

Important Issues in Growth of Islamic Banking Services in East African Context: Study of Selected Banks in Dar Es Salaam, Tanzania

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Abstract- *Introduction of Islamic Shariah principle based banking product by a number of international banks in recent past indicates the growing trend in Islamic banking in East Africa. Due to the expected growth, Islamic banking system is likely to face strong competition both from the well-known Islamic banks as well as conventional banks with Islamic banking products. To successfully cope up with the competitive pressures, the Islamic banking service providers need to understand the important issues related to product design and delivery. The present paper aims to analyze the customers' and service providers' views on different issues related to Islamic banking service in Dar Es Salaam, Tanzania. The study is based on sample of 50 respondents from three selected banks in the city. The findings present details of critical factors instrumental in growth of Islamic banking services in this region.*

Key Words: *Islamic Banking; Banking in East Africa; Tanzanian Banking; Factors in Islamic Banking*

1. INTRODUCTION

Islamic banking, also known as Sharia banking, refers to the type of banking activities, which are based on the principles of Islamic law (*Sharia of Shariah* in Arabic). Fundamentally, the Sharia forbids the imposition of loan interest rates (usury or *Riba* in Arabic). Further, it also prohibits investing in businesses that do not operate according to the principles of Islamic law and declare such income *Haram* (Arabic for 'forbidden'). Although Sharia principles of economics have been practiced for centuries, the concept of Sharia banking was introduced only near the end of the 20th century (Saeed 1996). The religion and economics have been closely linked in reference to the growth of banking system in Islam following countries. With the opening of local branches of the banks from economically powerful countries of West lead to the introduction of the modern banking system in Islam following countries. However, these banks were generally confined to the capital cities and the local population remained largely untouched by the banking system (Iqbal & Molyneux 2005). In terms of customer behavior, the local trading community avoided the "foreign" banks both for nationalistic as well as religious reasons. Even when the banking was considered essential for trading across borders, customers in Islamic countries were very selective in use of banking services and confined themselves to products like current accounts and money transfers and avoided borrowing from the banks and depositing their savings with the bank (Khan 1987).

Tanzania is one among the fast growing East African countries in terms of economic development. The country has experienced a number of financial and banking system reforms during last two decades. The liberalization of banking and finance sector in Tanzania has led towards new ways of banking to satisfy the needs of the market. The banking system in the country has witnessed many innovations in past ranging from Mobile banking to Islamic banking. With old aged conventional banking dominating world economies, the growth of Islamic banking as an alternative way presents a great challenge in conventional-banking dominated industry. The demographic composition is one of the important influencing factor in choice of banking system in the country. Nearly half of the population following faith, the growth of Islamic banking appears quite natural in Tanzanian context. Since the Islamic banking system is gaining momentum in Tanzania. Many banks have started to open branches which operate in accordance with the Islamic Shariah principles.

Consistent increase in the introduction of Islamic banking products by different banking service providers in Tanzania has influenced the industry dynamics very significantly. In order to be competitive and need-driven the service providers need to continuously observe and analyze the changing Islamic banking market-need. Therefore, the present paper broadly aims to analyze the important factors related to Islamic Banking services in East African context. More specifically, the paper looks into the following research questions:

- 1) Why do customers' prefer Islamic Banking in East Africa?
- 2) What are the major influences on service providers in designing and delivering Islamic banking services?
- 3) How the Islamic banking service can be competitively positioned in the banking service industry?

The study is supposed to be of benefit not only to the those with Islamic religious beliefs but for the whole society in general. The study would highlight the benefits as well as challenges associated with Islamic banking from both the customers' and the service providers' perspective and thus, profiling the relevant factors for improvement in the service.

