

RESEARCH REPORT

**A STUDY ON THE SMALL AND MEDIUM-SIZED ENTERPRISES'
(SMEs) PERCEPTION TOWARDS ISLAMIC BANKING
PRODUCTS AND SERVICES: IMPLICATION ON THE
MARKETING STRATEGY IN COMPETITIVE ENVIRONMENT**

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ISLAMIC UNIVERSITY COLLEGE OF MALAYSIA



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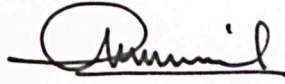
DECLARATION

بِسْمِ اللَّهِ الرَّحْمَنِ الرَّحِيمِ

We hereby declare the work in this research project is our own except for quotations and summaries which have been duly acknowledged.

Date: 10th March 2006

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ABSTRACT

Small and Medium Enterprises (SMEs) play an important supportive role in the Malaysian economy. In capturing this market segment, Islamic banks offer various banking products to cater SMEs' needs in daily business transactions. This research examines their perception towards the banking products offered which includes a study on their level of acceptance, knowledge, factors considered important in bank selection, current marketing strategy and customer satisfaction in Islamic banking. The research adopted a survey-based approach in collecting the data by distributing a set of self-administered questionnaires to the potential SMEs. A total of 180 SMEs from Federal Territory of Kuala Lumpur, Selangor and Negeri Sembilan participated in this research. The results indicate that majority of the SMEs still do not consider the Islamic banks as the most desirable financial institution. The less effective marketing strategy has been identified as one of the reasons contributing to the low acceptance of products offered. It is also found that variances in the SMEs profiles influence their perception towards Islamic banking. The research concludes with some recommendations to be adopted in enhancing the effectiveness of Islamic banks marketing strategy.

ABSTRAK

Industri Kecil dan Sederhana (IKS) memainkan peranan penting di dalam sektor ekonomi Malaysia. Demi menguasai pasaran IKS, institusi perbankan Islam telah menawarkan pelbagai jenis produk perbankan yang dapat membantu usahawan-usahawan IKS menjalankan perniagaan seharian mereka. Kajian ini meninjau persepsi usahawan-usahawan IKS terhadap produk perbankan Islam yang ditawarkan. Ini meliputi kajian tentang tahap penerimaan, pengetahuan, faktor-faktor dalam proses pemilihan sesebuah bank, keberkesanan strategi pemasaran dan kepuasan pelanggan terhadap perbankan Islam. Data yang diperolehi di dalam kajian ini didapati menerusi borang soal selidik yang diedarkan kepada usahawan-usahawan IKS. Seramai 180 usahawan dari Wilayah Persekutuan Kuala Lumpur, Selangor dan Negeri Sembilan telah menyertai kajian yang dijalankan. Hasil kajian mendapati bahawa sebahagian besar usahawan IKS tidak menganggap bank Islam sebagai institusi kewangan yang paling digemari. Kurangnya keberkesanan strategi pemasaran dilihat sebagai salah satu punca penerimaan yang rendah. Selain itu, kajian ini juga mendapati perbezaan profil syarikat mempengaruhi persepsi mereka terhadap perbankan Islam. Kajian ini juga mencadangkan beberapa langkah untuk meningkatkan keberkesanan strategi pemasaran perbankan Islam berdasarkan hasil dapatan borang kaji selidik yang diedarkan.

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CHAPTER ONE

INTRODUCTION

1.0 Introduction

Small and Medium-sized Enterprises (SMEs) account for more than 90% of the companies in the manufacturing sector in Malaysia. In 2003, SMEs contributed RM68.9 billion to total output, RM14.2 billion to value added and provided 375,840 jobs respectively. This was an increase of 9.6 percent of total output, 11.8 percent of value added and 3.7 percent of employment as compared to the previous year (SMIDEC, 2004). The largest number of SMEs is in the textiles and apparel sector (16.7 percent), followed by food and beverages (14.4 percent), metals and metal products (14.3 percent) and woods and wood products (13.6 percent). It is also reported that SMEs represent 96.8 percent of the total companies established in the service sector.

