**Full-Fledged VS Islamic Bank Windows: Which One Do Muslim Consumers Know Better and Prefer More?**

## Abstract

This study compares the knowledge of and preference for the Islamic banking window and the full-fledged Islamic bank among Muslim customers. Data were collected from 1171 banking clients. Data were analysed using descriptive analysis. The results show most Muslim consumers do not know the difference between the full-fledged Islamic bank and the Islamic banking window. Yet, most Muslim consumers favor the full-fledged Islamic bank to the Islamic windows since it is perceived to be more sharia-compliant.

### **Keywords:** Knowledge, Preference, Full-fledged Islamic Bank, Islamic Bank Window, Islamic bank

## Introduction

####  Currently, there is no standard definition of an Islamic bank in the world. In general, an Islamic bank refers to the institution that mobilizes financial resources and invests those resources based on the Sharia principles and their practical application through Islamic economics development (Al Baraka, 2017; “Islamic Banking,” n.d.). The objectives of Islamic bank itself should be directed to the objectives of Islamic economics, which is also guided by the objectives of Sharia which consists of five foundational goals to preserve a) religion/faith (din), b) life (nafs), c) lineage/progeny (nasl) d) intellect ('aql) and e) property/wealth (Mohammad and Shahwan, 2013). Islamic banks shift the focus from lending into an investment, change the emphasis on the ability to repay to the soundness of the project, shift the dependence on borrowing for the mobilization of resources into the partners' coordination in resource mobilization, and shift the application only of financial criteria into the moral standards in investment (Al Baraka, 2017).

Islamic banks now have a presence in more than 60 countries under 14 jurisdictions (International Monetary Fund, 2017). Islamic Banking may present itself either in the form of a full-fledged Islamic bank or as Islamic Banking windows in the conventional banks (Lone and Rehman, 2017). Thus, the Islamic banks face competition from other Islamic banks and the conventional bank, which also offers Islamic financial products and services (Naser et al., 1999).

Since its inception around the 1970s, Islamic banks have experienced a double-digit growth rate (Garbois et al., 2012). However, the Islamic bank is currently facing some challenges in slowing growth and eroding profitability (Garbois et al., 2012). The slowing growth in Islamic banks is evident in Indonesia. Since the inception of the first Islamic bank in 1992, the market share has never exceeded 5% until 2016. The Islamic bank Indonesia has experienced what so-called a 5-percent- trap phenomenon (Karim Consulting, 2016).

The slowing market growth in Islamic bank development, which to some extent has reached stagnation, raises the question of whether Muslim consumers know their options to open an account. The current study investigates Muslim consumers' knowledge regarding the Islamic bank windows and a full-fledged Islamic bank. The study also examines the preferences of Muslim consumers towards these two options. The study may theoretically contribute to Muslim banking behavior literature by providing empirical evidence on consumer knowledge and preference in choosing an Islamic bank. Besides, the study provides knowledge to both the Islamic bank windows and full-fledged Islamic bank on the Muslim consumers' understanding of both channels' availability.

## Literature review

#### Since the early development of the Islamic bank in 1975, no bank offered an Islamic window. Later on, the conventional banks became interested in developing Islamic banking using the Islamic window due to the potential growth of the Islamic bank and finance (Al-awsat, 2010). Although some countries like Malaysia categorize the Islamic bank into three types: a) windows, b) subsidiary c) full-fledged, some others categorize it into only two categories a) windows and b) full-fledged (Lone and Rehman, 2017). The current study will use the later classification.

**Islamic Bank Window**

The Islamic bank window is the department of a conventional bank offering Islamic or Sharia compatible financial products and services. The Islamic bank window is valid only if it complies with the requirements set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) (Yaquby, 2005) a) Complete segregation of funds b) Existence of a Sharia supervisory board (Sharia board) c) Management based fully on Islamic concepts d) Safeguarding of Muslim investors' funds against negligence, trespass and fraud e) Compliance with the Standards of the Accounting and Auditing Organization for Islamic Financial Institution.

The majority of the Islamic bank's jurisdictions do not allow the Islamic bank window or require the conventional bank to separate different Islamic Bank units into their corporate structures (International Monetary Fund, 2017). There are two main reasons why the Islamic bank should be separated from the conventional bank (International Monetary Fund, 2017). The first is to avoid mixing funds raised from the conventional bank and Islamic bank activities. Second, the risk of regulatory arbitrage due to the difference in regulatory issues between banks.