2. LITERATURE REVIEW

The growth in Islamic banking attracted a number of scholars to study the subject from different perspectives. Erol and El-Bdour (1989) investigated the factors that influence customers to choose Islamic banking. The study found that the provision of a fast and efficient service, bank's reputation and confidentiality were the most important bank selection criteria for customers who patronize Islamic banks. In their studies, religion was found to play a less important role in customers' decisions to transact with the Islamic bank. Khan (1983) observed Islamic banks operating in Sudan, United Arab Emirates, Kuwait, Bahrain, Jordan, and Egypt and concluded that these banks had little difficulty in devising practices in conformity with Shariah. He identified two types of investment accounts: one where the depositor authorized the banks to invest the money in any project and the other where the depositor had a say in the choice of project to be financed.

In context of Islamic banking, the overall system objective plays an important role in terms of positioning the product towards religious or profitability orientation. Haron (1996) emphasizes that the contradictory objectives in conventional banks versus Islamic banks is one of the important area of distinction. It can be seen that the objectives of Islamic banks are based on two fundamental pillars: the religion factor and the profitability factor. If the religion factor alone is accentuated, the banks will be driven into insolvency and bankruptcy, thus damaging the situation of the depositors and Muslim society as a whole. Conversely, if the profitability factor is given more priority, it will certainly divert from the true Islamic line that is based on the concepts of justice.

The growth of Islamic banking is also linked to educating the target customers about the product. Hamid and Nordin (2001) discovered that customers possess very limited

knowledge of Islamic banking, as 60% of the respondents could not differentiate between Islamic banking products and conventional banking products. Interestingly, another study by Hassan and Ahmed (2002) on the customers and employees of the Islamic bank in Dhaka, Bangladesh, found that the respondents were not interested in conducting banking transactions in Islamic banks because they believed that only the name of the bank had been changed to reflect that it was an Islamic-based bank. The researchers determined that the customers' and employees' understanding of the concepts and practices of Islamic banking is still vague. Another study by Makiyan (2002) measured the factors behind the performance of Islamic banking and revealed that inadequate employee knowledge and training was instrumental in most of the problems felt by the the service providers.

Profitability and significance of Islamic banking at different levels have often been debated on the grounds that there is no uniformity in terms of its' potential to earn profit. Nienhaus (1988) suggests that the relative profitability of Islamic banks, especially in the Middle East in recent years, is to a large extent due to the property (real estate) boom. He cited cases of heavy losses which came with the crash of the property sector. He concludes that Islamic banking is viable at the microeconomic level but dismisses the proponents' ideological claims for superiority of Islamic banking as 'unfounded'.

The earlier studies on service quality indicates that the overall service quality is function of both service providers' as well as and customers' perception about the different dimentsions (Donelly et al.,1985; Zeithaml and Bitner, 2000; Zeithaml, 2000). If we combine the findings of earlier Islamic banking related studies to the service quality framework, a framework can be developed with focus on both religious orientation and education dimension. The framework can be explained diagrammatically as shown in Figure 1.

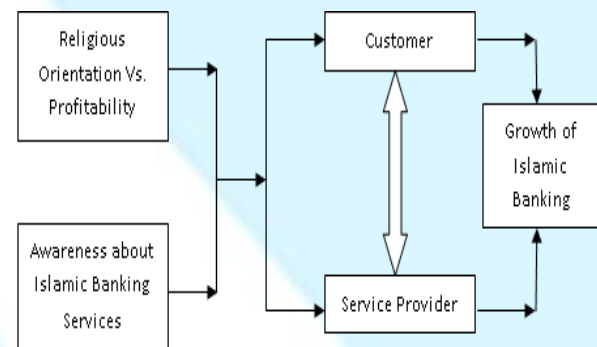


Figure 1: Factors Driving Islamic Banking Service - A Conceptual Framework

3. RESEARCH METHODOLOGY

The study is exploratory in nature. It was undertaken in city of Dar es Salaam. The city is considered significant trading centre in East Africa with one of the major commercial sea ports in the region. Historically, the trade in this region was influenced by the Arabs and its' impact can easily be witnessed in different trading activities. Because of these important factors, the city of Dar Es Salaam was selected for study related to Islamic banking. Three bank were selected for the study. The selection of banks was based on judgment about their experience with Islamic banking services. From each of the identified banks, two main branches, dealing with Islamic banking services, were selected. Respondents from each branch included banks management, customers and employees. In considering the study area and sample size, a note was taken in regards to affordability, adequacy for representation and accuracy of the results for the purpose of the study. A small sample was considered suitable as the aim was to get an "experience" of a problem. A sample of 50 respondents was selected for the study. The details are in Table 1.

