
Interest-Free Banking in Bangladesh: A Study on Customers' Perception of Uses and Awareness

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Abstract

Interest-free banking has become an inextricable part of economic development around the world. Taking this into account, the study investigates customers' perception of uses and awareness of various products of Islamic banks in Bangladesh through a convenience sampling technique. The findings reveal that despite the awareness of products such as mudarabah and musharaka, were not used. It is further depicted that majority of the respondents simultaneously operating their accounts with conventional and Islamic banks. It is due to insufficient branches and unavailability of some products and services with conventional banks across the country. In addition, religion is found to be the most important aspect of clients for Islamic banking. Hence, the quality of service and products must consistently be offered with the principles of interest-free finance as well as with the facilities of the conventional banks. Most of the customers are totally ignorant about interest-free products. The study suggests that Islamic banks should give more emphasize on convincing the customers to use interest-free products and services facilitating the growth of Islamic banks in Bangladesh.

Keywords: Interest-free banking; Customers' perception; Bangladesh

Prohibition of interest is the essence of interest-free banking which has surfaced with its popularity in Bangladesh as well as in Muslim world. Interest-free banking was developed as a result of the religious prohibitions of the payment or receipt of interest. The experiment of interest-free banking started in the mid-1990s proving its practicality and relevancy of Islamic banking system and the idea continued to develop theoretically until the commencement of Islamic Development Bank (IDB) as an international financial institution in 1975. Since then, IDB has been fostering economic cooperation and social progress among member countries. The expansion of Islamic banks span over the Muslim and non-Muslim countries. In the early 1980s, all banks and financial institutions of

Iran, Pakistan and Sudan have adopted Islamic banking principles (Othman & Owen, 2003). Other Muslim countries like Malaysia, Indonesia, Bangladesh, Jordan, Egypt, and Turkey operate their financial institutions based on interest-free principles along with conventional banks. The world has now been experiencing operation of as many as 250 Islamic banks and financial institutions in more than 50 Muslim and non-Muslim countries (Tamimi, & Amiri, 2003). Today, the market size of interest-free banking is estimated to be growing at the rate of 15% per annum. Islamic banks currently operate in approximately 75 countries and the industry has reached a market size of USD200-230 billion (Bahrain Monetary Agency, 2002). Bangladesh being the third-largest Muslim majority country (90%) inherited an interest based banking system. At present, out of 56 banks in Bangladesh, eight full fledged Islamic banks and nine conventional banks with 19 Islamic *Shariah*-based branches are working in the private sector with popularity in spite of some problems in their operation (Bangladesh Bank, 2014; IBBL, 2014; Ibrahim, Mohammad, Hoque, & Khan, 2014). The progress of Islamic banking system is well manifested with the growth of economy reflecting increased market share in terms of assets, financing, and deposits of the total banking system (Ahmad & Hasan, 2007).

Interest-free banking: the background

The emergence of Islamic Banking as an alternative to conventional counterpart can be attributed to religious as well as economic reasons, It is the prohibition of '*Riba*' in the *Quran* that, according to the proponents of the profit and loss sharing (PLS) system, was the source of inspiration for establishing banks in line with Islamic *Shariah* (Ahmad & Hasan, 2007). The basic intention behind establishing Islamic banks was the desire of Muslims to reorganize their financial activities in a way that do not contradict with the principles of *Shariah* and enable them to conduct their financial transactions without indulging into *Riba* (Khan, 1989). The outcome of the productive effort is uncertain, and so, interest necessarily involves an element of *Gharar*, that is, uncertainty (Mirakhor, 1997). On this religious ground, proponents of the PLS system urge the Islamic community to avoid all transactions with institutions that are interest-based. The economic reason derived from a verse of the *Quran* providing inspiration to devise an interest-free financial system has been substantiated in the way that interest, instead of increasing, reduces wealth [30:34]. The primary reason of

why the *Quran* has taken such a hard approach towards interest is that Islam stands for establishing a just economic system free from all kinds of exploitation (Ahmed, 1995). Further, Muslim economists consider depression and stagflation very often found in the capitalist world as an outcome of the interest based financial system (Gerrard & Cunningham, 1997). Thus, Islamic banking emerged as a response to both religious and economic necessities, thus, perceived as an improved system in all dimensions (Ahmad, 1984; Ahmed, 1992; Allais, 1993; Beck, 2008; El Qorchi, 2005).

