks and their services better, they still can have doubts, but again the customer is willing to continue banking with the bank. Doubts may be expressed, nevertheless they are dismissed and ignored, implying an implicit level of trust, that may not be outwardly expressed but is inherent amongst the participants

Well, I was curious myself to know more about Islamic banks since my friend has started working for one of the banks. I read the material online about Bank X's procedures and got enough knowledge about it. Now I don't think banks are following it properly, but still I would go for one!

It would seem that the participants do not display a cognitive level of trust or have confidence in the bank, they question what the banks are actually doing to following Shariah principles.

Islamic cues, trust and confidence

When explaining their choice of bank, participants did so, on the basis of Islamic cues. For example, if the bank had an Islamic name and/or described itself as compliant, this was sufficient for some customers. The rationale for this was that it was better to bank with an Islamic bank that was not fully compliant than a traditional (non-Islamic bank).

In addition, most respondents were also less likely to trust banks with an Islamic window, i.e. traditional banks with a separate Islamic arm (a well-known example is HSBC with its Islamic arm: Amanah):

I don't trust my bank even if it says it is Islamic (referring to a bank with an Islamic window).

The ownership of an Islamic bank by a traditional bank makes it difficult for consumers to trust or have confidence in their bank, although in this specific case the customer continues to bank with that bank.

Once again this demonstrates the strength of religious ties the participants have, it is clear from the findings that the importance of choosing an Islamic bank is a key; this choice goes beyond traditional financial decision making but is rather influenced by the participants faith, while recognising that they need to know and understand further the complexities of the banking sector. It is clear from these findings that the participants have a certain level of affective trust, their trust, albeit limited is based on their emotions and their loyalty to their religion, rather than on actual knowledge of the banks policies and procedures relating to Shariah principles.

> *I am dealing with the bank whose name states Islamic, which means it has at least some Islamic touch which is better than nothing.*

Consumer interest in financial services is typically low and it would appear in the above examples that the customers have taken some steps to ensure that they bank with an Islamic bank that *prima facie* complies with Shariah principles, but they have not taken additional steps to ensure that this is indeed the case. Here, trust does not appear to be a pre-requisite to opening or maintaining an Islamic bank account. In addition it is clear that the participants place greater importance in meeting their religious needs rather than simply looking at commercial gain. The desire to fulfil religious expectations is at the forefront of their thinking, even though they recognise that they need to develop their understanding further.

<u>Interpersonal relationships, trust and confidence</u>

Trusting the bank to be Shariah compliant was not at an institution level but at an inter-personal level (Moorman *et al.*, 1992). Where the customer did not have confidence in the bank he would follow the advice from a trusted source – in this case an employee of the bank. Word of mouth recommendation is a significant influencer, supporting the cultural values of the country, that of kinship, friendship and being part of a collective community.

> *I have doubts about the system, and I am not fully satisfied but as far as I know Ahmed (customer relationship officer), nothing would happen. Because he knows the system more than me and I know he would always give me genuine advice and would never cheat on me in my financial dealings.*

Employees therefore have a role in reassuring the consumer that the bank is compliant and suitable to do business with. Although interestingly there are those that are not fully confident in trusting the personnel's opinion and feel that they are making the best decision under the circumstances and with the limited level of knowledge they currently possess.

> *Even if you talk to bank personnel's, they themselves are not sure if the best practices are followed, then how would I know!*

> *Most of the people say these banks are not following Islamic principles and others say they may. I do not have knowledge about financial system myself so I have to decide on the basis of people's opinions.*

Product type, trust and confidence

The need for a bank to be Islamic was found to differ according to the type of banking product:

> *I deal with a bank* (a traditional bank) *but don't put my savings in it.*

Here, the interviewee was explaining that he used a traditional bank for his current account, but an Islamic bank for his savings. Typically current accounts earn little or no interest and therefore may be seen as Shariah compliant in that sense – however the account and bank would not be. This customer is differentiating between different banking products and is not prepared to save with a traditional bank where interest would be earned, which is clearly against Shariah principles. A customer's relationship with a current account and a savings account may be different and therefore the need for trust in Shariah compliance also differs.

It is clear from these findings that both trust and confidence is implicitly questioned by the participants. The strength of confidence in the banks is weak and is questioned by many. Any trust that does exist links to relationships with employees and personnel of the bank although this varies, from one participant to another. This thus supports that, in the main trust concerns the individual and is ever evolving, whereas confidence relates more to the organisation, including pre-held and actual perceptions held by the participants.

