

UNDERGRADUATES SELECTION TOWARDS ISLAMIC BANKING IN DUAL BANKING ENVIRONMENT: AN EMPIRICAL STUDY

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Abstract

To plan an appropriate marketing strategy to attract new customers is very importance, especially for Islamic banking in dual banking environment. Islamic banks need to identify the criteria on where potential customers determine their bank selection decision. The study focuses on examining the bank selection criteria being employed by undergraduates, the potential Islamic banking customers. The purpose of this paper are to examine the main factors that influence undergraduates in selecting their bank preference and whether there is a significant different between Muslim and non Muslim undergraduates in selecting their banking in dual banking environment. This study presents primary data collected by self-administered questionnaires involving 250 undergraduates at UNITEN as samples. The criteria are analyzed using factor analysis with varimax rotation, to cluster the criteria into several variables. The result shows that convenience factor and bank appearance played significant role in selection process by Muslim and non-Muslim undergraduates. We also found encouraging result that religious factor is among important criteria preferred by Muslim undergraduates in selecting their bank.

Keywords: Bank selection decision, Islamic bank, Syariah compliant products and services.

Introduction

Malaysia has developed over more than two decades, a comprehensive Islamic financial system that operates in parallel with the conventional financial system (Aziz, 2008). The first Islamic bank was established on 1983, carries out banking business similar to other commercial banks, but along the principles of Syariah. Since then, Malaysian Islamic financial system has grown tremendously. Zamani (2007) stated that Malaysian Islamic banking system shown strong performance in 2006 with higher profitability, and has remained well capitalized. In year 2006, Islamic banking assets has reached about USD34 billion or 13 percent in terms of market share.

According to Saeed (1996), the emerging of Islamic financial institutions was started with the establishment of Islamic Development Bank (IDB) on 1973. IDB was aimed to foster economic development and social progress of Muslim countries.

The first major collective step taken by Muslim countries is to promote Islamic financial system. In Malaysia, the establishment of Bank Islam Malaysia Berhad (BIMB) as the first Islamic bank in 1983 had open a new path to Malaysian Financial System especially in banking system towards the introductions of new products and services which based on al-Quran and Sunnah (Abdul Kadir *et. at.*, 2008).

Today, Islamic banking is no longer regarded as a business entity striving only to fulfill the religious obligation for Muslim community; rather Islamic banking has become one of the most important players in service industry (Wilson, 1995). Haron and Wan Azmi (2006) claimed that the Islamic banking sector has shown a tremendous increase in growth by 19% per annum from the year 2000 to 2004. This shows that Islamic products and services have made a strong impact to the Malaysian people.

As a business, it is very important for Islamic institution to winning over customers. According to Dusuki and Abdullah (2007), this necessitates Islamic banks to really understand the perceptions of their customers towards them in terms of service quality to secure customers' allegiance. Therefore, Islamic banking products and services should continued to strengthen their position in the market and able to compete with other conventional banking instruments, especially in the dual banking environment system.

The bank selection criteria have been given considerable attention by many researchers (for example: Evans, 1979; Ross, 1989; Hegazy, 1995; Almassawi, 2001; Dasuki

and Abdullah, 2007 and Abdul Kadir *et.al.*, 2008). According to Almassawi (2001), with the growing of competitiveness in the bank industry and services offered by banks, it has become increasingly important for banks to identify the factors that determine the basis upon which customers chose between providers of financial services.

The study by Dusuki and Abdullah (2007) reveals that the selections of Islamic products and services in Malaysia are because of the combination of Islamic and financial reputation and quality services offered. Meanwhile, the study by Mansur *et. al.* (2007) reveals that most of the respondents in Malaysia known the different of principles between Islamic banking system and conventional system but most of them required more knowledge of Islamic banking system before they use this scheme. Almassawi (2001) studied on 'young customers', which primary refers to college students, and claimed that this group is crucial as they are the banks potential customers. Whereas Haron *et.al.* (1994) found that there is no significant different among Muslim and non-Muslim in the bank selection criteria. Our research is based on these findings.

This paper is designed to identify the bank selection criteria among undergraduates' in dual banking environment. Specifically, the study was designed to determine the selection criteria between Muslim undergraduates and non-Muslim undergraduates in a dual banking environment; and the differences between Muslim undergraduates and non-Muslim undergraduates relating to factors which influence their selection decision. The finding of this research hopefully would

help us to determine the bank direction in providing their services.

This study is divided into five sections. Section one is an introduction to the study. Section two discussed findings review of previous research which relevant to Islamic banking selection and perceptions. Section three highlights the methodology used in our research. Section four present the study of the findings and section five embrace our conclusions and suggestions for future research.