Table 1. Distribution of Sample Size by Branch

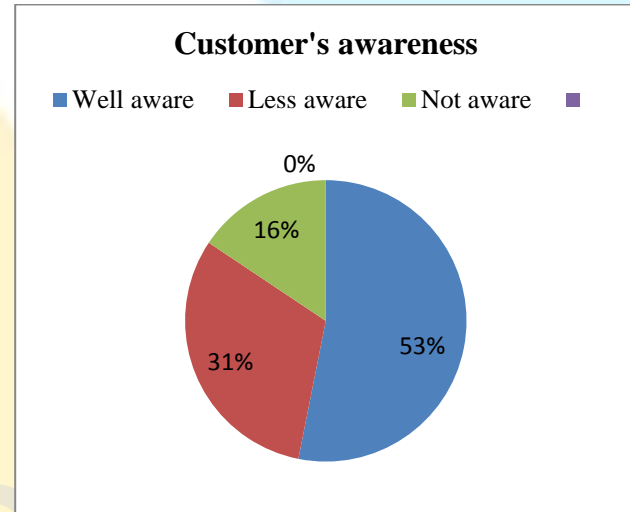
Sample	Branch 1	Branch 2	Total
Bank1 Staff	5	3	8
Bank1 Customers	8	5	13
Bank 2 Staff	5	0	5
Bank 2 Customers	4	3	7
Bank 3 Staff	5	0	5
Bank 3 Customers	7	5	12
Total			50

Thus, 32 customers and 18 bank staff from all identified branches were selected using non-probability judgmental sampling method. For data collection, structured questionnaires were distributed to bank employees and customers. Interviews with some of the bank employees and customers were also conducted to have in-depth understanding of the on identified issues. Researchers also employed observation method for data collection by observing day to day activities at the bank offices. The major focus areas of observation included the interaction between the customers and the bank staff and how each one reacts after or before a service. Data from questionnaire were summarized, tabulated and percentages was calculated and information was put together in a

tabular form. Data from interview was used to supplement the findings from the questionnaire based survey.

4. DATA ANALYSIS

The first issue was to measure the Customers' level of awareness on the benefits of Islamic Banking services .



Figur 2: Customer's awareness on benefits of islamic banking

Figure 2 shows the extent of customers' awareness regarding the benefits of islamic banking system. It can be seen that out of 32 respondents 17 (53.13%) are well aware of Islamic banking services, 10 (31.25%) are relatively less aware of benefits of islamic banking services and 5(15.63%) are not aware at all.

Regarding customers' orientation towards religious or profit motive in Islamic banking, table 2 presents the responses. It can be seen that out of 50 respondents, 18 (56%) agree that customers preferences towards islamic banking is influenced by religion, 9 (28%) out of 50 are influenced by profit and 5(16%) are not sure what influences them. Therefore it is clearly showing that majority of customers prefer Islamic banking products because of dominance of their religious orientation.

Table 2: Customers' orientation towards religion and profit

Orientation	No of respondents	Percentage
Religion	18	56.25
Profit	9	28.13
Not Sure	5	15.62
Total	32	100

On the other hand, the religious and profitability orientation of the service provider is another important dimension that influence the Islamic banking services. It was important to analyze whether the service providers balance both the objectives or inclined more towards any of these dimensions. As presented in table 3, it can be seen that out of 18 staff, who were interviewed by the researcher, 15(83.33%) agreed that in delivery of islamic banking preferences towards religion and profit were balanced while 3(16.67%) out of 18 said that their preferences towards religion and profit were not balanced and naturally inclined towards religious beliefs.

