AWARENESS OF ISLAMIC BANKING PRODUCTS AMONG MUSLIMS: THE CASE OF AUSTRALIA

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Abstract:
The purpose of this study is to analyze Australian Muslims‟ awareness of profit-and-loss sharing financial instruments. A sample of 300 Australian Muslims was surveyed. The survey utilized a short questionnaire containing specific questions relating to the willingness of respondents to purchase profit-and-loss sharing Islamic banking products. The results indicate that the majority of the Australian Muslim population sample would be willing to purchase Islamic banking products, but are not properly informed about profit-and-loss sharing instruments. The results further hint towards a lack of understanding of the principles of Islamic finance. This was deduced from the fact that a section of the population stated that they would not be willing to purchase Islamic banking products if credit facilities were not available, or if the banks shared losses as well as profits.

Keywords: Islamic financing, interest-free financing, profit-and-loss sharing, Australia.

INTRODUCTION

The concept of interest-free financing was practiced by Arabs prior to the advent of Islam, and was later adopted by Muslims as an acceptable form of trade financing. While the system had been used on a small-scale for centuries, its commercial application began in the 1970"s.[1] Since then Islamic financing has experienced worldwide acceptance, and by early 2003 there were at least 176 Islamic banks around the world, with deposits in excess of $147 billion.[2]

While Islamic financing has become popular in both Muslim and Non-Muslim countries, the system has not achieved wide spread success among Muslims in Australia. The main reason for this has been the lack of awareness about the principles of the system among the population.[3]

Australia"s Muslim population is increasing at a rapid pace, and based on the requirement of *Shari'ah*[i], one would expect an increase in demand for Islamic financial products. This has certainly been true in the case of other Non-Muslim majority nations like the UK, where the increase in demand for Islamic products has convinced bank regulators to provide permission for the operation of a purely Islamic Bank.[4] According to the Census of the population conducted in 2001, there are more than 281,000 Muslim in Australia, which is equivalent to 1.5 percent of the total Australian population. This marks an increase of 40 percent in the Muslim population since the previous census was conducted in 1996.[5]

Australia"s experience with Islamic financing has been relatively recent. The first attempt to introduce Islamic financing products in Australia was made by the Muslim Community Co-operative Australia (MCCA).[6] The organization began in 1989 with AU$22,300 worth of seeding capital and by 2003 had 5,600 members and deposits worth AU$24 million.[7] Majority of the MCCA members are from Melbourne and Sydney where the organization has a physical presence. In 2001 another organization, Iskan Finance, started providing *Shari'ah* compliant home financing options.[8]
The purpose of this paper is to ascertain the awareness of, and demand for profit-and-loss sharing Islamic financial products in Australia among the practicing Muslim population. This would represent the most likely purchasers of Islamic banking products in a country with a minority Muslim population. The paper is divided into five sections. Section two provides a brief overview of the Islamic financing system, followed by section three which details the methodology used for this study. Section four reports on the findings and implications of this study, while the final section provides suggestions for further studies.

THE ISLAMIC FINANCING SYSTEM

Islamic financing is based upon the principle that the use of *Riba* (interest) is prohibited.[9] This prohibition is based upon *Shari'ah* ruling. Since Muslims cannot receive or pay interest, they are unable to conduct business with conventional banks.[10]

To service this niche market, Islamic financial institutions have developed a range of *halal*[ii] interest-free financing instruments that conform to *Shari'ah* ruling, and therefore are acceptable to their clients.[11]

The idea of Islamic banking goes back to as early as the seventh century, but it was only commercially implemented in the last century.[12] As the end of the colonial era approached, some of the newly formed and independent Muslim states reassessed their economic policies on the basis of *Shari'ah* principles. This marked the beginning of the present-day revival of Islamic finance. Small scale limited scope interest-free institutions were unsuccessfully tried in the mid 1940"s in Malaysia and 1950"s in Pakistan.[13] From 1946 onwards, research by Muslim scholars gradually produced principles for banking practices that were likely to be acceptable to the banking and Islamic communities. The first successful application of Islamic finance was undertaken in 1963 by Egypt"s Mit Ghamr Savings Bank, which earned its income from profit-sharing investments rather than from interest.[14] By the 1970"s, the push for Islamic finance had gained momentum. In 1973 the conference of foreign ministers of Muslim countries decided to establish the Islamic Development Bank with the aim of fostering economic development and social progress of Muslim countries in accordance with the principles of *Shari'ah*.[15] This marked the first major collective step taken by Muslim countries to promote Islamic finance.

