

Factors Affecting the Choice of Islamic Banking by SMEs in Pakistan: Implications for Islamic Banks' Corporate Governance

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Abstract

Business is an important factor for the development of the economy of any country. Over the last ten years the Government of Pakistan has been playing an important role in promoting the Small and Medium Enterprises (SMEs) and improving their governance standards. It is also true that finance is one of the major elements for businesses and banks are playing an important role to finance the business sector of Pakistan. Therefore, this study has focused on the business community to analyze the factors which influence the adoption of Islamic banking among SMEs in Pakistan. In this regard, 400 business units have been selected as sample size. This research is based on the primary data collected from different areas of the Central Punjab. Several inferential statistics techniques have been used to get results. The study has found significant impact of corporate governance image of the bank, government support, relative advantage, perceived behavior control and subjective norms on the use of Islamic banking among SMEs in Pakistan. The results of this study show a positive impact of Islamic banking to promote the SMEs in Pakistan.

Key Words: Islamic banking, corporate governance, small and medium enterprises, SMEs.

1. Introduction

Business is a very valuable activity of the country. Government can get many benefits by promoting the business activities in the country and can resolve many issues such as

poverty, unemployment, illiteracy and corruption (Umrani et al., 2018). Ahmad & Sattar (2018) highlights that government would be able to find the solution 60 percent of its problems by creating productive environment to support entrepreneur activities among the people of the country. Such initiatives include existence of an efficient financial system to provide financial solutions to different business firms. The Government of Pakistan (GoP) has been trying to create entrepreneurship environment in the country since last fifteen years and motivating the people to start their own businesses instead of searching the job (Rasheed et al., 2018). According to the Small and Medium Enterprises Development Authority (SMEDA), SMEs have been growing in Pakistan. GoP supports the owners and workers of SMEs in order to promote the business activities in the country. The fame of SMEs is depending on the financial resources which are available for the businesses.

There are a number of financial institutions available in Pakistan to facilitate the financial needs of the SMEs. These banking institutions working in Pakistan are divided into two basic categories, such as conventional banks and Islamic banks. The system of Islamic banking is depending on the preaching of the Quran and Hazrat Muhammad (PBUH). It involves collective exposure between all customers, deal honestly with all transactions; Interest free banking transactions which are compulsory part of their business under the Shariah advisory board. According to the State Bank Pakistan (SBP), there are six full-fledge Islamic Banks (Meezan Bank Limited, Dubai Islamic Bank, MCB Islamic Bank Limited, Al-Baraka Bank and Bank Islamic Pakistan) operating in Pakistan. These banks have been properly working according to the Quran and Sunnah to fulfil the customer's needs (Rasheed et al., 2018).

Shariah advisory boards analyse the performance of these banks on a monthly basis and ensure that they are fully working within the boundaries of the Islam. On the other hand, sixteen conventional banks have also opened their Islamic banking windows in the different cities of Pakistan. The total number of Islamic bank branches is 2708. According to SBP press release issued in January, 2019 the Pakistani Islamic banking industry has shown a remarkable growth in last year with its assets reaching about 12.9% of the whole banking sector. Similarly, its deposits account for 14.8% of the total banking industry deposits. This information highlights that the trust of the users of various banking services on the Islamic banks has increased. Khan (2010) has already highlighted that the Islamic banking is not only attractive for Muslims but also appreciated by non-Muslims in Pakistan.

Now, the Islamic banking industry is working in this modern era as an alternative financial solution in the world. And this proves that the Islamic financial banking system

is a reliable system in the Pakistan and in other countries too (Hakimi et al., 2018). Because of the competition in the working environment, the Islamic banks are also attracting the business sector in the world and approaching the SMEs by offering different valuable products and services. There are many studies published from the last ten years about the importance and adoption of Islamic banking which help to build the customer's knowledge as well as help to enhance the Islamic banking sector in the world.

In the recent study on the Jordan Islamic banking has been conducted by Raza et al. (2018) shows that the outside image of the bank, parking and the favourable comments by the friends help the people to adopt the Islamic banking services. The other available literature gives the direction about the selection of banking criteria on the behalf of factors and mainly focused on the area of consumer behaviours towards the selection of Islamic banking. However, much selected research is available in the context of Pakistani SMEs.