Despite the resistance towards Islamic bank windows' existence, there are some advantages of the Islamic bank windows. First, the Islamic bank can take advantage of the well-established operations of the conventional bank to deliver high-quality services at a much lower cost. Second, Islamic bank windows drive healthy competition in the Islamic banking market, reducing Islamic bank products' costs. Third, it provides the option to develop Islamic banking in a country with low demand for Islamic bank services and enhance financial inclusion (International Monetary Fund, 2017). An empirical study found that Islamic windows were more efficient than their full-fledged counterparts (Salami and Adeyemi, 2015).

**Full-Fledged Islamic Bank**

The Islamic bank window's growing activities may drive the conventional bank to establish an Islamic subsidiary or even fully convert into a full-fledged Islamic bank (Solé, 2007). The full-fledged Islamic bank's advantage over the Islamic bank window is that the full-fledged Islamic bank will offer a broader range of Shariah-compliant products (Solé, 2007). The full conversion of the Islamic bank window into full-fledged Islamic banks signals the conventional bank's firm commitment to Shariah principles, enhancing its credibility (Solé, 2007). Full-fledged Islamic Banks have more opportunity to introduce new-to-market products based on the approvals obtained from Shariah Committees. The full-fledged Islamic banks are more efficient than Islamic windows (Mokhtar et al., 2008, 2006). Another study supported these results that found that Islamic banks perform better in terms of cost (or profit), technical, allocative, and scale of efficiency (Kamaruddin et al., 2008). Another study that examined the conversion of the Islamic bank windows into the full-fledged Islamic bank also found that the conversion effectively optimizes some funding sources such as capital injection and an increase in temporary investment deposits (Siswantoro, 2014).

**Previous Study on Full-Fledged Vs. Islamic Bank Window**

Several studies had examined and compared both the full-fledged Islamic bank to an Islamic bank window, but the majority of studies have compared those two entities based on the level of efficiency or productivity (Kamaruddin et al., 2008; Mokhtar et al., 2008, 2006; Salami and Adeyemi, 2015; Siswantoro, 2014).

There is a dearth of research examining and comparing the Islamic banking window and full-fledged Islamic bank from the consumer's perspective. Although some previous studies use the consumers of both the Islamic banking window and full-fledged Islamic bank as their samples, the study does not explicitly assess the knowledge and perception of the consumer regarding those two types of Islamic bank (Amin and Isa, 2008). Some studies only examine one type of customer, either the Islamic bank window only (Shafii and Khafafa, 2013) or the full-fledged customer only (Rehman and Masood, 2012; Rustam et al., 2011).

## RESEARCH Method

#### The descriptive research design was applied in this study. A survey of 1171 Muslim conventional banking customers was conducted online. The consumers' knowledge regarding the Islamic bank windows and full-fledge was measured using closed-ended questioning with dichotomous answers (yes or no). The preference of the consumers was measured using open-ended questions. Researchers coded the open-ended question. The descriptive analysis was conducted using SPSS software.)

## Results

The profile of the respondents can be seen in table 1. Based on the descriptive statistics, most of the respondents were young adults aged between 21 to 30 years and 31 to 40 years (n=1100; 93.93%). The majority of respondents were female (n=623; 53.30%), single (n=608; 51.78%), university bachelor graduates (n=658; 56.19%), work as a private employee (n=397; 33.90%) and have an income of around US$ 0-1499 per month (n=1129; 96.4%).

Table 1. Muslim Consumer Respondent Profile & Knowledge

|  |  |  |
| --- | --- | --- |
| **Description**  | **Frequency** | **Percentage** |
| a. | Age | 21-30  | 801 | 68.40 |
| 31-40 | 299 | 25.53 |
| 41-50  | 57 | 4.87 |
| 50-59 | 11 | 0.93 |
| ≥60  | 2 | 0.17 |
| Total | 1171 |  100,00  |
| b. | Gender | Male | 548 | 46.79 |
| Female | 623 | 53.20 |
| Total | 1171 | 100 |
| c. | Marital Status | Single | 608 | 51.78 |
| Married | 563 | 48.07 |
| Total | 1171 | 100 |
| d. | Education  | ≤ Senior high school | 163 | 13.91 |
| Diploma  | 87 | 7.4 |
| Bachelor degree | 658 | 56.19 |
| Master degree | 247 | 21.09 |
| Doctoral degree | 16 |  |
| Total | 1171 | 100 |
| e. | Occupation | Private Employee  | 397 | 33.90 |
| Professional | 238 | 20.32 |
|  Government Employee | 148 | 12.63 |
| Other  | 113 | 9.6 |
| Homemaker  | 135 | 11.52 |
| Entrepreneur | 78 | 6.6 |
| Students | 62 | 5.2 |
| Total | 1171 | 100 |
| f. | Income | US$ 0-1499 | 1129 | 96.4 |
| ≥US$ 1500  | 42 | 3.57 |
| Total | 1171 | 100 |
| g | Awareness about the difference between Islamic bank windows and Full-Fledge Islamic Bank | Yes | 287 | 24.50 |
| No | 884 | 75.49 |
| Total | 1171 | 100 |

To assess Muslim consumers' knowledge, the researcher asked the consumer whether they know the difference between Islamic bank windows and a full-fledged Islamic bank. The result shows that only 24.50 percent of the respondents knew the difference. The study indicates that only a few Muslim conventional bank consumers know about the Islamic bank windows and full-fledged Islamic bank.