The market leaders in this industry are Citigroup, HSBC, J.P. Morgan, and Standard Chartered who provide Islamic financing products through the use of Islamic windows (special facilities offered by conventional banks to provide services to Muslims who wish to engage in Islamic banking).[16] While a number of Islamic financial products are now available, the most widely recognized profit-and-loss sharing instruments are *Mudaraba* (finance trusteeship) and *Musharaka* (equity partnership). *Mudaraba* is an agreement between two parties, where one provides finance to another for utilisation in an agreed manner.[17] The financier of the venture is known as the *Rabb-ul-mal*, and the entrepreneur responsible for the management and execution of the project is referred to as the *Mudarib*. The parties achieve their returns by sharing in the profits of the venture, which are divided on a proportional basis. Under a *Mudaraba* agreement, returns cannot be provided as a lump sum, and cannot be guaranteed. To fulfill the requirements of this contract the parties must decide on a rate for sharing of the profits prior to the commencement of the business activity. After the business is completed the financier receives the principal and the pre-agreed share of the profit. The remainder of the profit is the entrepreneur"s compensation for their ideas and services.[13]

The other profit-and-loss sharing instrument is *Musharaka* which refers to a joint partnership formed for conducting business in which all partners share the profit according to a specific ratio while the loss is shared according to the ratio of the contribution.[14,18,19,20]

The two profit-and-loss sharing instruments described above are the oldest form of interest-free financing found in ancient Arabia. Prior to the advent of Islam, wealthy Arab merchants financed the caravan trade and would share in the profits of a successful operation but could also lose all or part of their investment, if, for example, the merchandise was stolen, lost or sold for less than its cost.[21] After the introduction of Islam, this system was permitted to continue and was legitimatized as a finance instrument. For this historical reason, scholars consider profit-and-loss sharing financial instruments to be the most authentic and most promising form of Islamic contracts.[22] Yet, partly due to the high risk involved, while the Islamic Banks are expected to grow at an annual rate of around fifteen percent, profit-and-loss sharing constitutes only a small part (about five percent) of their activities.[23] To ensure that Islamic financing continues to follow the concept of linking returns to risks, many scholars have argued for a greater use of the profit-and-loss sharing products.[19,22] Achieving this requires a deeper understanding and acceptance by the Muslim population of the principles of profit-and-loss sharing financing and the available alternatives.

METHODOLOGY

As the main focus of this paper is to examine the level of perceived awareness of *halal* banking among Muslim residents in Australia, a short questionnaire was formed containing specific questions relating to the willingness of respondents to purchase Islamic banking products. Also, questions were picked to distinguish between respondents that believe they were well informed about profit-and-loss sharing agreements, and those who had previously owned (or currently own) a *halal* stylized banking product.

Originally, a pilot study was carried out utilizing a host of questions on a small sample of individuals. These questions were conditional in nature and were used to determine the selection of sample population. The next step was to develop a short questionnaire that would be easy to understand and require minimal time to complete, six specific questions were chosen that; (a) provided maximum coverage of the research questions we were interested in answering; and (b) were not co-related questions. Specifically, this second point deals with the need for most questionnaires that ask a multitude of questions to undertake factor analysis to determine the relative groupings that constitute the framework of the questionnaire. Sometimes, however, factor analysis fails in as much as a subjective element is incorporated into this methodology in setting the appropriate number of latent factors inherent within the data. To avoid this issue, questions that were chosen were specifically selected to ensure the correlations between the variables were low, thereby ensuring each variable specifically targeted a question that could not easily be proxied by another.