Literature Review

Islamic banking is based on Islamic principle. In Quran, Al Baqarah, part of verse 275 stated that '*...but Allah has permitted trade but forbidden riba (interest)....*'. Islamic financing is based upon the principle that the use of *Riba* (interest) is prohibited (Gerrard and Cunningham, 1997). This prohibition is based upon *Shariah* ruling. Since Muslims cannot receive or pay interest, they are not allowed to conduct business with conventional banks. Jaffe (2002) claimed that, to service this niche market, Islamic financial institutions have developed a range of *halal* interest-free financing instruments that comply with *Shariah* ruling, and therefore are acceptable to Muslims.

According to Dusuki and Abdullah (2007), customers' positive perception towards Islamic banking is far more crucial mainly due to the fact that Islamic banks have to compete with the long established conventional banks in a dual-banking system. Aziz (2005) claimed that, the Islamic banking industry in Malaysia has been growing at average rate of 18 percent

per annum in terms of assets since year 2000. Furthermore, Aziz (2009) stressed that Islamic finance needs to be further regulated as it is now growing and becoming an increasingly important component in the international financial system and despite the current challenging global financial environment, the growth momentum of Islamic finance had continued.

Even though there are varieties of Islamic financial products available, but the most widely recognized is profit-and-loss sharing instruments agreement. Metwally (1994), identified three significant differences tools between Islamic financial and conventional financial: *Musharaka* (Partnership), *Mudarabah* or *Quiradh* (Investment with no participation in management) and *Murabaha* (Resale Contract). The financiers of the venture are 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 (Hussain and Zurbruegg, 2006).

Under a *Mudaraba* agreement, the parties must decide on a rate for sharing of the profits prior to the commencement of the business activities. After the business is completed, the financier receives the principal and the pre-agreed share of the profit (Metwally, 1994; Gaoor, 1996 and Usmani, 1998). *Musharaka* is 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. (Lewis and Algaoud, 2001; Metwally 1994; Usmani, 1998 and Haron *et.*

all., 1994). *Murabaha* is financing where the bank purchases for a client certain commodities and the client promises to buy the goods from the bank on a pre-agreed profit basis (Metwally, 1994).

There are many literatures on customers' preference towards financial products and services criteria. According to Metawa and Almosawi (1998), customers' preferences towards banking criteria have been heavily investigated over the past two decades. Among the areas studied and attributes found are availability of credit, relatives' advice and recommendations, friends' advice and recommendation, convenient location, variety of bank services, the quality of services, availability of ATM, adequate bank hours, return on investment, friendliness of personnel, understanding financial needs, special services for women, and bank name.

Hegazy (1995) studied on bank selection criteria for both Islamic banks and commercial banks. He concluded that the most important factor attributes for Islamic banks was advised and recommendations made by relatives and friends. Dusuki and Abdullah (2007) found that the customer satisfaction often depends on the quality of services provided by Islamic banks. The study by Haron et. al. (1994) shown that Muslims and non-Muslims who preferred commercial banks have a common perception in selecting their banks. This means that, the Islamic bank should not rely on the religion factor as a strategy in its effort to attract more customers. Erol and El-Bdour (1989), found that interpersonal contact and individual effort played an important role in terms of attracting individuals to utilize financing services.

Religious motivation did not appear to be a primary criterion.

Erol *et.al.* (1990), found that bank customers did not differentiate between the services offered by conventional banks and Islamic banks. Naser *et al.* (1999) stressed that large majority of customers' were satisfied with the Islamic bank's name and image and with the bank's ability to provide confidentiality. Their findings also indicate that a large majority of the respondents patronage with the Islamic finance because of its reputation. This finding differ with Erol and El-Bdour (1989) and by El-Bdour *et al.* (1990), as they reported that customers rely heavily on criteria like the bank's reputation and image and the confidentiality of the bank when choosing a bank. Metawa and Almosawi (1998) reveals that adherence to Islamic tenets is the main motivating factor for customers to preferring Islamic banks in Bahrain. Their results also indicate that bank employees and bank equipment plays important role towards customers' preferences.

According to Abdul Kadir *et.al.* (2008) the criteria used for bank selection should be based on respondents' profile. Since our respondents are undergraduates, we believe the need to detail out the selected criteria. Based on literature, we have identified twenty seven criteria in banking selection, including three criteria specifically mention about Islamic principles. We hope by separating Islamic principle, we can get a true picture of undergraduates' views on bank selection on these criteria. As stressed by Almosawi (2001), undergraduates are crucial because they constitute a sizeable market segment, tend to be good savers and are potential bank customers, who will have

one when they complete their education. We are focusing our study on these groups.

