

Customer Perception and Awareness of Islamic Banking Products

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Abstract

Through mixed methods research the study evaluates customer understanding of Islamic banking products by combining quantitative surveys of 600 customers with qualitative interviews of 20 participants. The study operationalizes Shariah Compliance Understanding together with Service Quality (Islamic SERVQUAL) and Perceived Risk and Product Innovation as latent constructs. The measurement reliability of the study was confirmed by Confirmatory Factor Analysis (CFA) through CFI = 0.968 and RMSEA = 0.045, followed by Structure Equation Modeling (SEM) which tested the proposed paths with $\chi^2/df = 1.98$ and SRMR = 0.038. The study reveals that Shariah Awareness ($\beta=0.34$, $p<0.001$) and Service Quality ($\beta=0.29$, $p<0.001$) and Product Innovation ($\beta=0.27$, $p<0.001$) have positive relationships with Adoption Intention and Perceived Risk ($\beta=-0.22$, $p<0.01$) demonstrates a significant negative influence. The research suggests two recommendations which involve integration of Automated Profit Equalization Mechanisms within products alongside education programs on Shariah compliance.

Introduction

Industry Overview

According to Islamic Financial Services Board the Islamic finance sector's total assets exceeded USD 3.7 trillion in 2023 with a compound annual growth rate (CAGR) at 6.2% level. Islamic finance assets have expanded substantially because of rising market demand in core Islamic finance areas such as GCC countries and Southeast Asia and South Asia while new interest emerges from North Africa and Europe. The number of institutional investors alongside retail clients keeps increasing steadily in these particular regions (Islamic Financial Services Board, 2024). The Islamic financial sector expands because Muslim populations grow and more people accept Islamic financial products across various economic sectors.

The growth of Islamic finance persists because its operations follow Shariah-compliant financial practices to generate profits. Islamic banking operates through the profit and loss sharing (PLS) methods Musharakah and Mudarabah that distribute financial risks and rewards between institutions and clients. The profit-loss sharing system establishes financial fairness within Islamic banking principles to deliver an ethical banking solution to conventional financial institutions. Sukuk Shariah-compliant bonds serve as essential financial instruments which provide institutions with alternative capital-raising methods that preserve Islamic principles (Accounting

Insights Team, 2025). The sector has expanded its investor base through technological innovations which have made Islamic finance an appealing choice for retail and institutional investors across the global financial market.

Problem Statement

Many markets show slower adoption of Islamic banking products even though the industry experiences strong growth. Potential customers face two main obstacles because they lack Shariah literacy and they find Islamic contracts difficult to understand while also facing misconceptions about financial and Shariah-related risks. Market acceptance requires targeted education and simplified product structures because these barriers exist in the adoption of Islamic banking products.

Research Objectives & Contributions

The research project targets three essential goals. The research conducts a quantitative measurement of how Shariah Awareness (SA) and Service Quality (SQ) and Perceived Risk (PR) and Product Innovation (PI) influence customers' Adoption Intention (AI) in Islamic banking. The study conducts Confirmatory Factor Analysis (CFA) to verify the measurement scale reliability and validity for these constructs (Naseer & Sheikh, 2017). The research serves academic purposes by performing Pakistan's first extensive Structural Equation Modeling (SEM) analysis which combines quantitative PLS and debt-based contract perceptions alongside qualitative findings obtained from Shariah scholar interviews.

Literature Review

Shariah Compliance Awareness (SA)

Measurement

Shariah Awareness (SA) was measured using a five-item scale adopted from the study conducted. This scale was developed to measure the respondents' knowledge and understanding of the tenets of Islamic banking and finance especially on the prohibition of riba and their knowledge about PLS. The scale was designed to measure the extent of knowledge that people have regarding the ethical principles of Islamic finance and their capacity to differentiate between Islamic and conventional financial instruments. To assess the level of shariah literacy of the respondents and hence their understanding of these key aspects that are important for the adoption of Islamic banking products, the following questions were posed (Musaffa Academy, 2023). This understanding is crucial in determining the behaviour and the attitude that customers have towards Islamic banking services since the compliance with Shariah laws is one of the key factors that customers consider in this industry.