Pakistan is a Muslim country; the Islamic banking industry is the most developing sector in the banking sector of Pakistan as demonstrated by the growth of itself and the growth of Islamic wealth. This is because of the Muslims directions towards the Islam. On the other hand, GoP pays full attention to promote the SMEs in different ways. Because of the China Pakistan Economic Corridor (CPEC), many business opportunities exist in the country. According to the current political change in Pakistan many countries want to invest in Pakistan for a business purpose. So, there is large number of business opportunities which exists in Pakistan; and many people are working on the behalf of the SMEDA. Every business needs financing either through Islamic banks or conventional ones to fulfil their business and financial demands (Uddin & Suzuki, 2011).

SMEs need financing in a high rate for their business. The Islamic banks have all the products and services to fulfil all needs and wants of the business of SMEs and the individual person to support the economy of the country. By mentioning the growth of Islamic banking and importance of SMEs in Pakistan this study will check and examine the further effect of Islamic banking on the behaviour of SMEs towards the adoption of Islamic financing in Pakistan. Therefore, it is valuable in this research to promote the Islamic banking in the field of SMEs and the problem which needs to be discussed is what are "the factors which affect SMEs to adopt the Islamic banking in Pakistan"?

1.1 Objective of the Study

The focus of this study is to determine the impact of various factors on the adoption of Islamic banking among SMEs in Pakistan.

- To examine the impact of various individual factors such as awareness, ideology, religious obligation, perceived behavior control, attitude and self-efficiency on the adoption of Islamic banking among SMEs in Pakistan.
- To explore the impact of corporate image of the bank, Government support, relative advantage, compassion and subjective norms on the adoption of Islamic banking among SMEs in Pakistan.

2. Literature Review

According to the previous literature, few studies exist which have been conducted in Muslim and non-Muslim countries; however, it is very interesting to show the significance of SMEs towards the attraction of the Islamic banking. This is the reality, SMEs are the key player for the economy of the any country, and financing is the basic need of every business either on a small or high rate of financing. The Islamic banking has created its own importance not in the Muslim countries but also in the whole world.

There are many studies published in recent years focused on the importance and adoption of Islamic banking. Schottman (2014) and Hakimi et al. (2018) studied impact of various factors on the adoption of Islamic banks in Bahrain. They found religious as the most important factors among the all other factors (awareness, usage of internet services, demographic variables). Similarly, some other authors (Yahaya et al., 2016; Ogunbado et al., 2017; Utama, 2018; Al Balushi et al., 2019; Butt et al., 2018; Nawaz, 2019) recognized different influencing factors such as awareness, corporate image, government support, ideology, relative advantage, religious obligation, compassion, perceived behaviour control, attitude, subjective norms and self-efficacy upon the adoption of Islamic banking.

According to a recent report of SBP published in 2018, less than 8 percent of banking customers understand the Islamic financing laws as well as Islamic banking products and services. However, Muneer et al. (2017) mentioned that the business customers have much better knowledge about Islamic banking methods, products and services than others. Al Balushi et al. (2019) identified awareness as an important variable towards the adoption of Islamic banking in SMEs. Butt et al. (2018) has elaborated that people were not well-aware of Islamic Banking in Pakistan during the nineteenth century. However, their awareness about the Islamic banking products and services has been improved with the help of social media, mass media and print media.

Corporate image of the bank is also an important aspect in banking selection criteria. Different authors explain the corporate image of bank in different series. According to Iqbal et al. (2018), corporate image refers to the large branches network, ATM services

availability, facility of online banking, and modern look of the bank's infrastructure. Positive image of the bank plays a vital role in the banking selection criteria for the business firms as well as individual households (Al Balushi et al., 2019). Zameer et al. (2018) has highlighted that the successful banking institutions also focus on the said attributes while establishing any new branch to promote their banking products and services in Pakistan context. Mostly bank branches are opened near business hubs in big cities to attract business persons.

The agenda and activities of any government effect attitude and commitment of the households, SMEs and multinational companies (Lajuni et al., 2017). The GoP has also made the friendly environment for banks to establish and promote the Islamic banking industry in the country (Butt et al., 2018). According to the SBP Islamic Banking Division, a number of circulars have been issued to encourage the CEOs of all the schedule banks to promote the Islamic banking within their institutions. The SBP has directed all the conventional as well as Islamic banks to open new branches of Islamic banking in major cities of Pakistan (Yaseen & Naqvi, 2018). Considering the fact, this support of the GoP has facilitated the growth of Islamic banking industry in Pakistan and has a positive impact on the behaviour of various business units including SMEs to adopt the Islamic banking in Pakistan (Shome et al., 2018).