The data above implies that SMEs play an important supportive role in the Malaysian economy. They collectively enhance the level of socioeconomic in the rural areas, improve indigenous entrepreneurship skills and promote forward and backward industrial linkages. In cognizance of this fact, the government has taken numerous development programmes to assist SMEs in enhancing their quality and strengthen their competitive edges. Under the Eight Malaysia Plan, the government has allocated RM221.4 million for this sector. In addition to that, there are at least 12 ministries and 40 government agencies involved in providing advisory services, fiscal and financial assistance, infrastructure facilities, market access and other support programmes (SMI, Business Directory, 2005).

1.1 Definition of Small and Medium-sized Enterprises (SMEs)

Similar with any other developing countries, there is no consensus on the definition of SMEs in Malaysia. The government agencies use various indexes to classify the SMEs such as the number of employees, invested capital, total amount of assets, sales volumes and production capability. The prior researchers however, tend to define the SMEs by certain size which normally measured by either the number of person employed or the invested capital or a combination of both (Moha Asri, 1999).

Perhaps, the Coordinating Council for development of Small-scale Industries (CCDSI) offered one of the earliest definitions of SMEs in Malaysia (Mohamad Sulaiman & Mohd Khairuddin, 2005). The CCDSI defined SMEs as enterprises with fixed assets of less than RM250,000 or in the case of companies, the shareholders' funds are not exceeding RM250,000. Recently this Council was transferred to the Ministry of International Trade and Industry (MITI) and was renamed the Small Scale Enterprises Division (SSED). It amends the existing definition and further classifies the enterprises into two groups. The small enterprises are defined as having invested capital not exceeding RM500,000 and medium-sized enterprises as having invested capital of RM2.5 million.

However, for the purpose of this research, SMEs are identified based on the definition from the Small and Medium Industries Development Corporation (SMIDEC). Established in May 1996, SMIDEC is considered as the leading government agency that specialized in providing technical assistance for this sector. It classifies SMEs into two categories namely (1) manufacturing, manufacturing-related services and agro-based industries and (2) services, primary agriculture and information communication technology (ICT). In terms of size of the enterprises, they are categorized into micro, small and medium companies.

The detailed definition is presented in Table 1.1.

Table 1.1: SMIDEC's definition of SME

Category		Micro-Enterprises	Small-Enterprises	Medium-Enterprises
1	Manufacturing, manufacturing related services and agro-based industries	Sales turnover of less than RM250,000 OR full time employee less than 5	Sales turnover between RM250,000 and less than RM10 million OR full time employee between 5 to 10	Sales turnover between RM10 million to RM25 million OR full time employee between 51 to 150
2	Services, primary agriculture & Information and Communication Technology (ICT)	Sales turnover of less than RM200,000 OR full time employee less than 5	Sales turnover between RM200,000 and less than RM1 million OR full time employee between 5 to 19	Sales turnover between RM1 million to RM5 million OR full time employee between 20 to 50

(source: smidec.gov.my)

In terms of size classification, the first category which consists of manufacturing, manufacturing-related services and agro-based industries have higher pre-requisite of sales turnover as well as full time employees compared to services, primary agriculture and ICT category. The pre-requisite of sales turnover for the first category for micro, small and medium enterprises are less than RM250,000, between RM250,000 and less than RM10 million and from RM10 million to RM25 million respectively. Meanwhile the sales turnover for the second category are less than RM200,000, between RM200,000 to RM1 million and between RM1 million to RM5 million.

The SMIDEC has also listed the main types of business activities operated by the SMEs. There are chemical petrochemical products, electrical and electronics telecommunication, food beverage and tobacco, machinery and engineering, manufacturing related services, metal products, non-metallic mineral products, palm oil based products, paper and printing, plastic products, rubber products, textile, apparels and leather, transport equipments, pharmaceutical, supporting products and activities, logistics, retail and wholesale, professional and management services, services provider, education services and IT related services.

1.2 The Roles of Islamic Banks towards the Development of SME

The Islamic banks and Takaful operators are expected to capture 20 percent of Malaysian banking and insurance market share by the year 2010 (Financial Sector Masterplan 2001). In achieving the target, the Central Bank of Malaysia (BNM) has outlined several approaches for implementation purposes. These include three phases which are (1) strengthening the operational and institutional infrastructure (2) stimulating competition and upgrading infrastructure and (3) raising performance standard through progressive liberalisation. Currently, the industry is embarking into the second phase that is creating a healthy competition environment. The full-fledged Islamic banks are not the only financial institutions involved in Islamic banking. Other financial institutions are also offering Islamic banking products and services through the "Islamic banking schemes". As at February 2006, 6 full fledged Islamic banks, 11 commercial banks, 1 finance companies, 4 merchant banks and 7 discount houses are already participated in Islamic banking schemes. See Appendix IV for more details.