Prior studies

Customer perception is an important aspect of contemporary marketing thought, particularly in the case of service industries (Bielski, 2004). It is argued that customer satisfaction over quality of product or service will lead to the repeat purchase intention (Uddin, Khan, & Farhana, 2014). Since, it is the feeling or attitude of a customer toward a product and/or service after it has been used (Solé, 2007). A satisfied customer will also convey positive messages about it others. On the other hand, customer will also engage in a negative word of mouth, causing a serious damaging effect on the business (Community Banker, 2003). This “market damage” can be subtle but extensive undermining the best intentions and the strongest marketing companies (Bielski, 2004). Therefore, it is important for the companies to make their customers satisfied with their products/services they offer which, in turn, leading to increase popularity of measuring customer satisfaction in recent years (Ibrahim et al. 2014; Khan & Ali, 2012; Kuehnet-Hebert, 2003).

Banking is one of those sectors in which customer satisfaction has drawn great deal of attention by many researchers over the last decade (Gerrard & Cunningham, 1997; Othman & Owen, 2003). One reason is that the banking industry is increasingly experiencing a growing level of competition and some banks consider customer satisfaction as a principal vehicle of their marketing strategies. Consequently, many financial institutions are now focusing on increasing satisfaction and retention of customer through improving the quality of their service in order to secure desired growth (Jones, 2004). Customer satisfaction contributes to a good customer-organization relationship; thereby underpinning the latter’s development. Parasuraman et al. (1988) use their SERVQUAL instrument to operationalize customer satisfaction with five-factor service quality construct which represents perceived

customers' satisfaction from functional and technical quality dimensions (Jamal & Naser, 2002). Liang and Wang found that customers who are attached with their bank for five years are much more profitable than those who are in the first year of relationship. Therefore, longer customer relationships are more worthy to the bank than new ones, contribute to higher account balances, relatively lower account costs and are more likely to use other bank products and services (Liang & Wang, 2004).

Notwithstanding the introduction of technology in the banking sector with ATMs, call centers and internet banking, most people would still prefer to do their banking face-to-face with a teller at a local branch. A survey of Lorien Consumer Focus (LCF) indicate that of those who visited a cashier at bank branch, 35 percent preferred communication channel in terms of customer service satisfaction (Management Services, 2003). In a similar vein, Yavas et al. (2004) also examined the determinants of customer satisfaction for the Turkish banking sector and found customer and bank employee relationship is the main driving factor to satisfy their customer. Several studies revealed that the satisfaction of corporate clients with their bank does not directly affect their propensity to use electronic banking (Rexha et al., 2003), rather the importance of satisfaction depends on the reliability, access, and savings (Polatoglu & Ekin, 2001).

The above discussion highlights the importance of constructing strategies to investigate customer satisfaction in financial institutions such as those that engage in interest free finance. Sundaranjan and Errico (2002), in their study found that profitability (return on investment) was one of the main factors of bank selection criteria rather than religiosity that tends to interest-free banking among Jordanian people. The authors subsequently commented on this issue that Islamic banks might not offering sufficient interest-free loans which could contribute to solving community problems in a just and efficient manner and can eliminate pre-determined interest rates on loans of needy and poor borrowers. Special Finance House (2003), in a survey compared the bank selection criteria of customers of conventional and Islamic banks in Jordan. The survey results emerged with three most important bank selection criteria for Islamic banks such as - (1) the provision of a fast and efficient service, (2) the bank's reputation and image, and (3) confidentiality of the bank. Sudin et al. (1994) undertook contextually a similar study in three medium-sized towns in Malaysia which also asserted the first two criteria and additional

one; the speed of the transaction. It is mentionable that the image of the bank and compliance to Islamic principles are in common findings of several studies such as Naser et al. (1999) and Metawa and Almossawi (1998) in Bahrain. Hence, considering the above discussions, the authors like to empirically investigate customers' perceptions of interest-free banking services underpinned by the following objectives.

Objectives

The study aims to evaluate perceptions of uses and awareness of customers towards interest-free products and services of Islamic banks in Bangladesh. The main objective divided into the following specific objectives;

1. To identify the main factors of customers for choosing to interact with Islamic banks.
2. To find out the key aspects of customers' choice dealing with conventional banks as well as Islamic banks.
3. To evaluate the extent to which customers are aware of and use the interest-free products and services of Islamic banks.
4. To measure the degree of customers' perception with various aspects of Islamic banks.