Ideology in the adoption of Islamic banking comes in one's mind when he or she needs to change his life or business activities according to Islamic rules and laws (Rahman et al., 2018). Pakistan has been created with the name of Islam so that the ideology of the Islamic norms comes in their behaviors in day to day activities (Latif, 2019). Consequently, special attention towards the Islamic norms has been paid and the interest free banking is also an important elemental in Pakistani culture (Suki, 2018).

Customers prefer relative advantage while using banking products and services both in Islamic banks as well as conventional banks (Gupta & Arora, 2017). Similarly, many SMEs working in Pakistan want to seek the advantages while using the financing source or banking products and services (Butt et al., 2018). Some account holders in the Pakistan prefer the better customers relations with the banking industry while some of them prefer transparency while using the banking products or financing (Yahaya et al., 2014). Some users consider the banking sector as a mean of borrowing funds from banks. Consequently, Butt et al. (2018) has revealed that the owners of the business firms as well as individuals in Pakistan consider their own benefits and advantages while using the banking products and services.

Islamic banking practices are strictly based on fundamental Islamic financing principles and laws. The availability of wide range products and services attract the business community towards the adoption of Islamic banking to satisfy the financial needs and help the owners for decision making in the business transactions according to Islamic laws and values (Lajuni et al., 2017). The greater involvement of Islamic principles in banking industry increased the possibility to use the Islamic banking product and services and give the positive effect to the people mind towards the Islamic financing or banking. In the previous studies, mostly people use Islamic banking because of their strong attachment with religion (Rizal & Amin, 2017).

Al Balushi et al. (2019) have highlighted compassion as the more value-added services of the Islamic banks than the conventional banks. According to this study, compassion refers to facilitate the customers, check the performance of the bank, innovative ideas and technology delivered to the customers, malleable terms and conditions for the customers. Many banks in Pakistan use the word compassion with facilitating the business owners by providing them special services (Butt et al., 2018). Islamic banks are also facilitating SMEs by giving them the facility of special account for business owners with free of cost services and financing with minimum charges (Latif, 2019).

Perceived behaviour control explains the action of one's which is regulated by his understanding and capability to manage his determination (Rahman et al., 2018). The previous research work in Islamic finance has judged the subjective norms and attitude over the perceived behaviour control to examine the adoption of Islamic banking. Perceived behaviour control has widely been used in many studies to examine its impact on the adoption of Islamic banking conducted in Malaysia, Pakistan, Oman, and Nigeria (Yahaya et al., 2016; Ogunbado et al., 2017; Butt et al., 2018).

Several studies (Kaakeh et al., 2018; Raza et al., 2018) on the topic of Islamic banking have focused on the attitude of customer with the relationship of behaviour. The attitude may be positive or negative. It depends upon the behaviour of an individual or the owner of the business. According to the business point of view of all over the world, owners of small business are adopting the financing by their own choices not by their easily access to the financing sources (Haridan et al., 2018). Business owners are using the banking services in different scenarios like they use banking services for business transactions and to fulfil the financing needs of their business.

The subjective norms refer to the normative forces. Actually, the subjective norms are those religious or social norms with the moral intentions which help to adopt the Islamic banking by the individuals. The pressure has come from many forces such as family

members, friends, peers and business parties under this factor (Amin et al., 2011). The impact of social influence is mixed while adopting Islamic banking in the available literature (Amin et al., 2011; Al Balushi et al., 2018; Rasheed et al., 2018).

While discussing the business environment in Pakistan context, mostly people follow the rules and norms which are followed by their elders. Hussain et al. (2018) have revealed that the pressure which is exerted by their peer groups, their friends and family members enables them to do the right or wrong things in the business activities. Considering the fact, the factor subjective norms are also one of the reasons which may instigate and have impact on the business owner mind-set to use the Islamic banking.

One's self-efficacy shows the importance of his or her goals and plans. Bloom et al. (2018) have highlighted that people with high motivation and self-efficacy achieved their goal quickly and efficiently. Nawaz (2019) has highlighted that the self-confidence is coming in one's mind because of his or her trust on Islamic banking and provoke the individuals to adopt the Islamic financing (Latif, 2019). There is lack of research in which the variable self-efficacy is used for checking the behaviour and self-confidence of the owners of SMEs to adopt the Islamic banking (Kaakeh et al., 2018).