Given such an intense competition, the banks now adopt different strategies to capture the market from this sector. Previously, banks are reluctant to extend loans to the SMEs on the ground of high risks and low overall profitability. As a result, the Central Bank of Malaysia has to implement a policy to enforce banks to allocate a set of minimum proportion of lending to the said sector. However, the SMEs are now increasingly viewed as profitable bank customers. Banks begin to capture this segment of the market by offering a range of banking products and services to facilitate the SMEs in their daily business transactions. In 2004, RM3.16 billion of loans were approved to more than 92,000 SMEs and this accounted for about 40 percent of total outstanding loans to businesses (Bank Negara, 2004).

The Islamic banks in particular continue to focus on providing financing and facilitating business transactions to the SMEs. Total financing provided by the Islamic banks to this sector increased by 29.6 percent from RM6.2 billion in 2003 to reach at RM8 billion in 2004. In fact, in 2004 the Islamic financing contributed 13.8 percent of

the total financing extended by the banking system as compared with 7.5 percent in 2003 (Bank Negara Annual Report 2004). Apart from that, the Islamic banking institutions offer a number of banking products and services to cater the needs of SMEs customers.

Among the products and services available are fixed deposit or special investment account (based on *mudārabah*), overdraft (based on *bay' bithaman ājil/ bay' mah*), letter of credit (based on *wakālah* or *mushārah* or *murābahah* or *ijārah*), trusts receipts (based on *wakālah* or *murābahah*), acceptance bills (based on *bay' dayn* or *murābahah*), export credit financing/refinancing scheme (based on *bay' dayn*), import/ export documentary collection bills/ foreign negotiation (based on *bay' dayn*), remittance, Islamic letter of guarantee (based on *wakālah*), revolving financing (based on *bay' bithaman ājil*), foreign exchange (based on *al-ṣarf*), bills exchanged/purchased commercial/industrial hire purchase (based on *al-ijārah muntahiah bil tamlīk*).

1.3 Islamic Contracts Related to Banking Trade Products

Islamic banks have adopted several Islamic medieval contracts in their products innovation to replace the practice of interest based transaction. One of them is the concept of *mudārabah*, which is known as a mutual agreement between two parties: capital provider and entrepreneur. This agreement allows the entrepreneur to carry out business based on a profit sharing basis of a pre-agreed ratio. In the case of losses, the losses are borne by the capital provider. Meanwhile the concept of *mushārah* refers to a partnership or joint venture for a specific business whereby the distribution of profit will be apportioned according to an agreed ratio and both parties will share the losses in the event of losses based on their equity participation. The concept of *murābahah* refers to sale of goods at a price, which includes a profit margin as agreed by both parties. This contract is valid on the condition that the price and the profit margin of the seller are stated at the time of the agreement of sale.

Bay' bithaman ājil on the other hand refers to the sale of goods on a deferred payment basis at a price, which includes a profit margin agreed by both parties. *Bay' al- dayn* refers to a business between financier and the customer whereby the financier sells an

asset to the customer on a deferred payment and then the financier immediately repurchases the asset for cash at a discount. On the other hand, *al-ijārah thumma al-bay'*^c (leasing and subsequently purchase) refers to a leasing contract to be followed by purchase contract. Under the first contract, the hirer leases the goods from the owner at an agreed rental over a specific period. Upon expiry of the leasing period, the hirer enters into a second contract to purchase the goods from the owner at an agreed price.

1.4 Problem Statement

It is recognized that in spite of gaining various forms of assistance from the government, the commercial banks are no less important to the SMEs. Commercial banks are important not only to obtain initial capital but in day-to-day business as well.

However, it is observed that these products are still not fully accepted by the SMEs customers. In other words SMEs still do not consider the Islamic banks as the most desirable financial institution either in seeking financing or doing daily business transaction. Prior research demonstrates the low usage among trade customers on the banking products and services offered by Islamic banks (see for example Edris and Almahmeed, 1997, Sudin and Norafifah, 2002, Mansor and Halim, 2005). For instance in 2004, Bank Islam Malaysia Berhad (BIMB) indicated in its report that its SMEs customers constitute only 12.2 percent of the total RM9.2 million of its financing, advances and other loans (BIMB Annual Report 2004). The general presumption is that the Islamic banking products and services for the SMEs is less competitive as compared to their conventional counterparts. Since SMEs are significant market segment to be captured in achieving the 20 percent market share, the Islamic banks should identify their shortcomings in current marketing strategy.