Methodology

A sample of 250 undergraduates UNITEN students from College of Business and Accounting (COBA) was chosen based on random sampling technique. We choose UNITEN and COBA because of the fair population of Muslim and non-Muslim undergraduates at this college. They are come from all over Malaysia. Furthermore, these undergraduates are business students and we hope they have a general idea on the question to be asked. By choosing these undergraduates, we hope at least we can get closer result to the whole population. From 250 questionnaires distributed, 150 have been returned by Muslim undergraduates and 85 by non-Muslim undergraduates.

Data collection was obtained from questionnaires designed based on the review of the literatures. All of the criteria had been applied from the previous studies, including three specific Islamic principle criteria. We had identified twenty seven criteria to be used. In our judgment based on the literature review, these were the most suitable criteria. Other researchers who were studied on undergraduates such as Gerrard and Cunningham (2001) on Singapore's undergraduates used 20 criteria, and Almosawi (2001) on Jordan's college students used 30 criteria.

We used exploratory factor analysis with varimax rotation to analyze the data. Factor analysis used to cluster the criteria and consequently group the independent variables into smaller factors. According to Mohd Dali *et. al.* (2008), the main

applications of factor analytic techniques are: (1) to *reduce* the number of variables and (2) to *detect structure* in the relationships between variables, that is to *classify variables*. Therefore, factor analysis is applied as a data reduction or structure detection method. This method also had been commonly used by other researchers such as Haron *et al.*, 1994; Gerrard and Cunningham 1997, 2001; Almosawi 2001; Dusuki and Abdullah, 2007.

The questionnaire was divided into two sections. Section A, based on the demographic profile, a set designed to gather information about the sample's personal, demographics and education background of the respondents. Section B comprises the twenty-seven selections bank criteria including three specific criteria on Islamic principles. The five-point Likert scales ranking from very important (scale 1) to not important at all (scale 5) was used to measure the Muslim and non-Muslim undergraduates selections criteria.

Findings and Discussion

The findings are based on 150 respondents among Muslim undergraduates and 85 respondents among non-Muslim undergraduates. From Table 1 it shows that the highest percentage on age is below 22 for both groups. Majority of the respondents were female. This is shown by the highest percentage for both groups (Muslim and non-Muslim) which represented by 73 percent and 89 percent. Coincidentally, all the Muslim undergraduates are from accounting course, and 88 percent of non-Muslim undergraduates are from accounting course. It is also found that the respondents are almost equally coming from all over

Malaysia (North, South, East and West) which a ranging from 17 percent to 42 percent. Majority of the respondents already

have their bank accounts in conventional banking.

Table 1: Profile of Respondents

	Muslim N = 150 (%)		Non – Muslim N = 85 (%)	
Age				
Below 22	133	89%	80	94%
Above 22	17	11%	14	6%
Gender				
Male	41	27%	17	11%
Female	109	73%	68	89%
CGPA				
2.00 – 2.49	23	16%	19	22%
2.50 – 2.99	38	25%	5	6%
3.00 – 3.49	51	34%	42	50%
3.50 Above	38	25%	19	22%
Course				
Accounting	150	100%	75	88%
Human Resource	-		5	6%
Business Studies	-		5	6%
Origin				
North	27	18%	19	22%
South	25	17%	24	28%
East	35	23%	15	22%
West	63	42%	24	28%
Account types				
Islamic	23	15%	5	6%
Conventional	81	54%	52	61%
Both	46	31%	28	33%

We run the exploratory factor analysis with varimax rotation to analyze the data. From table 2, the KMO Measurement of Sampling Adequacy (MSA) Test is 0.714, which is higher than 0.6 that enable the factor

analysis to be further analyzed. Furthermore the Bartlett's Test of Sphericity is significant at 0.00 level. It means that there are intercorrelations among the variables.

Table 2: KMO and Bartlett's Test

Kaiser-Meyer-Olkin Measure of Sampling Adequacy.		.714
Bartlett's Test of Sphericity	Approx. Chi-Square	3502.746
	df	351
	Sig.	.000

The result of factor analysis with a varimax rotation appears in table 3. The analysis produced eight factor groups. We have decided to titles each factor group as described below. The items grouped under Factor 1 could be called 'transaction', with examples of several bank branches, availability of ATM in several locations, 24-hours availability of internet services,

employer uses the same bank and ease of opening an account. Factor 2 relates to 'religious factors' and, in this grouping, and the ability to provide Islamic facilities, which include providing wide range of Islamic facilities and providing Islamic bank account.