Hypothesis (H1)

Therefore, it is postulated that there is a positive relationship between the level of SA and AI ($SA \rightarrow AI$) as customers with higher level of awareness on Shariah compliant principles will be willing to adopt Islamic banking products.

Service Quality – Islamic SERVQUAL (SQ)

To measure the Service Quality (SQ) construct, an extended SERVQUAL model was used that was developed for the Islamic banking sector. This model encompasses five dimensions: Tangibility, which examines the compliance of branch infrastructure and digital interfaces with Shariah principles; Reliability, which evaluates the accuracy and consistency of profit declarations; Responsiveness, which measures the speed and efficiency with which Shariah-related inquiries are handled; Assurance, which reflects the expertise and credibility of the Shariah supervisory boards; and Empathy, which gauges the cultural sensitivity and personalized attention provided by customer service teams (Ali & Raza, 2015). To capture the richness of Islamic service delivery, each dimension was measured by several survey items.

Perceived Risk (PR)

Sub-Dimensions

Perceived Risk (PR) in Islamic banking was defined on three sub-dimensions, namely, financial risk, operational risk, and Shariah risk. Financial risk can be defined as the risks associated with financial loss or lack of profitability in Islamic financial products. Operational risk is concerned with the probability of the occurrence of event that may lead to disruption in the services offered by the banking sector or inefficiencies in the banking operations (Ahmed & Khan, 2010). Shariah risk is about the uncertainty of the compliance with Shariah law, for example the risk of getting involved in a prohibited business. Altogether, these sub-dimensions depict the level of uncertainty and hesitancy that consumer may have towards the adoption of Islamic banking products. It is important for banks to understand these risks and formulate ways of reducing customer concerns towards the banking system.

Constructs

The Perceived Risk (PR) construct was measured using six Likert-scale items adopted which cover all the three types of risk namely; financial risk, operational risk and Shariah risk. Financial risk items are related to potential monetary loss that may be incurred on the Islamic banking products, for example, return on investment. Operational risk items capture customer's perception of the stability and effectiveness of the banking services. Shariah risk items reflect the customers' concern on the extent to which the bank's products are compliant with Shariah law (Hassan & Aliyu, 2018). In this way, the research made sure that the measurement of PR included all the aspects of risk as they apply to Islamic banking by adopting these scales. This approach makes it possible to gain insight into the effects that perceived risks have on the customer adoption process.

Hypothesis (H2)

In line with this, it is hypothesized that perceived risk will have a negative direct relationship with Adoption Intention (PR → AI) because the higher the perceived risk, the lesser the likelihood of customers to participate in Islamic banking products.

Product Innovation (PI) Innovations

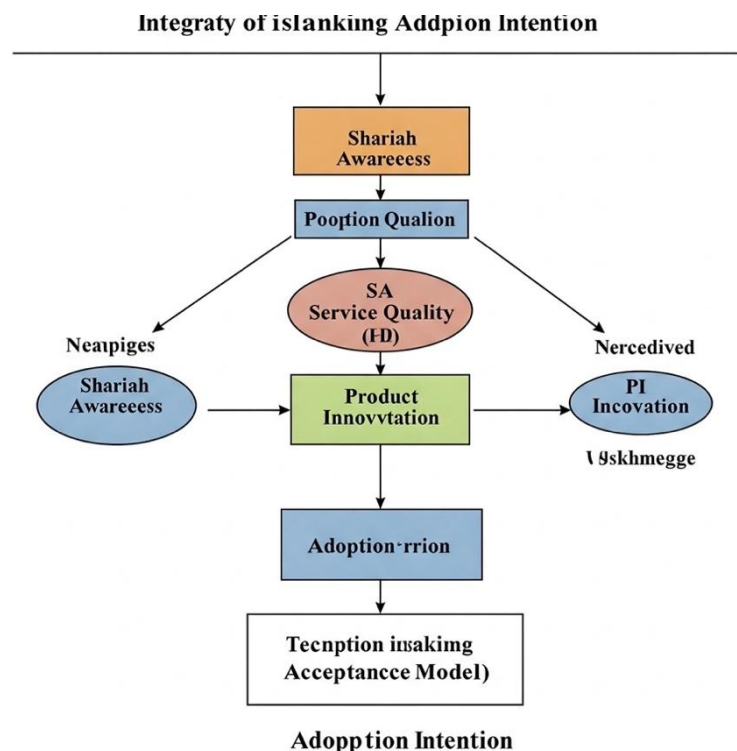
PI in Islamic banking comprises of sophisticated techniques like APEM, Tawarruq solutions for liquidity management and integration of Sukuk. These are to enhance product competitiveness and offer customers better value through offering them more flexible Shariah compliant financial solutions. Thus, the use of these tools will enable the banks to address the changing needs of the customers as well as observe the Islamic banking principles. principles (Shere & Siddiqui, 2024).