As far as the researchers are concerned, the low acceptance among SMEs could be due to several reasons. Firstly the marketing strategies that have been carried out by the Islamic banks are viewed as still less effective and less persuasive to attract the SMEs. The Islamic banks' advertisements focus mainly on the retail customers and do not specifically address themselves as the SME core supporter. Another loophole identified is the emphasis on the religion factor as the impetus for customers to choose

the Islamic banking products. Perhaps the strategy is inappropriate especially since majority of SMEs owners in Malaysia are non-Muslims. Hence, it is suggested that the Islamic banks have to adopt different marketing strategy to entice the non-Muslims customers.

Service quality is perhaps another area that needs to be improved by the Islamic banks. Since the banking products are generally intangible, it becomes vital for the banks to strive on service quality in order to cope with stiff competitions. Furthermore, Cheese *et. al.* (1988) propose that the trade customers are in need of different approach in banking marketing strategy such as personal attention, personal referral and recommendation. With the exception of a few studies on the service quality among the retail bank customers (see for example Sharil Shafie *et.al.*, 2005), the study between service quality and the trade customers particularly the SMEs is very limited.

In addition to that, there is a need to examine the issues of knowledge and awareness among the SMEs on the banking products and services since the industry is relatively new and customer education is crucial to ensure the success of Islamic banks. For instance, Coca-Cola has successfully popularized the coke soft drink worldwide because the company continuously educates the customers about its product. When coke was founded in 1886, no one had expected that the soft drink could be a multi billion-dollar business. However, by educating the customer and spending heavily on the advertisement cola soft drink has become one of the popular drinks throughout the world.

Furthermore, Halim and Norizatun (2001) found that the level of understanding of Islamic banking products is still low among the general public. This may become a contributing factor of the low acceptance on the products and services offered. The lack of knowledge and understanding not only on their existence but also on the concept will deprive the SMEs from obtaining the benefits of the existing Islamic banking products and services.

1.5 Research Objectives

The research has the following objectives:

1. To examine the perception of SMEs towards Islamic banking based on their knowledge, factors considered important in bank selection process, current marketing practices and customer satisfaction on Islamic banking.
2. To study the banking products and services that most commonly used by SMEs.

1.6 Research Questions

Based on the research objectives, the research aims to answer the following questions:-

1. Is there any significant difference between numbers of employees on their perception towards Islamic banking?
2. Is there any significant difference between ages of business on their perception towards Islamic banking?
3. Is there any significant difference between levels of operation on their perception towards Islamic banking?
4. Is there any significant difference between ownership of business on their perception towards Islamic banking?

1.7 The Significance of Research

The research may provide some insights on the marketing effectiveness of Islamic banks. Appropriate marketing techniques and tools could be developed by the Islamic banks, once information on the trend of usage, selection criteria, the level of satisfaction and knowledge have been identified. The appropriate marketing strategy is important for Islamic banks to increase their market share among the SMEs.

On the other hand, the SMEs will also benefit from the research from at least two aspects. Firstly, the findings are expected to assist the Islamic banks in creating and further promoting their products especially designed to cater the needs of SMEs.

Secondly, by disseminating the finding of this research, it can also increase the level of awareness on the advantages of Islamic banking products and services among the SMEs.

1.8 The Scope of the Research

As far as the government is concerned, the two keywords central to the strengthening of SMEs are technology and finance (Mohd Shafie, 1997). The technology refers to the technical or industrial training by the government in order to develop the SMEs into a high-tech sector that capable of producing high value-added and quality products for the global market. Meanwhile the finance is always referred to the various financial packages either introduced by the government such as Industrial Technical Assistance Fund (ITAF), Financial Package for Small and Medium Industries (PAKSI) and Rehabilitation Fund for Small and Medium Industries or credit extended by commercial banks.

Even though this research is focusing on the finance matter but it will not touch on neither the financial aids introduced by the government nor the credit extended by the commercial banks. Rather the research emphasizes on the products and services offered by commercial banks to facilitate the SMEs in their daily business transactions.