Table 3: Factor groups of the bank selection criteria

Factor 1 (Transaction) – Cronbach alpha (0.8453)	
Several bank branches	0.747
Availability of ATM in several locations	0.715
24-hours availability of internet services	0.658
Employer uses the same bank	0.622
Ease of opening an account	0.595
Percentage of Variance	24.93
Factor 2 (Religious factor) – Cronbach alpha (0.8835)	
Providing Islamic facilities	0.921
Providing wide range of Islamic facilities	0.835
Providing Islamic bank account	0.758
Percentage of Variance	12.97
Factor 3 (Convenience) – Cronbach alpha (0.7644)	
Adequate number of tellers	0.724
Convenient ATM locations	0.536
Convenient location of the main branch	0.526
Percentage of Variance	10.56

Factor 4 (Bank appearances) – Cronbach alpha (0.7747)	
External appearance of the bank	0.790
Bank reputation	0.595
Staff appearance and attire	0.594
Percentage of Variance	7.760
Factor 5 (Financial benefits) – Cronbach alpha (0.6606)	
Providing credit card with no annual fees	0.744
Paid high interest rates on saving accounts	0.579
Percentage of Variance	6.448
Factor 6 (Charges and confidentiality) – Cronbach alpha (0.8140)	
Low services charges	0.814
Confidentiality of bank	0.540
Low interest rates on loans	0.512
Percentage of Variance	4.903
Factor 7 (People influences) – Cronbach alpha (0.7639)	
Recommendation by relatives	0.931
Recommendation by friends	0.565
Percentage of Variance	3.221
Factor 8 (Personnel and product pleasant) – Cronbach alpha (0.6888)	
Convenient in bank manager	0.610
Ease of obtaining loans	0.576
Percentage of Variance	2.816

Factor 3 is seen as a 'convenience' and the criteria are adequate number of tellers, convenient ATM locations and convenient location of the main branch. Factor 4 we named as 'bank appearance' which relate to external appearance of the bank, bank reputation and staff appearance and attire. Factor 5 is a 'financial benefits' grouping consisting of providing credit card with no annual fees and paid high interest rates on saving accounts. Factor 6 relates to 'charges and confidentiality', particularly on low services charges and confidentiality of bank. Factors 7 is name as 'people influences', relates to criteria of recommendation by relatives and recommendation by friends.

Finally, Factor 8 can be titled as 'personal and product pleasant', this relating to convenient in bank manager and ease of obtaining loans.

The criteria listed in Table 3 include only those which had factor loadings of 0.50 and above and for which the Cronbach alphas for each of the groupings were 0.60 and above. The eight factor groups accounted for 71.62 per cent of total variance. A few factors which had been remove because the factor loadings are less than 0.50 are available parking space nearby, saving are guaranteed by government, giving a wide

range of facilities and friendliness of bank personal.

We further analyse the data by ranked the factors loading based on mean. The result is shown in Table 4. From the result, a few interesting issues could be highlighted. First, Muslim undergraduates select a convenience banking as their first preference such as location, availability of ATM services and several bank branches. The result also shown there is no significant different between Muslim and non-Muslim in perceiving convenience banking.

Table 4
Bank selection criteria: A comparison of Muslim and non-Muslim undergraduates

	Muslim			Non – Muslim			Sig.
	Rank	Mean	SD	Rank	Mean	SD	
Convenience	1	3.8977	.6952	3	3.4889	.9706	.018*
Religious factors	2	3.8683	.7698	7	2.9822	.9898	.340
Charges and confidentiality	3	3.8066	.8711	4	3.4630	.7595	.263
Bank appearances	4	3.7990	.7216	1	3.5185	.6785	.858
Transaction	5	3.6298	.7932	5	3.3241	.7105	.737
Personnel and product pleasant	6	3.5802	.9089	2	3.5000	.7276	.260
Financial benefits	7	3.5076	1.0038	6	3.2833	.8952	.223
People influences	8	3.0229	.9111	8	2.9722	.9922	.227

Third, we found a very encouraging result that, for Muslim undergraduates, they perceive religious factor as second importance factors. This means that, a young Muslim observe religious factor as something to be applied in their daily life. This factor might explain why Islamic banking in Malaysia grow faster then conventional bank. Forth finding to be grow highlighted is that, people influence was ranked as the last preferred factor for both

Meaning that whether the consumers are Muslim or not, convenience factor is very important to attract potential customers. Second finding is for non-Muslim, they perceived bank appearance factor such as external appearance and bank reputation as a first preference selection. So therefore, it is worth for the bank to expense more to build up their reputation and image as undergraduates perceived this as important factor.

groups. This indicate that, in undergraduates preferences process, they are prefer to act independently and make choices by their own rather than listening advice from others.