Some recent studies on Islamic banking in Pakistani context (Aziz et al., 2018; Butt et al., 2018; Iqbal et al., 2018; Al Balushi et al., 2019) have tried to check the management structure, performance and individual behaviours on the adoption of Islamic banking. However, it is universal truth that financing is an important element for doing any business (Rammal & Zurbruegg, 2016). The available studies on the adoption of Islamic banking in Pakistan do not fully address the specific factors among business community especially in SMEs. Therefore, the current study has tried to give specific directions to the top management of Islamic banks to improve the effectiveness of corporate governance on the SMEs sector of Pakistan.

Choice of Islamic Banking by SMEs

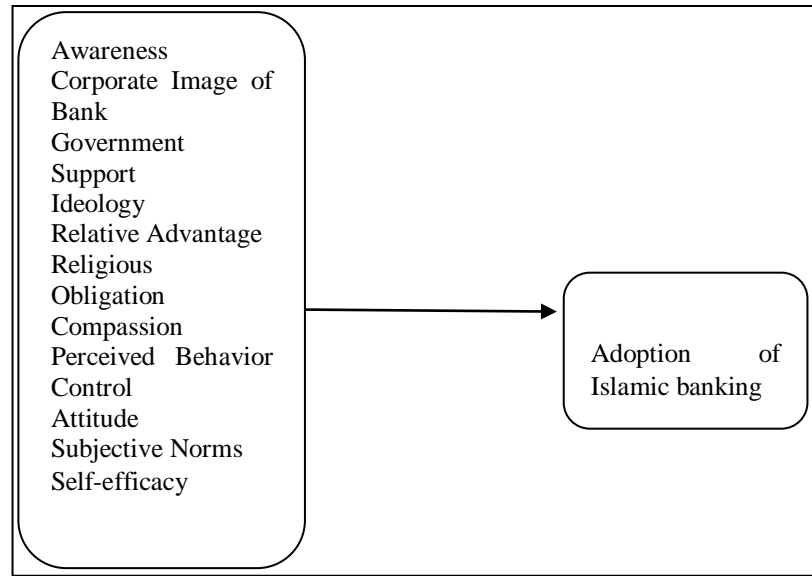


Figure 1: Conceptual Framework of the Study

The current research has considered the study population to all the SMEs which are working in Pakistan and are using Islamic banking products and services for their business purposes. Table 1 outlines brief explanation of Small and Medium Enterprises according to various Pakistani organizations regarding number of workers and business assets.

Table 1: The explanation of SMEs by the particular organizations in Pakistan

Sr. No.	Name of Organization	Size	No. of Workers	Business Assets Millions Per Year (PKR)
1	Small and Medium Enterprises Development Authority of Pakistan (SMEDA)	Small Sized	30-35	21 - 25
		Medium Sized	36-100	26-45
3	State Bank of Pakistan (SBP)	Small sized	25 - 55	70-160
		Medium sized	56-255	161-850
4	Small and Medium Enterprises Bank Pakistan (SME Bank)	Small sized	31-35	25-29
		Medium Sized	99-125	30-100

Simple random sampling has been used in this study. Considering the time and money constraints, 500 SMEs across the different cities of Pakistan have been selected to collect data. The study has used primary data which have been collected through questionnaires. The said technique of primary data collection has been undertaken by considering the fact that it is the most reliable method to collect data from the SMEs (Al Balushi et al., 2018). Self-delivery and collection method has been adopted in this study to increase the response rate. All the items of the study questionnaire variables have been adopted from earlier studies (Rammal & Zurbrugg, 2016; Yahaya et al., 2016; Lajuni et al., 2017; Aziz et al., 2018; Bizri et al., 2018; Iqbal et al., 2018; Tabrani et al., 2018; Al Balushi et al., 2019) in the English language. However, the questionnaire has been translated into Urdu language according to the need of the targeted population. For this purpose, this study has taken help from teacher of the English Department of the National University Modern Languages, Islamabad (Faisalabad Campus).

The study questionnaire has been divided into two basic sections. First part has contained the business and personal information of the respondent. While second section has covered the different types of statements to measure the study variables such as adoption of Islamic banking, awareness, corporate image of the bank, Government support, ideology, relative advantage, religious obligation, compassion, perceived behaviour control, attitude, subjective norms and self-efficacy. Five likert scale (strongly disagree = 1, disagree = 2, neutral = 3, agree = 4, strongly agree = 5) have been used to gain the response. As mentioned earlier, total 500 questionnaires have been distributed out of which 419 filled questionnaires have been collected? Furthermore, nineteen questionnaires were found incomplete. Hence, the response rate of this research is 80 percent.