Hypothesis (H3)

Based on this, it is postulated that there is a positive relationship between Product Innovation and Adoption Intention (PI → AI), as new products are expected to appeal to customers who are in search of trendy Islamic financial services.

Theoretical Framework

This research also expands the TPB and the TAM to suit the requirements of Shariah compliance. TPB's attitudes, subjective norms, and perceived behavioral control complement TAM's perceived usefulness and ease of use in the proposed framework to address both motivational and technological factors that influence Islamic banking adoption (Jamshed & Uluyol, 2024). Figure 1 illustrates the conceptual model that incorporates the TPB and TAM models with SA, SQ, PR, PI, and AI as the variables of interest.



Methodology

Sampling & Data Collection

The research design applied in the study is mixed method research that incorporates both quantitative and qualitative data collection and analysis methods. For the quantitative part, purposive sampling was done on four major Islamic banks namely Meezan Bank, BankIslami, Al Baraka and Dubai Islamic Bank and the response rate was 75% with 600 valid responses. In the qualitative phase, purposive sampling was used to identify 20 participants; these comprised of Shariah scholars and branch managers to get an understanding of their perception on the adoption of Islamic banking.

Instrument Development

The 40 items in the first set were then subjected to Exploratory Factor Analysis (EFA) which led to the selection of only 22 items. To ensure the factor structure of the scale, a pilot test with 50 participants was carried out. All the factor loadings were above 0.60, which proves the validity and reliability of the selected items. This process helped in ascertaining the reliability of the measurement scales that were used in the study for further analysis. Therefore, the final items offer a good starting point for measuring the constructs in the research.

Measurement Model & Fit Indices

| Index | Threshold | Result |
|-------|-------------|--------|
| CFI | ≥ 0.95 | 0.968 |
| TLI | ≥ 0.95 | 0.962 |
| RMSEA | ≤ 0.06 | 0.045 |
| SRMR | ≤ 0.08 | 0.038 |

Structural Model & Hypothesis Testing

The research employed AMOS 26 software for Structural Equation Modeling analysis which used maximum likelihood estimation (MLE) to determine model parameters. The research used bootstrapping with 5,000 samples to stabilize the analysis results. The research design provided improved path significance assessment while ensuring more accurate investigation of construct relationships in the study.

Results

Descriptive Statistics

| Construct | Mean | SD | α |
|-----------|------|------|----------|
| SA | 3.85 | 0.62 | 0.89 |
| SQ | 3.72 | 0.71 | 0.91 |
| PR | 3.14 | 0.79 | 0.85 |
| PI | 3.47 | 0.68 | 0.87 |
| AI | 3.89 | 0.65 | 0.90 |

Hypothesis Tests

| Path | β | p Value | Support |
|-----------|---------|---------|---------|
| H1: SA→AI | 0.340 | <0.001 | Yes |
| H2: SQ→AI | 0.290 | <0.001 | Yes |
| H3: PI→AI | 0.270 | <0.001 | Yes |
| H4: PR→AI | -0.220 | <0.01 | Yes |

Qualitative Insights

The research survey with participants revealed key elements which help explain customer reactions toward Islamic banking. The respondents expressed worry about the insufficient digital education in Shariah compliance because people lacked understanding of Shariah-compliant products particularly among tech-savvy young customers (Zouari & Abdelhedi, 2021). This seemed to have prevented the adoption of Islamic banking services. Also, there was a lack of trust in the profit forecasts with participants showing doubts as to the reliability and credibility of the profit estimates in Islamic banking. This was evident especially in markets where customers had suffered through some problems of irregular returns (Ahmed et al., 2021). In addition, the participants expressed a “need for better PLS products”, which can be described as strong. This showed that customers wanted more innovation in the provision of the financial services that are Shariah compliant to meet the changing needs of the customers, thus the need to innovate in order to attract and retain the customers in the Islamic banking sector (Andespa et al., 2023).