#### To assess the perception of the Muslim consumers of the Islamic bank windows and full-fledged Islamic banks, the researcher questioned 287 respondents who had knowledge about both types of banks. The researchers asked their preference and the rationale for choosing a particular type of Islamic bank using an open-ended question. The respondents' perceptions can be seen in Table 2.

Table 2. Muslim Consumers Respondent Profile & Knowledge

|  |  |  |
| --- | --- | --- |
| **Full-Fledge Islamic** | **Frequency** | **Percentage** |
| More Sharia-compliant, independent, pure, clear capital sources, more credible, reliable, and secure | 126 |  43,85  |
| More variety of Sharia products | 21 |  7,31  |
| Larger scope | 19 |  6,61  |
| Better services and satisfaction  | 16 |  5,57  |
| More facilities | 10 |  3,48  |
| Direct supervision from the regulator | 8 |  2,78  |
| More complicated interbank process | 4 |  1,39  |
| Clearer regulations | 4 |  1,39  |
| Better technology  | 4 |  1,39  |
| **Total respondents who prefer Full Fledge Islamic Bank** |  **212**  |  **73,79**  |
| **Islamic bank window** | **Frequency** | **Percentage** |
| More entrepreneurial friendly |  35  |  12,32  |
| More network (branches, ATM, etc.) |  24  |  8,35  |
| Backed-up by a well-established bank |  12  |  4,18  |
| More transparent system |  4  |  1,37  |
| **Total respondents who prefer Islamic Bank Window** | **75 75**  | **26.10 26,21**  |
| **Total** |  **287**  |  **100**  |

Based on table 2, most respondents who know the difference between the full-fledged Islamic bank and Islamic bank windows prefer a full-fledged Islamic bank over the Islamic bank window (n=212; 73.97%). The three main reasons for this are the bank is more sharia-compliant due to its independence from the influence of the non-Islamic bank (n=126; 43.85), offers more variety of products (n=21; 7.31%), and is larger in scope (n=19; 6.61%).

The survey result also shows that only around 26.03 percent of respondents prefer to go to Islamic bank windows. The main three reasons for their choice are: more entrepreneur-friendly (n=35; 12.32%) and has a wider network (branch and ATM) (n=24; 8.35%). The first reason why the respondents prefer the Islamic bank window over the full-fledged Islamic bank is that they perceive that it is much more complicated to get a loan from the full-fledged Islamic bank compared to the Islamic bank window. Many respondents felt that the process to get a loan from the Islamic bank window is much friendlier to entrepreneurs.

## DISCUSSION

#### This study supports a previous study conducted in Malaysia which showed that Islamic banks had not done enough to educate their customers (Ahmad and Haron, 2002). The low number of consumers who have knowledge about the difference between the Islamic bank windows and the full-fledge Islamic banks indicates that it is very important for the Islamic banks to educate the Muslim consumers about the available format of Islamic banks that can serve their needs.

Previous studies had shown that full-fledged Islamic banks have several advantages in terms of efficiency or product and service offerings (Mokhtar et al., 2008, 2006). The current study gives more empirical evidence that the full-fledged Islamic bank offered a competitive advantage when it was assessed based on the bank performance indicator. The positive perception of the Muslim consumers on the full-fledged Islamic bank also implies that there may be an opportunity for the Islamic bank windows to be transformed into the full-fledged Islamic bank as the banks are perceived to be much more Sharia-compliant, independent, gives better service and gives more satisfaction to the consumers. In addition to that, full-fledged banks may also learn from windows in terms of friendliness and accessibility of loans

## Conclusion

The results indicate that Muslim customers do not have perfect knowledge about types of Islamic banks. The study also shows that the Muslim customers' underlying reasons to choose the full-pledged or Islamic bank windows are totally different. For those who choose the full-fledged Islamic banks, shariah compliance becomes the most fundamental reason. In contrast, the Muslim customers who prefer the Islamic bank windows consider services as their primary rationale for choosing the banks.