Discussion and Conclusions

This paper aimed to provide insight into the role of trust and confidence in the decision making process where Muslims choose to bank (or not to bank) with Islamic banks in Pakistan. Levels of trust and confidence were not found to be strong and this is directly linked to knowledge levels. Those from the indigenous population are not fully aware of what it means to be an Islamic bank and do not know if their banks adhere to the principles that they are aware of. This finding not only echoes previous studies of Islamic banking where knowledge has been found to be low (Khan et al., 2008; Okumus, 2005; Khattak and Rehman, 2003), but the willingness to act on the bank's compliance at face value reflects findings from research on other halal products, in particularly halal meat (see for example Salman and Siddiqui, 2011; Ahmed, 2008) where the customer did not actively seek evidence to the contrary, i.e. to cast doubt on the supplier's compliance. In addition, the willingness of customer's to act where doubt existed may also reflect general customer apathy known to exist within financial services where customer lack interest in the subject matter and are unwilling to take the time to fully research the choices available to then (Farquhar and Robson, 2014)

Participants feel that they need to know more, however, there is a strong tie to religious practices that draws them into following and using Islamic banks even though they may not feel a strong level of confidence and trust in the banks. The authors found this particularly surprising as the majority of participants held post-graduate qualifications and so had a high level of education as well as being the main decision makers for finance related issues.

Evidence of affective trust was found, however this was not with the bank, but personified in the relationship between the bank employee and the customer. The participants were looking to the employees as someone they could trust to advise them. This is the human side of trust (Newton, 2007; Barber 1983). In the context of this study, this opportunity to build trust disappeared when the bank's personnel themselves lacked knowledge about and its compliance with Shariah principles. Bank personnel have long been known to reduce risk, build trust and improve customer satisfaction (Bejou et al 1998) and in a culture such as that which exists in Pakistan, the importance of the role of bank personnel in communicating Shariah compliance is clear. It would seem that participants are still questioning their and the employees understanding regarding Islamic banking principles, however their strong loyalty to their beliefs and religion mean they continue to choose Islamic banks over traditional banks where possible.

The findings from this research have implications for managers. First, the willingness of those interviewed to use traditional banks for their current accounts is likely to be of concern for managers of Islamic banks. Customers using traditional banks for their current accounts may go on to buy other financial products from that bank thereby developing a closer relationship and loyalty with that bank. Haron et al (1994) suggested that Islamic banks should not only rely on religion to promote their services. With this in mind, we recommend that Islamic banks adopt a two-pronged approach here using customer education and awareness programmes. Advertising and promotional campaigns can be used to highlight the need to select a Shariah compliant bank for all financial products in order to adhere to Islamic guidelines. In addition, and to ensure that product comparisons can be easily made by potential consumers, Islamic banks should also highlight the positive features of their own current accounts. This would address Muslin's customer's desire to comply with their religious convictions and also provide Muslim customers with the ability to ascertain the quality of the current account.

Second as this study found that consumer decisions are based on the *prima facie* Islamic nature of the bank, i.e. Islamic cues, then banks should examine their Islamic tangibles. The question here is in what ways are they projecting and reinforcing an Islamic image? The Islamic name is a starting point, but other physical evidence can be addressed. In a study based on UK Muslim consumers choosing Islamic banks by Abdullrahim et al (2008) consumers were found to use a wide range of Islamic tangible cue including Islamic inspired architecture, dress code (e.g. female staff wearing hijabs) and closure for Friday prayer time. It would appear that these tangible cues also have relevance to banks in Muslim based countries such as Pakistan to help them to communicate their Shariah compliance.

Finally given the important role that bank personnel have been found to play in building trust (and eroding it) within this study, it is recommend that Islamic banks develop formal internal marketing programmes to more clearly communicate the vision and values of the bank. Focus needs to be given on what it means to be an Islamic bank and how this translates into everyday products and services. This can be achieved through staff training and education, for example weekly briefing sessions on key themes; quality standards assessed through mystery shopping; and rewards systems to recognize best practice. Bank personnel have a strong impact on consumer perception of the brand and the organization (Papasolomou and Vrontis 2006). Internal marketing can also help build rapport, promote word of mouth and reduce perceived risk (Gremler et al 2001; Bejou et al 1998).

This research has several limitations. Data was collected from 15 interviewees in one country, Pakistan. It is recommended that further research continues in the trust and confidence vein but with a larger sample of consumers and in different Muslim and non-Muslim countries to explore further consumer trust and confidence in the banks compliance with Shariah guidelines and its impact on consumer behaviour. A surprising finding from this study has been the difference in importance of Shariah compliance for different banking products. Participants of this study were willing to have a current account at a traditional bank but not invest their savings. Clearly the decision making process if fine grained and we would call for more research into the need for trust and confidence in relation to the different Islamic financial services products including Takaful (insurance) and Sukuk (bonds). In addition, future studies could compare and contrast the role of trust and confidence in other religious contexts (for example Catholic financial service providers) to establish whether compliance is also considered to be relevant to consumers.

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