1.9 Conclusion

In the recent decade, the Islamic banking in Malaysia has experienced remarkable growth and transformation, demonstrating its potential as a competitive form of financial intermediation. The banks proactively offer various interest-free products to SMEs customers. However, the current marketing strategy by Islamic banking institutions is viewed as less effective which leads to the low acceptance of the products offered. Hence, this research is an attempt to suggest measures to be adopted by Islamic banks in order to enhance their marketing strategy effectiveness. The research focuses on the differences between Muslim and non-Muslim SMEs perception towards Islamic banking.

The research has five chapters. After the introductory chapter, chapter two reviews the literature on Islamic banking patronage factors. This is followed by chapter three that explains the methodology employed throughout this research. Chapter four discusses the findings of the survey conducted. Chapter five concludes the discussion and offers some recommendations.

CHAPTER TWO

LITERATURE REVIEW

2.0 Introduction

Much has been written since the early of 1970s on the area of Islamic banking (Siddiqi, 1981). Aspects studied were both theoretical and empirical. While the theoretical research provides an initial framework for interest-free banking system, the empirical work observes its current practice and performance. However, it is observed that research to date on Islamic banking is still largely theoretical in nature. Muhamad Muda *et al* (2005) reveals that in the case of Malaysia, among the topics of interest are the different types of Islamic financing modes such as *Bay' Bi thaman Ājil* and *Al-Ijārah thumma al- Bay'* and also the prospects and challenges faced by Bank Islam Malaysia Berhad. Even though, there is a growing tendency to shift from theoretical research to empirical studies, they are still basically at infant stage.

Studies on the determinants of Islamic bank selection have become one of the significant empirical works. The studies had been conducted in various parts of Muslim world to examine the criteria which motivate customers in selecting Islamic banks. The main objectives of the studies are to enlarge the customer base and also to enhance the marketing strategy of the said institution. Analysing by using different methodologies, the previous studies had taken retail customers (e.g. household and student) and trade customers (e.g. small and medium-sized enterprises and listed companies) as their samples.

In this section, the related articles are reviewed in three sections according to three main themes. Retail customer determinant factors in bank selection process were discussed in section one. Section two investigates the preferences of trade customers in selecting their banks. Studies have shown that there are significant different with regard to the preferences between both groups of bank customers. The third section focuses on marketing management in an Islamic banking environment. In relation to

that, articles related to marketing tools, implemented by the Islamic banks in selling their products implemented would be analysed.

2.1 Retail Customer Determinants in Bank Selection Process

A review of the literature, particularly studies conducted on the conventional banks in industrialized countries established an ideal reference source of material on the bank selection criteria among the retail customer (see for example Anderson *et. al* 1976, Kaynak 1986, Laroche *et. al* 1986, Denton and Chan 1991, Lewis *et. al* 1994, William *et. al* 1994, Hostious and Kaynak 1995, Cui *et. al* 2003). The articles that were published in the *International Journal of Bank Marketing* had provided lists of attributes in bank selection process. Though a few universal attributes have been identified, the ranking of each attributes are varied from country to another country due to differences in cultural, economic and legal environment. Such a different in preferences has a profound impact on banks marketing strategy.

With a few modifications, researchers had employed almost the same attributes as established by the stipulated literature when examined the customers' attitudes towards Islamic banks. The studies on patronage factors in Islamic banking are motivated by two main factors namely the religion influence and the different cultures in which majority of Islamic banks run their operation. As generally known, the establishment of Islamic banks is based on the prohibition of *ribā* in Islamic law. Thus, researchers are interested to know whether the sole religion factor able to guarantee the survival of Islamic banks. In addition, majority of Islamic banks operate in developing countries such as in the Middle East and the South East Asia. Customers in both regions adopt different culture in their daily business dealings and transactions. Therefore it is expected that some of the selection attributes that have been found to be crucial in the selection of conventional banking in industrialized countries might not play the same role in the selection of Islamic banks.

Perhaps, the works of Erol and El-Bdour (1989) and Erol *et. al* (1990) are considered as the pioneers studies in this particular area. In both studies, they had analyzed questionnaires of 434 respondents of middle income such as doctors, lawyers and businessmen from three major cities in Jordan. Employing univariate and multivariate

statistical analysis, the attitudes of bank customers, the variables that distinguish Islamic banks from conventional bank and the clustering factors in selecting Islamic banks were identified. It was found that the religious motivation did not appear to be the primary factor for the selection of Islamic banking services. In contrast, Jordanian customers were shown to be profit-oriented. However, since in Islam, a fair return on investment is an optional matter, the researchers were in opinion that such an attitude is not contradicted with the Islamic legal doctrines.