Table 3: Service-Providers' Approach to Religious and Profit Motives

Banks' Preferences	Number of respondents	Percentage
Balanced Religious and Profitability Motive	15	83.33
Inclined Towards Religious Motive	3	16.67
Total	18	100

While analyzing the reasons behind lack of customers' awareness about the Islamic banking benefits, it was observed that employee education and training was considered to be a limiting factor. This is quite clear from the employees' perception about the level of their preparedness to deliver the Islamic banking services. Table 4 presents the details on this dimension. It can be seen that out of 18 respondents only 5 (27.77%) agree that employees are well trained in Islamic banking activities, 11 (61.11%) are perceived to be less trained and 2 (11.11%) are not trained at all.

Table 4: Employee's Perception about their Preparedness

Level of Education/ Training	No of respondents	Percentage
Well Trained	5	27.77
Less Trained	11	61.11
Not Trained	2	11.11
Total	18	100.65

However, despite the challenges the Islamic banking service products are considered to be highly competitive.

This dimension was measured in survey of both the respondent groups i.e. customers as well as the employees. The overall response about product competitiveness is summarized in Table 5. The respondents had the following views regarding competitiveness of islamic banking products to conventional banking products.

Table 5: Respondents' views on Islamic Bbanking competitiveness

Status	No of respondents	Percentage
Competitive	35	70
Non competitive	15	30
Total	50	100

It can be seen that out of 50 respondents 35(70%) agrees that islamic banking products are competitive to conventional banking products, while 15(30%) agrees that islamic banking products are not so competitive to conventional banking products and thus, leaving a room for further desired improvements.

5. DISCUSSION OF THE FINDINGS

Findings have showed that most respondents agree that their preferences towards islamic banking is influenced by religion. Therefore it is clearly showing that majority customers orientation lies on their religious beliefs rather than other factors. These results also corresponds with (Hunt (1978) who studied about customer's satisfaction and dissatisfaction upon the need to use Islamic banking services. Customers agreed that some of them prefer Islamic banking due to religious beliefs since there will be no interest as interest is contrary to Islamic principles. However for the Muslims, they are very grateful for these banks because for years they have been living against their faith for they were forced to enter into other banking systems (Ayub, (2002). During interviews, customers confirmed their believe that all investments made under Islamic banking are never associated with any of the traditional 'sin' industries, such as alcohol, tobacco, gambling or pornography; as a result the product stands on an individual's faith, ensuring not only financial security but also moral and mental satisfaction (Oliver (1997).

It was observed also that the customers prefer various accounts like the Cheque Account and Saving Account with an embedded Death Benefit that is built around the Shariah Laws (Walid, Mohamed & Omar 2010). This is important to note that the Shariah Law forbids the earning of interest. Funds deposited in the accounts will be invested in businesses that are approved under Shariah Law. Respondents said that they benefit from various

accounts that are provided under Islamic banking which are riba free. For example at one bank, there are completely riba free personal savings accounts aimed at enabling customers to safely keep their funds. The religious influence on the banking was also observed in customers' preference towards Hajj savings account, a special product aiming to promote the fifth pillar of Islam and is first of its kind in Tanzania Islamic banking market. Customers also displayed strong preference towards Biashara current account in one of the banks under study. This is a special account designed to meet the needs of small and medium enterprises (SME). Biashara current account enables them to run their accounts through the use of cheque book in daily business transactions. It is safe as well as convenient. The above discussions lead to following important hypothesis:

- H₁: The customers prefer Islamic banking services because of their religious orientations or in other words the stronger the religious orientation, the greater the chances of adopting the Islamic banking
- H₂: The Islamic banking customers balance their profit with variety Islamic banking portfolios.