3. Results and Discussion

Descriptive statistics have been used to report and describe the data in appropriate method. Important aspects of the business and personal information of the respondents have been presented in Table 2.

Table 2: Business and Personal Information of the Respondents

Category of Info.	Details	Frequency	Percentage
Type of Business	Sole Proprietorship	119	29.8
	Partnership	225	56.2
	Company	56	14.0
No. of Employees	Less than 10	18	4.5
	10 – 49	201	50.2
	50 – 249	176	44.0
	250 – 999	5	1.3
Frequency to Use Banking Services	Daily	256	64.0
	Weekly	126	31.5
	Monthly	15	3.8
	Other (Occasionally)	3	0.7
Gender	Male	387	96.8
	Female	13	3.3
Age	30 or Less	57	14.3
	31 – 40	129	32.2
	41 – 50	127	31.8
	51 or More	87	21.7
Religion	Muslim	386	96.5
	Non-Muslim	14	3.5
Education	Intermediate or Less	141	35.2
	Graduation	231	57.8
	Post- Graduation	28	7.0

The above table explains different demographic information regarding type of business, number of employees and frequency to use banking services. Similarly, some personal information of the respondents such as their gender, age, religion and level of education has also been described.

4.1 Correlation Analysis

This study has conducted Pearson correlation analysis to examine the association between the study variables. Table 3 reports the results of the said analysis. According to the results, there is positive moderate correlation between adoption of Islamic Banking and awareness, bank corporate image, government support, relative advantage, relative obligation, compassion, perceived behaviour control, attitude, subjective norms and self-efficacy. However, a weak correlation positive correlation between adoption of Islamic Banking and ideology has been

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found. Table 3 shows the maximum value of Pearson correlation among all the independent variables is .476. This results has proved that the data is free of multicollinearity issues and suitable for multiple regression analysis (Gujarati and Porter, 2009; Garson, 2012).

Table 3: Correlation Analysis Results

Sr. No.	Name of Variable	1	2	3	4	5	6	7	8	9	10	11	12
1	Adoption	1											
2	Awareness	.0391**	1										
3	Bak_crport_Img	.450**	.402**	1									
4	Govt. Support	.476**	.261**	.320**	1								
5	Ideology	.268*	.079	.274**	.172**	1							
6	Relative adv.	.441**	.193**	.381**	.332**	.173**	1						
7	Religious obl.	.373**	.177**	.274**	.256**	.178**	.352**	1					
8	Compassion	.352**	.270**	.426**	.324**	.175**	.439**	.261**	1				
9	Per_Behvr_ctrl	.437**	.269**	.370**	.307**	.034	.392**	.313**	.461**	1			
10	Attitude	.444**	.176**	.311**	.337**	.142**	.428**	.321**	.416**	.458**	1		
11	Subjective Norms	.374**	.127*	.274**	.303**	.155**	.312**	.272**	.367**	.314**	.407**	1	
12	Self-efficacy	.384**	.163**	.286**	.218**	.086**	.341**	.248**	.342**	.446**	.409**	.370**	1

*Correlation is significant at the 0.5 level. (2-tailed)

**Correlation is significant at the 0.01 level. (2-tailed)

Key: Bnk_crport_Img = Bank Corporate Image, R_adv = Relative Advantage, Rel_Obl = Relative Obligation, Per_Behvr_ctrl = Perceived Behavior Control.

4.2 Regression Analysis

According to Table 4, the majority of the independent variables such as awareness, bank corporate image, government support, ideology, relative advantage, relative obligation, perceived behaviour control, attitude, subjective norms and self-efficacy have significant impact on the adoption of Islamic Banking. On the other hand, the study has failed to find any significant relationship between Compassion and dependent variable. The R2 value (.47, $p < .001$) shows that all the independent variables are explaining about 47 percent variation in study dependent variable that is Adoption of Islamic Banking.