As far as we are concerned, the issue here is not whether the profit-oriented is forbidden or not but it concerns with the desirable mindset of Muslims in their economic affairs. Without overlooking the importance of profit in business venture, Muslims are supposed to prioritise the adherence to *sharī'ah* than worldly economic benefits. Other important findings were that the opening of new branches is not an important factor in increasing the utilization of service provided by Islamic banks. Besides, peer group influence plays an important role for Jordanian to choose Islamic banks. As stated by the researchers, this indicates that marketing activities should concentrate on the peer group in order to increase potential customers' awareness. There was also a high degree of awareness on the advantages related to the profit-loss-sharing concept. Hence, the researchers argue that Islamic banks should move towards profit-loss sharing concept instead of duplicating the existing conventional products. The study also suggests that Islamic banks should increase their service quality, as the complaint on inefficient and inexperienced personnel at Islamic banks was relatively high.

Haron *et. al* (1994) investigated the perception of Muslim and non-Muslim customers in Malaysia, where the Islamic banks operate in parallel with the conventional banks. Having a sample of 301 commercial bank customers, the study found that there was no significant different between Muslim and non-Muslim when selecting their banks. The four common factors in selection decision by both groups of customers are "fast and efficient services", "friendliness of bank personnel", "speed of transaction" and "confidentiality of bank". In terms of knowledge, only 27.3 percent of Muslim and 8.6 percent of non-Muslim had a complete understanding about the basic principles underlying the operation of Islamic banks. The finding clearly indicates that the Malaysian understanding on Islamic banking principles is lower as compared to

Jordanian. However, the finding of this study is consistent with Erol and El-Bdour (1989) and Erol *et. al* (1990) studies as they prove that the rate of profit has been perceived as more important than the religious motivation in selecting the Islamic bank. Therefore, as pointed out by Haron *et. al* (1994), the Islamic banks should not over emphasis, or rely on, the religion motivation as a strategy in their efforts to attract more customers.

While the above literature demonstrated the study in Muslim majority population, Gerrard and Cunningham (1997) surveyed the perception of Singaporean in which Muslim is minority resident. The main objectives of the study were to examine the culture of Islamic banking, the attitude towards Islamic banking and bank selection criteria. 190 respondents participated in the study, which includes 29 Muslim respondents and 161 non-Muslim respondents. It is not surprising when they discovered that non- Muslim had little awareness of the meaning of fundamental term used in Islamic banking. For instance only 0.6 percent of the non-Muslim respondents can describe accurately the meaning of *ribā'*. However, the percentage of 20.7 recorded by Muslim respondents for answer of the same question is something needs to be worried. This is because the percentage indicated the general lack of awareness by Muslim on the core principles underlying the establishment of Islamic bank. Consistent with the findings of Haron *et. al* (1994), Erol and El-Bdour (1989) and Erol *et. al*. (1990), bank customers in Singapore were of the opinion that solely religion reason is not the most important determinant factor for customers patronizing Islamic banks.

Metawa and al-Mossawi (1998) examined the banking behaviour of Islamic bank customers in Bahrain. Unlike the previous studies, which sampled together both conventional and Islamic bank customers, this study restricted its sample to those who use Islamic banking products and services in their daily activities. 300 respondents were surveyed in which majority of them were well educated and 50 percent of them have maintained their banking relationship with Islamic bank for more than six years. Perhaps, the profile of the surveyed customer explains some of the dissimilar findings as compared to previous studies. One of the notably findings is Bahrain customers perceived the religious motivation or the adherence to Islamic principles as more important than the rate of return. The study revealed that there was a significant

relationship between the level of education and the relative importance of "Islamic principles" in the bank selection process. In other words, well-educated customers (high school and college degree) tend to put more emphasis on Islamic principles in selecting their banks than those customers in other educational groups. In addition to that, the level of satisfaction was found relatively high for three products/services namely saving account, current account and investment account. On the other hand, the financing facilities recorded low mean satisfaction score. Informal interviews conducted with some of the surveyed customers indicate some concerns about the cost and flexibility of the financing schemes.