The study also tried to analyze the orientation of the service-providers. The objective of Islamic banking is not only to earn profit, but to do good and bring welfare to the people, Islam upholds the concept that money, income and property belong to Allah and this wealth is to be used for the good of the society (Saeed, 1996). Therefore Islamic banking, under ideal conditions, should work with no interest, but trading with profit. Islamic banks are not different from other financial institutions in terms of their legal modalities, constitutive structures, objectives and means of achieving those objectives. The only difference lies in their description as Islamic. The Islamic banks have enjoined on themselves to conduct their affairs within the limit of the rulings of Shari'ah and to comply with its overall objectives. In all banks, the respondents agreed that Islamic banking is just like regular banking only with no interest whatsoever. The interest in Islam is called "Riba" (Usury). Riba or Usury which is strictly forbidden in Islam because it is unfair.

Therefore, introduction of Islamic Banking in the Tanzanian market can be considered more as a social responsibility driven marketing strategy than something of very high religious influence. It was observed that the main focus of the banks is coverage of the market i.e. the banks offer products that appeal to all Tanzanians regardless of their faith or background. For example; the concept of Islamic Banking in one bank is more open and offers the options of the Cheque Account and Saving Account with an embedded Death Benefit. The service is built around the Shariah Laws. Funds deposited in the accounts will be invested in businesses that are approved

under Shariah Law. One of the officials observed that although this service would mostly appeal to their Muslim clientele, it was completely open to everyone regardless of their faith. Islamic Banking services will be available to all who choose an alternative to conventional banking. But this practice and degree of openness varies from bank to bank. For example, at another bank, the funds will be used in lawful and profitable investments (assets) to earn profit and share with banks' valued customers based on the agreed predetermined weightages (profit sharing ratio) declared at the start of every month. The banks with origin from Islamic faith appeared to be more religiously inclined than the other conventional banks with Islamic service as a portfolio. The discussion leads to other potential hypothesis:

- H₃: The banking service providers balance their religious and profitability orientation in designing and delivering the Islamic banking services.
- H₄: The degree of religious orientation in Islamic banking product depends on the type of bank i.e. a bank promoted/ operated by religious organization would have more religious dominance in its banking services.
- H₅: The conventional banks promote Islamic banking services more because of marketing reasons than any religious/ emotional factor. .

Another important question of concern is whether the selection of Islamic banking service is mainly on religious belief or the other perceived benefits of the product. One of the unique and salient characteristics of Islamic banks is that the integration of ethical and moral values with its banking operation. The ethical and moral consideration of Islamic banks can not be detached and their behavior should be consistent with the moral and ethical standards laid down by the Islamic sharia. In contrast with conventional banks, Islamic banks do not consider only the credit worthiness and interest rate as standards; instead they must apply Islamic moral/ethical criteria in their provision of financing. This adds another merit for Islamic banks since there is a beneficial impact on the productivity in the economy as it reduces the social and economic cost of such harmful products and activities. Interestingly, majority of the customers of Islamic banking were not fully aware of the benefits of the Islamic banking in terms of its' contribution to the social good. One major reason behind this could be employees education and training, as it was found in the survey. Therefore, the following set of hypothesis could be developed:

- H₆: The degree of understanding of the product benefit has no significant influence on selection of religiously influenced product like Islamic banking.

H₇: Banks internal capacity development is not linked to the product development i.e. they may develop the product for marketing purpose but may not prepare them fully to handle it.

In the course of its business growth, Islamic banking in Tanzania is also expected to face a number of operational and environmental challenges in its verge of utilizing the system. However, despite the challenges it was found that both the service providers as well as the customers show the confidence about competitiveness of the product.

6. CONCLUSIONS

This study pointed out some of the significant issues and challenges important for growth of Islamic banking Islamic banking. It was found that religious orientation is important for the customer in selection of the Islamic bank however, at the same time most of the customers were not fully aware of the potential benefits of the service. On the side of service providers, they were more balanced in religious and profitability dimensions. However, the conventional banks were found to be involved in delivery of the product more due to marketing reasons. This is also evident from the fact that some of the banks are offering this product without preparing the staff to the required level. It can be seen that the results of this exploratory study has been summarized in form of a set of hypothesis H₁ to H₇. In future, these hypothesis could be further researched and verified to develop knowledge about the Islamic banking in East African context. The findings of this study would also help the banking service providers in closely understanding their customers' needs and responding to them effectively.

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