Table 4: Results of Regression Analysis

Sr. No.	Relation of Variables	Standard Beta	Standard Error	T value	Significance Value
1	Awareness	0.187	0.044	4.58	0.000***
2	Cor_image_bnk	0.106	0.047	2.33	0.020**
3	Govt_Support	0.213	0.038	5.10	0.010**
4	Ideology	0.122	0.044	3.15	0.002**
5	Rel_Advantage	0.121	0.048	2.69	0.007**
6	Rel_Obligation	0.093	0.046	2.26	0.024**
7	Compassion	-0.076	0.050	-1.64	0.101
8	Per_Beh Ctrl	0.11	0.054	2.43	0.015**
9	Attitude	0.11	0.59	2.41	0.016**
10	Sub_Norms	0.085	0.043	1.98	0.048**
11	Self-Efficacy	0.10	0.044	2.29	0.022**

Model Summary: Adjusted R square = 0.47, Standard error of estimate = 0.713
F value = 33.24, N = 400, R = 0.69
Significance level = 0.000

Key points in table: Cor_image_bnk = Corporate image of the bank,
Govt_Support = Government support, Rel_Advantage = Relative advantage,
Per_Beh_Ctrl = perceived behavior control, Sub_Norms = Subjective norms.

Table 4 shows that awareness has significant positive impact on adoption of the Islamic banking among SMEs in Pakistan. It means that owners of the SMEs are more aware of the Islamic banking and they are satisfied to adopt the Islamic banking for their business purpose. Similar results have been found in previous studies (Muneer et al., 2017) in local context and (Yahaya et al., 2014; Al Balushi et al., 2019) in an international scenario. The current research has proved that the management of Islamic banks in Pakistan should work more on the awareness of business community to increase the numbers of Islamic banking users.

According to Table 4, there is significant relationship between Corporate Image of the Bank and Adoption of Islamic banking among SMEs in Pakistan. These results highlight that bank image is an important aspect for the bank success. Iqbal et al. (2018) have also found similar findings in Bangladesh. All the participants of Islamic banking industry need to work hard on their corporate image to enhance their business share in the market.

The reported values of regression analysis show a positive link between Government Support and Adoption of Islamic banking in Pakistan. Some former foreign studies (Yahaya et al., 2016; Lajuni et al., 2017) have also tested this variable in Nigeria and Indonesia respectively and have reported similar results. The current results have acknowledged the support of GoP in the growth of Islamic banking in the country. Furthermore, the Government can promote the Islamic banking in the country among different business sectors by providing valuable support.

According to the study results, a significant positive relationship has been found between the Ideology and Adoption of Islamic banking. Some previous studies (Boone & Özcan, 2016; Lajuni et al., 2017) have also concluded similar results in their studies. The current study has also determined that ideology is also an important factor in the adoption of Islamic banking among selected SMEs. If the Islamic banking industry of the Pakistan wants to promote the Islamic banking among the people and business community, then they should change their mind set. Consequently, more people will start to adopt the Islamic banking instead of conventional banking in the Pakistan. The improvement of this factor helps to promote the Islamic banking industry in country. Similarly, the top management of Islamic banks also consider some more aspects such as relative advantage, relative obligation, perceived behaviour control, attitude, subjective norms and self-efficacy should also consider growing their business in the country.

5. Conclusion

Management of financial resources are the basic necessity to do any kind of business. It is factual that SMEs in Pakistan like other developing countries have limited financial

resources due to political instability, high inflation rates and rapid devaluation in currency. Therefore, this study intends to address an important aspect and gap in the field of Islamic banking and SMEs. The current research has focused on the SMEs who are using the Islamic banking services in the country to manage their financial resources. For this purpose, this study has collected primary data from four hundred SMEs owners.

The results of current study have revealed that different factors such as awareness, bank corporate image, government support, ideology, relative advantage, relative obligation, perceived behaviour control, attitude, subjective norms and self-efficacy have significant positive impact on the adoption of Islamic Banking among the selected SMEs in Pakistan. It is concluded that Islamic banking industry of Pakistan has grown with very high rate because of a number of factors including Government Support.

Now, it is important for GoP as well as SBP to conduct awareness campaigns among the business community and develop fruitful policies to improve corporate image of the Islamic banks to increase Islamic banking users among small business as well as corporate sector of the country mentioned earlier in the results. The current study has tried to examine the behaviour of SMEs towards the Islamic banking. Practically, this research will be helpful for the top management of Islamic banks in Pakistan to improve the quality of corporate governance practices by formulating effective policies and strategies to safeguard and enhance stakeholders equity. Furthermore, the study results are also important for both owners of the SMEs and Islamic banking industry by highlighting the issues according to customers' point of view. It is also provide important information to all the Islamic Banks to build up a strong relationship with their customers in Pakistan.

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