The questionnaires were distributed simultaneously by 3 trained[iii] administrators to 300 respondents after Friday prayers at 3 different mosques during June 2004 in the city of Adelaide, Australia. The number of people available for the survey was far greater, but only those people meeting specific selection criteria were asked to complete the six questions. The selection criteria was devised to ensure only those people who (a) came from a Muslim background, and were practicing Muslims, (b) currently owned a bank account in Australia, (c) were interested in *halal* banking products, and (d) gainfully employed were selected (18 years and over). By default, 89% of the respondents were male. This led to a sample dataset of respondents with highly specific demographics. Our dataset therefore analyses the awareness and willingness of this specific cohort of the population for undertaking *halal* accounts. This cohort also represents the demographic of most likely people any profit and loss sharing account would be catering for and so provides an interesting study on how well *halal* banking practices would sell under current informational conditions.

The results tabulated in the succeeding empirical section show cross-tabulations of how the respondents" answers were dependent on their perceived knowledge of *halal* style banking, plus prior experience with these products. Also, results from a logit model are presented, showing the significance of how respondents" familiarity with *halal* banking influenced their willingness to purchase *halal* banking products under various conditions. The logit model is a maximum likelihood regression where the dependent variable is a binary variable (yes=1 or no=0 answers). A standard linear regression would not be suitable, as the conditional mean equation would place unsuitable assumptions on the residuals of the model, as now the dependent variable can only vary between 0 and 1. Instead, we model the probability of observing a value of 1 as a function of *F*, which is a continuous, increasing distribution that returns a value ranging from zero to one. Specifically, for a latent variable y_i that is linearly related to *x*, then the logit regression of:

$y_i = x_i'\beta + u_i$ where u_i is random noise and *ß* is a vector of coefficients for the independent variables, the probability of obtaining a one can be written as:

$$\Pr(y_i = 1 \backslash x, \beta) = 1 - F(-x_i'\beta) = 1 - (e^{-x_i'\beta}/(1 + e^{-x_i'\beta})) \qquad (1)$$

where *F* is now a cumulative distribution function for the logistic distribution. The main difference with this type of regression and normal ordinary least squares regressions is that the coefficients of the explanatory variables do not show the marginal effect on the dependent variable. The sign and significance values attributed to the coefficients remain, however, the same. For example, the more positive a variable is, the greater the probability of a positive value being attributed to the dependent variable.

To provide a goodness-of-fit test for the above maximum likelihood regression, the Andrews (1988)[24] χ^2 test is performed for each regression. It tests to compare the fitted expected values to the actual values by specific groups. If the differences are significantly large, it indicates we should reject the model as producing a good fit to the actual data. Therefore, the null hypothesis is that the model is a good fit, with the alternative being that it isn"t. Standard Akaike and Log likelihood values are also reported.

EMPIRICAL RESULTS

Generalized Results and Contingency Tables

Table 1, below, shows the generalized answers to the six specific questions that were asked. It is interesting to note that from the outset, their perceived awareness of *halal* banking practices (profit and loss sharing agreements) amongst the selected pool of respondents is not particularly high, at 55.7%. Even more so are the numbers of persons having previously held (or are holding) a *halal* stylized bank account, making up only 19.3% of those interviewed. This is probably largely due to the lack of Islamic banking products in Australia in general.

Table 1. Proportional Responses to Survey Queries.

Query	**Yes**	**No**	**N/A**
Awareness of *halal* banking products	55.7%	44.1%	0.3%
Ever having held a *halal* stylized bank account	19.3%	80.1%	0.7%
Willingness to switch to a *halal* product given same quality of conventional banking service (ATM, online access, phone banking)	92.5%	7.4%	1.5%
Willingness to switch without credit facilities	79.0%	20.9%	0%
Willing to switch to a profit-and-loss agreement where you might incur losses	60.8%	37.9%	3.3%
Willingness to switch dependent on brand recognition	60.1%	39.7%	0.3%

Responses are quoted in percentage terms with N/A representing the proportion of missing responses for a particular question.

Surprisingly, the lack of knowledge and experience with utilizing *halal* bank products does not seem, at the face of it, to be a detriment to the willingness for people to purchase a *halal* bank account if the same facilities were available to them as that currently offered by the mainstream conventional banks. In fact, 92.5% of the respondents were keen to be part of a profit-and-loss sharing arrangement. If we take a look at tables 2 and 3 we can also break this figure up between those that answered yes to those answering no to having said they are aware of *halal* banking. The difference in the response they give is independent of how aware they believe they are of *halal* profit-and-loss sharing agreements, with 94% and 90.8% of the respondents answering positively to purchasing a *halal* product regardless of whether they believe they are familiar with halal practices or not, respectively. A simple Pearson Chi- square test on the independence between the two questions results in a test statistic of 0.952 and probability value rejecting the null hypothesis of independence at 30.9%, indicating these two factors are indeed statistically independent of each other.