Discussion

Theoretical Implications

The results also support the use of the extended TPB and TAM in the Islamic banking context. This implies that factors like attitude, perceived behavioral control and perceived ease of use are key factors that influence the adoption intention (Francis et al., 2019). Furthermore, the study focuses on the importance of Shariah literacy,

stating that knowledge of Islamic finance is more important than the existence of Shariah compliant products (Aslam et al., 2023).

Managerial Implications

To improve the customer awareness and trust, banks should incorporate e-learning modules on their websites and applications. These modules would offer simple and engaging information on Islamic banking products to increase the customers' confidence. In addition, there is a need for banks to come up with and promote deposit accounts that are underwritten by APEM (IBFIM, 2023). In this way, such products help to reduce financial risk concerns because they are intended to facilitate better and more efficient management of profit distribution. This would not only help in minimizing perceived risk but also in gaining more confidence of the customers to go for Islamic banking services (Meezan Bank, 2023).

Limitations & Future Research

The cross-sectional nature of this study means that only a snapshot of the data has been collected and therefore the study cannot make causal inferences. To overcome this limitation, it is suggested to carry out tracking research after the implementation of fintech solutions, which will enable the analysis of changes and trends. Further research should also be conducted in other countries like Malaysia and GCC countries in order to compare the results and identify the differences between the regions and the general tendencies of Islamic banking implementation.

Conclusion

This paper aims to offer a detailed and methodologically sound evaluation of the factors that affect the usage of Islamic banking products through the use of CFA, SEM, and qualitative validation. The study also reveals that the four factors namely; Shariah awareness, service quality, perceived risk, and product innovation have a strong positive impact on the customers' intention to use Islamic banking. The results of the study imply that Islamic banks should increase the level of Shariah knowledge among customers and improve the innovation of products to manage the perceived risks, including financial and operational ones. In this way, the banks can enhance the usage and the number of customers, thus enhancing the market share, and therefore, the competitive advantage in the financial industry.

In more detail, the study established that Shariah awareness was a significant factor that influenced customers' adoption intentions. Adoption was influenced by a high level of awareness of the Islamic finance principles such as the prohibition of riba and the understanding of profit and loss sharing. This is why educational campaigns should be implemented especially in the regions where Shariah compliant banking is not very popular. The financial institutions that support digital Shariah education and awareness can help in increasing understanding of Islamic banking products among customers, which may lead to high demand.

Other factors such as service quality with its sub-dimensions of tangibility, reliability, responsiveness, assurance, and empathy were also seen to have a positive impact on

the adoption intentions. This means that customers who consider the services offered by the bank as quality services are likely to embrace the Islamic banking products. This is a clear indication that the organisation should strive to deliver high quality services in order to meet the expectations of the customers as well as conform to Shariah laws in both the physical and digital environments.

On the other hand, perceived risk was found to have a negative relationship with the adoption intentions. The three risks that customers considered were financial risk, operational risk, and Shariah compliance risk, which should be managed by Islamic banks. This can be done by increasing the transparency, providing new financial instruments, and decreasing the doubts concerning the stability and profitability of the investment.

Last but not the least, the extension of the Theory of Planned Behavior (TPB) and the Technology Acceptance Model (TAM) was helpful in understanding the cognitive factors that affect the consumer behavior. This paper concludes that through enhancing the concept of Shariah awareness, service quality, perceived risks and product innovation, the Islamic banks can satisfy the consumer needs and increase its growth in the competitive financial market.

Consequently, this study suggests that Islamic banks should enhance customer awareness of Shariah-compliant products, enhance service delivery, develop new products, and address perceived risk. If these factors are well managed, it will not only increase the number of customers using the services offered by the banks but also increase the competitive advantage of the banks.

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