## LIMITATION

The current study applied a descriptive analysis which helps to facilitate data visualization. In addition, the analysis also allows for data to be presented in a meaningful and logical way, which in turn, generates a simplified interpretation of the data set in question. However, descriptive analysis has its limitations. The analysis is unable to test hypotheses. Therefore, the future researchers are suggested to test the impact of Muslim customers knowledge on their preferences for choosing the full-pledged or Islamic bank windows by using a hypothetical study.

## References

Ahmad, N., Haron, S., 2002. Perceptions of Malaysian corporate customers towards Islamic banking products and services. Int. J. Islam. Financ. Serv. 3, 13–29.

Al Baraka, 2017. Principles of Islamic Banking [WWW Document]. URL http://www.albaraka.com/default.asp?action=article&id=46 (accessed 10.15.17).

Al-awsat, A., 2010. Islamic Windows or Islamic Banks [WWW Document]. Middle East Arab News Opin. URL https://english.aawsat.com/theaawsat/business/islamic-windows-or-islamic-banks (accessed 10.15.17).

Amin, M., Isa, Z., 2008. An examination of the relationship between service quality perception and customer satisfaction: A SEM approach towards Malaysian Islamic banking. Int. J. Islam. Middle East. Finance Manag. 1, 191–209. https://doi.org/10.1108/17538390810901131

Garbois, C., Gourp, C., von Pock, A., Bhatnagar, M., 2012. The Future of Islamic Banking, Security Dialogue. https://doi.org/10.1177/0967010693024004005

International Monetary Fund, 2017. Ensuring Financial Stability in Countries with Islamic Banking.

Islamic Banking [WWW Document], n.d. URL http://www.islamic-banking.com/what\_is\_ibanking.aspx

Kamaruddin, B.H., Safa, M.S., Mohd, R., 2008. Assessing production efficiency of Islamic banks and conventional bank Islamic windows in Malaysia. Int. J. Bus. Manag. Sci. 1, 31–48. https://doi.org/10.5897/JAERD12.088

Karim Consulting, 2016. Embracing the Future of Islamic Banking. Maj. Outlook Perbank. Syariah 2017.

Lone, F.A., Rehman, A.U., 2017. Journal of internet banking and commerce : JIBC. J. Internet Bank. Commer. 22, 1–20.

Mohammad, M.O., Shahwan, S., 2013. The Objective of Islamic Economic and Islamic Banking in Light of Maqasid Al-Shariah: A Critical Review. Middle-East J. Sci. Res. 13 (Resear, 75–84. https://doi.org/10.5829/idosi.mejsr.2013.13.1885

Mokhtar, H.S.A., Abdullah, N., Alhabshi, S.M., 2008. Efficiency and competition of Islamic banking in Malaysia. Humanomics 24, 28–48. https://doi.org/10.1108/08288660810851450

Mokhtar, H.S.A., Abdullah, N., Al-Habshi, S.M., 2006. Efficiancy of Islamic Banking in Malaysia: A Stochastic Frontier Approach. J. Econ. Coop. 27, 37–70. https://doi.org/10.1108/08288660810851450

Naser, J.K., Jamal, A., Al-Khatib, K., Naser, K., 1999. Islamic banking: a study of customer satisfaction and preferences in Islamic banking. Int. J. Bank Mark. 17, 135–151. https://doi.org/10.1504/IJMEF.2009.029063

Rehman, A.A., Masood, O., 2012. Why do customers patronize Islamic banks? A case study of Pakistan. Qual. Res. Financ. Mark. 4, 130–141. https://doi.org/10.1108/17554171211252475

Rustam, S., Bibi, S., Zaman, K., Rustam, A., Haq, Z.U., 2011. Perceptions of Corporate Customers Towards Islamic Banking Products and Services in Pakistan. Romanian Econ. J. 107–123.

Salami, O.L., Adeyemi, A.A., 2015. Malaysian islamic banks’ efficiency: An intra-bank comparative analysis of islamic windows and full-fledged subsidiaries. Int. J. Bus. Soc. 16, 19–38.

Shafii, Z., Khafafa, A.J., 2013. Customer Satisfaction and Islamic Banking Awareness in the Islamic Banking Window System in Libya. Middle-East J. Sci. Res. 13, 12–17. https://doi.org/10.5829/idosi.mejsr.2013.13.1875

Siswantoro, D., 2014. Analysis of Islamic Bank’s Performance and Strategy After Spin-off as Islamic Full-fledged Scheme in Indonesia. Procedia - Soc. Behav. Sci. 164, 41–48. https://doi.org/10.1016/j.sbspro.2014.11.048

Solé, J., 2007. Introducing Islamic Banks into Conventional Banking Systems.

Yaquby, N., 2005. Shariah Requirements for Conventional Banks. J. Islam. Bank. Finance 22.