One important point to highlight is that what the respondents consider awareness of profit-and-loss sharing agreements are not necessarily translated into the willingness to purchase a *halal* product if explicit consideration is made that losses are a real possibility. For example, even though 94% of the respondents who answered yes to being aware of *halal* banking products said they were keen to take out a profit and loss sharing product, 21.9% said they would not be interested if credit facilities were not available and 34.3% would not if they might incur a loss. These results highlight an important facet of the data, which is that the respondents perceived knowledge of *halal* banking practices are not necessarily in alignment with some of the more basic principles of Islamic banking, namely the inability to obtain credit (interest-charged) and possibility of experiencing a loss on a profit and loss sharing account. However, it is also important to point out that those who answered no to being aware of *halal* profit and loss sharing practices, were also even less keen to buy a product if losses could occur (44.7%). A Pearson Chi-Square test reveals there is a dependent relationship between the two sets of queries at the 10% significance level (with a Chi- square statistic of 3.04).

Table 2. Positive conditional responses to specific queries.

Query	Having held a *halal* product		Aware of *halal* banking products		Awareness of *halal* products and willing to switch given conventional bank service	
	Yes	No	Yes	No	Yes	No
Willingness to switch to a *halal* product given same quality of conventional banking service (ATM, online access, phone banking)	77.0%	23.0%	94.0%	6.0%	-	-
Willingness to switch without credit facilities	76.9%	23.1%	78.1%	21.9%	82.7%	17.3%
Willing to switch to a profit-and-loss agreement where you might incur losses	77.0%	23.0%	65.7%	34.3%	70.3%	29.6%
Willingness to switch dependent on brand recognition	67.4%	32.6%	67.3%	32.7%	66.9%	33.1%

This table displays cross-tabulations for all affirmative (Yes) responses made to each specific query listed in the first column to subsequent queries asked to these same respondents in the first row.

Table 3. Negative conditional responses to specific queries.

Query	Having held a *halal* product		Aware of *halal* banking products		Awareness of *halal* products and willing to switch given conventional bank service	
	Yes	No	Yes	No	Yes	No
Willingness to switch to a *halal* product given same quality of conventional banking service (ATM, online access, phone banking)	56.6%	43.3%	90.8%	9.2%	-	-
Willingness to switch without credit facilities	79.4%	20.6%	80.8%	19.2%	82%	18%
Willing to switch to a profit-and-loss agreement where you might incur losses	56.6%	43.3%	55.1%	44.7%	27.7%	72%
Willingness to switch dependent on brand recognition	58.0%	41.9%	37.7%	54.6%	55%	45%

This table displays cross-tabulations for all negative (No) responses made to each specific query listed in the first column to subsequent queries asked to these same respondents in the first row.

Following on from this, respondents who indicated that they had prior experience in having held a *halal* banking product before were more likely to be willing to hold a profit and loss sharing account, regardless of whether losses were a possibility (77%). However, having held a *halal* banking product is not a direct indicator of the willingness to purchase profit and loss sharing products. Respondents who answered no to either having owned a *halal* product before or even claim to be aware of *halal* practices are actually far more likely to be willing to purchase profit and loss sharing products even if credit facilities are not available (80.8%).

Regression Results

Before examining the regression results tabulated in table 5, it is necessary to briefly comment on the cross-correlations presented in table 4. First, this table shows that none of the specified equations have a large correlation with any of the other questions, removing the problem of multicollinearity prevalent in many survey studies. Also, it is probably worthwhile spending some time looking at a few particular correlations. To begin, and although one would expect a high correlation to exist between those that stated they had owned a halal bank account and whether they claim to be aware of *halal* profit-and-loss sharing practices, the actual answer is, surprisingly, no. The correlation between the two is only 0.36. This provides an indication that those who have or do hold *halal* banking products are perhaps more willing to acknowledge their own lack of awareness of the actual products, probably because they have had to actually deal with them. It also indicates that a large pool of those answering that they are aware of *halal* banking, have actually had no experience with any of the products.