Research Methodology

The present study is conducted on Islamic banks in Dhaka and Chittagong, the capital city and the commercial capital city of Bangladesh, respectively. Seven Islamic banks from private sector have been selected for the study. Two branches from each of the banks have been selected randomly. 261 complete questionnaires have been analyzed collected from randomly selected customers from selected branches of banks. To achieve the study objectives, a survey questionnaire in English was designed in consultation with literature and academicians of Islamic finance. The English version of the questionnaire was then back translated into Bengali by two bilingual professors in the field of Islamic Finance and Development Studies to make the items understandable to the respondents (Brislin, 1976). The questionnaire was divided into six sections: section 1 includes demographic information of the respondents. In the following section 2, the main reasons behind dealing with Islamic banks and conventional banks are included. Section 3 comprises information on financial products and services utilized by the respondents. In section 4, ten items were selected to determine

the Islamic banks' customers' awareness and their use of interest-free products and services provided by the Islamic banks. Section 5 engages in the selection criteria of the customers of Islamic banks using nineteen selection criteria. Section 6 evaluates the main aspects of customers' satisfaction in eighteen items.

In total, 94 items were selected to achieve the objective of the study. All items, except for those in Section 4, were measured on a five-point Likert scale from 1 (Strongly agree/ Highly Satisfied) to 5 (Strongly disagree/Not satisfied at all). In section 4, respondents express their awareness and use of different products/services on the basis of "not aware of it", "aware and do not use it" and "aware and use it". The questionnaire was pre-tested by the experts to check the validity and logic of the questions included in it. After assessing the feedback from the pilot study (n=22), several changes were made before the questionnaire was distributed. The questionnaire were randomly distributed among the accounts holders in the selected Islamic banks. These are Islami Bank Bangladesh Limited (IBBL), Al-Arafah Islami Bank Limited (AAIBL), Social Islami Bank Limited (SIBL), First Security Islami Bank Limited (FSIBL), Exim Bank Limited (EBL), Shahjalal Islami Bank Limited (SJIBL), and Basic Bank Limited (BBL). 320 questionnaires were distributed among bank clients in 38 branches consist of 22 from Dhaka and 16 from Chittagong. Out of 320 questionnaires distributed, 273 questionnaires were returned from which 261 (84.74% response rate) useable questionnaires were emerged for analysis. Branches have been proportionately chosen in terms of number of branches, deposit, and customers.

Results and Discussion

Demographic profile of respondents

Out of 261 respondents, 73.6% are male and 64.7% are married. 43% of the respondents are aged between 30 and 39 years old. Overall, 42.5% respondents are involved in private service while 32.6% respondents are associated with their own business. In terms of education, 41% are qualified with secondary education, 27.5% are below than secondary level. Only 23% respondents have got bachelor and other higher educational degrees.

Types and duration of banking

It was necessary to know whether the respondents have accounts in Islamic banks and/or conventional banks and to explore the types and durations of accounts services held by the respondents

with Islamic banks as well as conventional banks. According to Table 1, 44% of the respondents hold accounts and utilize the services offered by the Islamic banks. However, 56% of the respondents indicate that they bank in a conventional as well as in an Islamic bank. At this point, it was indicative to explore the main factors why the Islamic bank customers also choose to bank with a conventional one operating in accordance with interest-based principles.

Table 1
Types of banks where respondents hold their accounts

Value Labeled	Frequency	Percent
Islamic banks only	115	44.0
Conventional banks & Islamic banks	146	56.0

Factors to deal with conventional as well as Islamic banks

Table 2 outlines the factors that influencing a conventional as well as Islamic banks. Insufficient branch of Islamic banks is the main reason to bank with traditional banks. The respondents pointed out that they choose to bank with conventional banks because the Islamic banks are lacking particularly short-term and fixed-income investment opportunities. It is also worth mentioning here that more than 43% of the respondents have not expressed any views on fixed-income investment opportunities such as *Sukuk* (equivalent to fixed-income securities under interest-based banking). However, the customers of *Shariah*-based banks made positive comments on the financial counseling provided by the Islamic bank staff and the effective and efficient IT being a degree of more than 73% and 67%, respectively. This implies that the main reason behind transacting with a conventional as well as an Islamic bank is essentially product-related.