Lastly, another encouraging finding is religious factor was at the second last preferred for non-Muslim undergraduates. This means that banking based on Islamic religious are not totally rejected by non-

Muslim. Islamic religious factor are acceptable even for non-Muslim. The low ranking might due to misunderstanding of the concepts, but not totally rejected. As reflections to this finding, Islamic banker should see this as an opportunity to expand their market. Banking based on Islamic principle is not totally rejected. With the proper marketing plan and sufficient explanations about Islamic concepts, especially to the non-Muslim, there is a wider opportunity for Islamic banking to further expand.

Limitation of Findings

All the information gathered for this study was obtained from UNITEN undergraduates at Muadzam Shah Campus, Pahang. Therefore, the sample is limited to only one university. The number of respondents also small which is only 235 respondents consists of 150 Muslim respondents and 85 non-Muslims respondents. It is suggested that more university should be involve with more respondents in both groups.

New Market Opportunity

Islamic banking in Malaysia has taken on a new dimension to become more internationally integrated. This is part of the strategy to evolve Malaysia as an integrated international Islamic financial hub that will have a greater role in facilitating international economic and financial flows. As Islamic finance market is 'significantly untapped', Malaysia has unveiled plans to open its Islamic finance industry further and trying to lure larger overseas banks to provide services that comply with Muslim tenets. With initiatives to turned Islamic banking and insurance into an industry with

\$1 trillion in assets globally, Malaysia government had said in plans to issue as many as two Islamic banking licenses to overseas lenders in year 2009 and will let in more foreign banks.

Until now, Bank Negara Malaysia has licensed three overseas Islamic banks, including Kuwait Finance House, the Persian Gulf's largest Islamic investment bank, and Saudi Arabia's Al-Rajhi Bank. Malaysia has 17 Islamic banks, which include the Islamic units of HSBC Holdings Plc, Oversea-Chinese Banking Corp. and Standard Chartered Plc. With the current development and government initiative on Islamic finance, the existing Islamic finance must observe this as opportunity to strengthen their position and growth.

In Malaysia, Bank Negara Malaysia and the Association of Bank Malaysia play a significant role in regulating finance sectors. According to Che Wel and Mohd Nor (2003), finance companies in Malaysia do not have a free hand in pegging interest rate to attract customers, thus it is importance for them to know and understand the factors that influence customer bank selection decision. Therefore, a study of customers' preference and future customers' preference is a vital step in understanding the customers need and to ensure they are stepping on the right tract.

The most significant and interesting findings reveal in this study is the potential of Islamic banking products. For Muslim undergraduates, they ranked religious factors as second preferential factors, but for non-Muslim graduates, they ranked at seventh or second last. This means that there were non-totally rejected by non-

Muslim undergraduates on Islamic finance. We believe that the lower ranking was due to misunderstanding of Islamic finance concept.

As a result found by Abdul Kadir *et. al.* (2008) on knowledge of Islamic product among academician and non-academician, there are many Malaysians did not fully understand the Islamic finance concept. And, again in this research we found the misunderstanding of Islamic concepts is the major obstacle in attracting customers. There are large potential for Islamic banking in Malaysia, but the major issue to be resolved is on how to educate customers about the Islamic financial product. Thus, the huge opportunities of Islamic finance in Malaysia will belong to the party who can overcome this obstacle.

Conclusion

The era of Islamic banking was regarded as a financial instrument to fulfill Islamic obligation was no longer exist. Islamic banking is no more considered as a secondary banking but now is competed to be the primary banking in Malaysia. Research about selection criteria in banking sector is very important especially for Islamic banking to place their self as a primary banking in Malaysia.

The purpose of this study is to determine the factors which Muslim and non-Muslim undergraduates perceive as their preferred selections relevant to their preference of Syariah products and services. As a reflection to these findings, we have come out with three vital conclusions; first, Muslim undergraduates perceive convenience as their main preference

whereas, non-Muslim undergraduates preference bank appearance as their preference.

Secondly, we found encouraging outcome that Muslim undergraduates perceive Religious factor as second preference criteria. This might indicate the bright future for Islamic banking as their future customers perceive religious factor as one of importance factors. Thirdly, Islamic religious factor was not totally rejected by the non-Muslim undergraduates, even though it was ranked among the lowest factors.

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