Table 4. Cross correlations.

	Awareness of *halal* banking products	Ever having held a *halal* stylized bank account	Willingness to switch to a *halal* product given same quality of conventional banking service	Willingness to switch without credit facilities	Willing to switch to a profit-and-loss agreement where you might incur losses	Willingness to switch dependent on brand recognition
Awareness of *halal* banking products	1.00					
Ever having held a *halal* stylized bank account	0.36	1.00				
Willingness to switch to a halal product given same quality of conventional banking service	0.06	0.03	1.00			
Willingness to switch without credit facilities	-0.02	0.01	0.42	1.00		
Willing to switch to a profit-and-loss agreement where you might incur losses	0.11	0.18	0.24	0.23	1.00	
Willingness to switch dependent on brand recognition	0.17	0.08	-0.00	-0.11	0.02	1.00

The values in the table represent correlation coefficients between each query listed in the first column with those queries in the first row.

Examining now the actual logit regression results, the statistics reveal an interesting picture on the willingness of the respondents to purchase Profit-and-loss sharing. It should also be noted that one of the regressions only fails the Andrews goodness-of-fit test at the 10% significance level.

Table 5. Logit Regression Results.

	Dependent variable	
Explanatory Variables	Query 6	Query 7
Awareness of *halal* banking products	0.2085	0.6520[b]
	(0.2905)	(0.2784)
Ever having held a *halal* stylized bank account	1.0581[b]	0.1400
	(0.4200)	(0.3669)
Willingness to switch to a *halal* product given same quality of conventional banking service	1.4981[b]	0.3225
	(0.6285)	(0.5511)
Willingness to switch without credit facilities	0.9077[b]	-0.7304[c]
	(0.3585)	(0.3828)
Willing to switch to a profit-and-loss agreement where you might incur losses	-	0.1061
		(0.2817)
Willingness to switch dependent on brand recognition	0.1095	-
	(0.2822)	
Constant	-1.9898[a]	0.2322
	(0.6359)	(0.4859)
Akaike info criterion	1.2569	1.3506
Log likelihood	-156.7798	-168.9135
Andrews Statistic:	15.4268	16.3331[c]
	(0.1173)	(0.0905)

[a] Indicates significance at the 1% critical level, [b] indicates significance at the 5% critical level and [c] at the 10% critical level.
Query 6 asks the question "Are you willing to switch to a profit-and-loss agreement where you might incur losses"
Query 7 asks the question "Would your decision to switch to a profit-and-loss sharing agreement be affected if the bank providing these services was well established (brand-recognition important)?

Focusing in more detail on the first regression, it examines the possible determinants for a respondent to answer yes to being willing to buy a profit-and-loss sharing product despite possibly incurring losses, based on how they answered the other questions. As a compliment to the cross-correlations and the contingency tables already discussed, we are now able to examine the dynamic relationship these questions share in leading to this specific query response. Of all the questions, only the questions querying the respondents awareness of *halal* banking products and whether brand recognition is an important factor are not significant variables in determining whether the respondent answers yes to being willing to purchase a Profit- and-loss sharing account, despite incurring losses. This brings to the fore one very interesting matter; perceived awareness is not a strong determinant, at least for the case of purchasing profit-and-loss sharing products that might experience losses. Although this was briefly discussed before, when analyzing the contingency tables, in this regression framework it also highlights the insignificance of the variable, relative to the other questions that were asked.

Following on from the above, the second regression places brand recognition as the dependent variable against all the other questions. In this case, only those people who perceive themselves as being aware of *halal* banking products is a significant determinant at the 5% critical level. At the 10% significance level, those respondents still willing to purchase Profit-and-loss sharing accounts despite not having access to credit, are also statistically more likely to believe brand recognition is important. For the remainder of the questions, their impact on determining whether brand recognition is important is not significant. Whether respondents have previously held *halal* products, for example, or their interest in ensuring the same level of service as offered by other conventional banks seems to bare little impact on how important brand recognition is.