Table 2
Factors influencing conventional as well as Islamic banks

Sl.	Items (n=261)	Strongly Agree	Disagree	Strongly Disagree	No View	WA	Rank
1	Some products not available at Islamic Banks	27	95	75	37	27	3.13 2
2	Many products not available at Islamic Banks	18	72	117	25	29	3.10 3
3	Insufficient Branch networks	37	98	83	19	24	3.40 1

4	Lack of efficient and effective IT	7	49	122	53	30	2.81	5
5	Lack of financial counseling provided by computers	10	31	129	64	27	2.74	6
6	Lack of short-term investment opportunities	10	86	77	33	55	2.86	4
7	Lack of available credits with favorable terms	18	46	116	23	58	2.78	6
8	Lack of fixed-income investment opportunities	24	69	38	17	113	2.52	3
9	Higher commission and fee on transactions	13	38	118	31	61	2.66	7
10	Lack of credit cards with favorable terms	15	54	65	59	68	2.57	4

Customer selection criteria

The summary of reasons for banking with Islamic banks only is shown in Table 3. The results shown that religious aspects, offering facilities similar to traditional banks, and lower service charge are the key reason for banking with Islamic bank. Factors like high return on investment (24.6%), religious and profitable reasons for banking with Islamic bank (33.3%), advice from relatives and friends (34.1%) and resistance to economic crisis (35.2%) did not appear to play a significant role in the banking choice of customers who transact with Islamic banks. It is worth of noting that high return on investment criteria ranked 18th out of 19 selection criteria.

Table 3
Customers' Selection Criteria for Islamic Banks

Sl.	Items (n=261)	Strongly Agree	Disagree	Strongly Disagree	No View	WA	Rank
1	Religious reasons only	54	143	42	6	16	3.82 1
2	High return on investments	22	42	111	17	69	2.74 18
3	Low service charge	37	130	43	10	41	3.43 3
4	Religious and profitability reasons	23	64	104	16	54	2.95 13
5	Advice from relatives and friends	17	72	95	12	65	2.86 16
6	Resistance to economic crisis	23	69	90	9	70	2.87 15
7	Advertising/image of Islamic banks	27	92	63	4	75	2.97 11

8	Efficiency and speedy transaction	25	134	43	5	54	3.27	4
9	Staff friendliness	16	105	54	9	77	2.90	14
10	FC transactions on favorable terms	19	79	61	7	95	2.69	19
11	Location of branch	17	121	54	6	63	3.09	8
12	Interior design of the Islamic banks	21	100	61	7	72	2.96	72
13	Available loans on favorable terms	20	99	48	7	87	2.84	17
14	Customer confidentiality	22	118	43	9	69	3.06	9
15	The wide range of facilities offered	25	121	49	-	66	3.15	6
16	Efficiency & speedy transactions	19	129	44	7	62	3.14	7
17	Financial counseling provided	24	137	37	5	58	3.24	5
18	Islamic banks (IB) offering as conventional but IBs also operate in compliance with Islamic principles	28	158	27	7	41	3.48	2
19	The availability of assurance fund	25	111	41	8	76	3.00	10

Note: Ranking was done on the basis of Weighted Average (WA) Score.

Duration of the accounts and the service utilization

Table 4 reports output regarding types of accounts and duration for which respondents hold their accounts and utilize the services offered. Table 4 specifies that almost 69% reported that they have current accounts with an Islamic bank for more than one year whereas only 39.8% of those maintained their relationship with an Islamic bank for more than three years. This might imply a low level of customer loyalty towards Islamic banks. It comes to view that more than 55% of respondents held credit cards provided by the Islamic banks.

Likewise, more than 34% of the respondents had credit cards provided by the conventional banks for the same period and almost 50% of them held current accounts with conventional banks. Only 26.4% of the respondents utilize the individual finance products of the Islamic banks that are in the form of vehicle credit which operate in compliance with the principle of *murabaha*. Furthermore, less than 20% of the respondents hold time deposit accounts with conventional banks that basically gain interest.

The figures in Table 4 also reveal that almost 70% of the respondents do not have a participation account with an Islamic

banks in the form of profit and loss participation. In other words, a significant majority of the respondents who bank with an Islamic bank do not show an interest for specific interest free accounts like *mudarabah* and *musharaka*. In the same way, only approximately 7% of the respondents borrowed from Islamic banks in the form of profit and loss participation. This result needs to be assessed in line with the following analysis of the degree of awareness among the respondents of the interest-free products and services offered by the Islamic banks in Bangladesh.

Table 4

Duration of the account(s) and services

Sl.	Items (n=261)	Do not have or not applicable	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
(A) Islamic Banks						
1	Current (Wadiah)	42	39	76	60	44
2	P/L Participation (Mudarabah)	186	30	20	15	10
3	Consumer credit (Murabaha)	216	15	12	11	7
4	Vehicle credit (Murabaha)	192	20	27	17	5
5	Financial support for business (Murabaha)	224	5	15	10	7
6	Leasing (Ijara)	239	5	9	4	4
7	P/L Participation investment	237	17	3	2	2
8	Credit card	115	22	63	37	24
9	International foreign business	228	7	10	9	7
10	Others	222	12	15	6	6
(B) Conventional Banks						
1	Current	132	24	35	19	51
2	Time deposit	208	5	13	6	29
3	Consumer credit	238	3	10	5	5
4	Vehicle credit	233	5	12	4	7
5	commercial loan	236	9	7	-	9
6	Govt. bonds & Mutual funds	239	6	4	4	8
7	Credit card	171	4	37	19	30
8	International foreign business	239	2	7	-	13
9	Others	236	9	6	2	8

Customers' awareness/ use of interest-free products and services offered by Islamic banks

Table 5 presents results extent of use and awareness about interest-free products and/or services offered by Islamic Banks in Bangladesh. It is found from table five that majority-78 percent- of respondents are aware and use current account based on the *wadiah* principle. It is also clear, however, that a significant number of the respondents reported that they are not aware of specific terms of *mudarabah* (19.5%), *murabaha* (63%), *musharaka* (48.3%) and *ijara* (39.8%). In addition to that, almost half of the respondents are aware of the profit and loss participation accounts and financial supports for business based on the interest-free principles of *mudarabah* and *murabaha* respectively but do not use them.

Table 5

Customers awareness and use of products/services of Islamic banks

SL.	Items (n=261)	Not aware of it	Aware and do not use it	Aware and use it
1	Current account (Wadiah)	16	41	204
2	P/L Participation account (Mudarabah)	51	119	91
3	Financial support for business (Murabaha)	86	136	39
4	Housing loan (Murabaha)	30	213	18
5	Individual finance (Murabaha)	33	183	45
6	Vehicle loan (Murabaha)	18	174	69
7	Credit card	241	20	0
8	Leasing (Ijara)	104	142	15
9	Joint venture (Musharaka)	126	119	16
		Aware of it Not Aware of it		
Coverage of the Account held with Islamic banks by the Assurance fund.		144	117	

Other products operating in accordance with the principle of *murabaha* are known by the customer at a high level but are not regarded as a profitable investment opportunity. Furthermore, more than 48 percent respondents are totally ignorant about *musharaka*. Hence, the findings of Table 5 indicate the fact that the respondents have a considerable level of awareness about few of the products and services of Islamic banks, a very limited number of them deal with them. It is also seen that no respondent is aware of and use credit card of Islamic banks. It may be attributed to the fact that Islamic banks in Bangladesh as if do not offer this product.

Customer perception with the services and products offered by the Islamic banks

Customers' perception with services and products offered by Islamic banks in Bangladesh also evaluated in this study which is shown in Table 6.

Table 6

Customers' perception

Sl.	Items (n=261)	Highly Satisfied	Satisfied	Not Satisfied	Not Satisfied	No View	Rank
1	Efficiency and speedy transaction	76	160	19	3	3	1
2	Quality of advice offered by the Islamic Banks' personnel	59	150	18	3	31	2
3	Location of the branch	40	137	32	9	43	6
4	The interior design of the bank	31	129	38	4	59	9
5	Parking facilities provided to customers	20	40	87	4	110	15
6	Staff sociability and friendliness	64	142	16	2	37	3
7	The name and image of the bank	47	158	15	2	39	4
8	Loan availability on favorable terms	26	118	15	3	99	12
9	Customer confidentiality	48	103	19	3	88	11
10	Working hours	51	129	12	8	61	5
11	Internet facilities provided by the bank	50	82	17	4	108	13
12	The wide range of the facilities offered	42	124	17	4	74	7
13	Efficiency and speed in inter-branch transactions	40	117	25	34	45	10
14	Financial counseling provided	44	119	21	5	72	8
15	Advertising and informing of new products and services	40	77	43	10	91	14

Notes: The ranking is based on the level of agreement expressed by the respondents.