IMPLICATIONS

The findings indicate that the population would be receptive to the idea of purchasing Islamic financial products as long as the organization that is providing the service is well known, and benefits such as ATM access, phone banking and so on, are provided. This provides a great opportunity for Australian financial institutions. If Australian organizations can build on their experience and reputation in the financial world, and can provide Islamic financial products in Australia, they can aim to gain a growing customer base of the Muslim population, some of who may have previously stayed away from dealing with the conventional financial institutions due to the use of interest. The Muslim Community Co-Operative Australia (MCCA) has led the way in the Australian market. From humble beginnings in Melbourne where the brand was unknown, the organization now has a large market share and continues to experience strong growth.[6] However, popular conventional banks such as the Australia and New

Zealand Bank (ANZ) should aim for even faster growth due to the high customer confidence in their brand name, and their ability to promote new products.

The findings also highlighted the lack of awareness in regards to the basic rules and principles of Islamic financing. The results indicate that a number of respondents would not take up *halal* financing options if credit facilities were taken away. In the Islamic financial system money is not lent out, instead its an asset-backed system where financial institutions invest in projects.[13] Therefore, financial institutions deal in equity, not debt.[25] Providing credit facilities contravenes this principle. To counter this limitation, some financial institutions have started issuing „debit‟ cards. These cards are similar to the credit cards except for the fact that they use the client‟s own funds instead of reliance on any credit.

Another issue is that of sharing profits and not losses. The results of the survey indicate that a number of respondents who had held a *halal* banking product were not aware of the loss sharing concept. This would indicate that some financial institutions have been guaranteeing profits. This contravenes the basic law of Islamic finance, that is, linking rewards to risk. Gains made on investment without risk is merely interest rather than profit.

In order to understand how the Islamic system differentiates between profit and interest, one has to look at the differences in economic ideology. In capitalist theory, capital and entrepreneurs are treated as two separate factors of production where the former gets interest and the latter is entitled to profit. It is assumed that interest is a fixed return for providing capital, and profit can only be earned after distributing the fixed return to land, labor and capital (in the form of rent, wage and interest). In contrast, the Islamic economic system does not consider capital and entrepreneurs as separate factors of production.[23] It believes that every person who contributes capital in the form of money to a business venture assumes the risk of loss and therefore is entitled to a proportional share in the actual profit.[26] The system is protective of the entrepreneur, who in a capitalist economy would have to make fixed interest repayments even when the venture is making a loss.[20] Capital has an intrinsic element of entrepreneurship, so far as the risk of the business is concerned and therefore, instead of a fixed return as interest, it derives profit. The more the profit of the business, the higher the return on capital. With no fixed interest repayments, the profit would be higher. In this way the profits generated by the commercial activities in the society are equally distributed amongst those who have contributed capital to the enterprise.

Leading scholars in the area of Islamic Finance have declared that guarantees made by institutions that customers will receive a set rate of return without having to incur losses are illegal and unethical. Yet, not only are financial institutions continuing the practice but government agencies in Muslim countries are also offering investment opportunities with guaranteed profits. Considering that the Muslim governments are responsible for supervising the system in order to combat the illegal practices of financial institutions, by offering guaranteed returns the governments are seen to be condoning the behaviour of the financial institutions.

Although these actions may help Islamic Banks grow in the short-run, the long-term costs (harm to reputation and authenticity) will outweigh the benefits. Such moves also provide ammunition to the critics of the system who are already questioning whether the system is nothing more than an interest-based system operating under the guise of profit.[27]

CONCLUSION

As competition intensifies, financial institutions increasingly must be able to deliver personalized and customized financial solutions. Therefore, it is important for institutions to understand the dynamics of customer segmentation, build customer relationships and address requirements and preferences of specific segments of the market.

It is therefore important that financial institutions invest in new products to meet Islamic customer needs and demands. Equally important is the need to develop an effective communication plan that goes beyond just marketing and advertisement. As the results of this study show, institutions also need to educate customers to adapt to the new ways of doing banking transactions, and understanding that Islamic finance involves the sharing of both profits and losses.

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FOOTNOTES

[i] *Shari'ah* refers to Islamic law, which is based on the teachings of the Quran.

[ii] *Halal*: Products that fulfill the criteria laid out by Islam of being acceptable for use.

[iii] The 3 administrators were practicing members of the Adelaide Muslim community. The administrators were experienced in administering surveys, and were provided information on Islamic finance.