Table 6 shows that a vast majority of respondents expressed a significantly high level of satisfaction with various aspects of the Islamic banks' products and services. More than 90% (n=226) of respondents were satisfied with efficiency and speed in completing a transaction at the branches of Islamic banks they deal with. 80.1%

(n=209) of respondents reported that they were satisfied with the quality of advices offered by the Islamic bank personnel. Staff sociability and friendliness ranked third with an almost 79% degree of customer satisfaction. As far as the performance of bank personnel was concerned, the majority of the respondents were satisfied with most aspects of customer-client interaction. However, financial counseling provided by the Islamic banks did not get a better response from customers. Only 62.5% of the respondents mentioned that they were satisfied with the Islamic banks in terms of financial advice offered. Only 23% of the respondents expressed their satisfaction with parking facilities. Furthermore, 20.3% of the respondents pointed out that they were not satisfied with Islamic banks in terms of informing customers about new products and services as well as the development regarding interest-free banking in Bangladesh. The respondents also expressed a degree of dissatisfaction with location of the branch (15.7%) and interior design of the branch (16%). The results also specify that 38% respondents did not comment on several issues.

Conclusion

This study aims to evaluate the use and awareness of customers of *Shariah*-based products and services provided by the Islamic banks and customer perception with the practices of such financial institutions in Bangladesh. The findings of the study indicate that 56% of the Islamic bank customers deal with conventional bank as well as an Islamic bank. This is due to the fact that the Islamic banks do not have a nation-wide branch network and do not have products and services offered by conventional banks like fixed-income and short-term investment opportunities. The results of the study also indicate that customers' awareness and usage rates are high for some of the products and services of the Islamic banks. Approximately 84% of the customers hold only current accounts, *wadiah*, and almost 40% of which have account with Islamic banks for more than three years. About 56% of respondents also use credit cards provided by their banks. However, the findings of the study points out that more than 71% of the customers do not hold an investment account in the form of profit and loss participation account. Furthermore, more than 48% of those customers are totally ignorant of the *musharaka* equivalent of equity partnership in interest-based banking system.

The results reported, additionally, indicate that Islamic bank selection criteria by the customers are predominantly based on

religion followed by ‘compliance with Islamic principles’. The factor of ‘staff friendliness’ and ‘efficiency and speed in completing a transaction’ rank third and fourth position, respectively. ‘High rate of return’ received no support from the respondents and ranks 18th position which is the second last. It also appears that the factor of ‘efficiency and speed of completing a transaction’ received the highest satisfaction score by the customers of Islamic banks, followed by ‘quality of advice offered by the Islamic banks’ and then ‘staff friendliness’. In terms of our findings, it may be suggested that customers of the Islamic banks are not more likely to remain with the same as the relationship between an Islamic bank and its customers heavily relies on the efforts of the staff.

The findings of the study, however, highlight some concerns for the Islamic banks in Bangladesh. Since, religion is the main factor in attracting customers, the Islamic banks should recognize that customers do not view them just like any other conventional one operating in Bangladesh. Hence, the quality of service and the products and services offered must be compatible with the principles of interest-free finance as well as with the facilities of the conventional banks. The opening of new branches seems to be an important factor in increasing the utilization of the financial products and services provided by the Islamic banks. It is not reasonable that the vast majority of Islamic bank customers are totally ignorant of specific interest-free products to a great extent. It is worth noting that convincing the customers to use their specific interest-free services using affordable proportions is unlikely to facilitate the popularity growth of the Islamic banks’ interest-free financing facilities. Furthermore, the results of the customer profile analysis revealed that the Islamic banks’ customers are quite young and have a middle income. These findings can be used as a basis for savings and financing schemes that suit the socio-demographics of the customers.

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