With the purpose of suggesting new education strategy for Islamic banks, Halim and Norizatun (2001) have also examined the Malaysian Muslim knowledge of Islamic banking and its products. Having a sample of 967 commercial bank customers in Kuala Lumpur, the study concludes that the level of understanding of Islamic banking products is still less among the general public. They reported that 60 per cent of the respondents could not differentiate between the Islamic banking schemes and conventional bank financial products. However, as far as we are concerned, inability to differentiate between both schemes does not necessary demonstrate a low understanding of Islamic banking products and services. The difficulty to see the distinct features of products and services offered by Islamic banks is obvious because the Islamic banks tend to duplicate the conventional products with necessary Islamic alterations.

Baharum (2004) also investigated the Malaysian customer selection criteria in Islamic banks. The study identified five most influential factors for bank selection that are friendliness of bank personnel, reputation of the bank, employee efficiency in handling transactions, available parking space and fast services. On the other hand the least important five factors determining customer's selection are found to be advertising on the new products, available of website, advertising on the existing products, charging fee on check transaction and tele-banking services.

From the studies above, perhaps we can conclude that the level of public awareness in the Middle East and South East Asia on the Islamic banking is considered high. In other words, the general public in both regions are aware with the existence of Islamic

banking as an alternative to conventional banking system. However, in terms of knowledge, majority of Malaysians and Singaporeans still lack of understand mainly on the Islamic principles underlying the operations of Islamic banking. A large number of Muslims as well as none Muslim in both countries do not know the meaning of Arabic terms (e.g. *Wad'iah*, *Mud'arabah*, *Kafalah* and *Musharakah*) used by Islamic banks to exemplify their products and services.

Having said that may be the implication on marketing strategy is different for both regions. For Islamic banking players in South East Asia the most important marketing strategy is to educate customers. Consumer education about Islamic banking is critical to its success and future development. On the other hand, management of Islamic banks in the Middle East must put a coherent pattern of action to improve its long-term competitive action (Naser and Moutinho, 1997). They have to shift from tactical level to strategic level that required innovation and creativity in product development. This is true particularly because Islamic banks operate in the business environment where customers view the rate of profit as more important than the religion motivation.

2.2 Trade Customer Determinants in Bank Selection Process

Trade customer refers to either small or medium or big businesses. As far as the marketing strategy is concerned, trade customers have distinctive characteristics that make them differ from retail customer such as the need to personal attention, personal referral and recommendation (Cheese *et. al*, 1988). As the competition in banking industry is becoming more intense, many bank, big and small, began to make determined efforts to attract and retain corporate customer by for example, setting up special corporate divisions or branches which offer specialized knowledge, expertise and service (Turnbull and Gibbs, 1987).

A few studies had been conducted in the industrialized countries to investigate the attributes considered important by trade customers in selecting their bank. Roach (1989) had studied the behavior of small businesses towards bank in the United Kingdom. Having a sample of 904, he concluded that the small businesses are generally extremely conservative in their financial affairs. They are single-bank users

where normally they open both business account and personal account with the same bank. Of importance findings, the research produced a segmentation of small business market on the basis of high or low requirements of banking service. A total of ten market segments were identified.

File and Prince (1991) examined the distinctive patterns of banking behavior in small and medium enterprises (SMEs) in the United States. The size of sample in this study was 1021. Two findings are of interest to bank marketers. First, SMEs owners did not feel they were especially knowledgeable about banking products and services. Second, there was considerable entrenched reluctance to test new banking products.

In addition to studies investigating trade customers behavior towards conventional bank, a few studies have been conducted to examine determinants factors of Islamic bank selection process. Perhaps, Edris and Almahmeed (1997) were among the first who studied in the respective area. They surveyed 500 business firms in the commercial, industrial and services in Kuwaiti. Based on the number of employees and the total asset owned by the firms, they found that 60 firms were classified as large, 180 were medium and 260 were small. In their analysis, they further categorized the firms into Kuwaiti, non-Kuwaiti and joint firms. The findings of the research revealed that 82 percent of the firms are multiple bank users, which means they use two or more banks. Nevertheless only 23 percent of the firms deal with Islamic banks.

As far as the determinant factors are concerned, size of bank asset was rated as the most important bank attributes by firms in Kuwait. Another important attributes are efficiency of personnel, help in financial emergencies, banking expertise and friendliness of staff. The study also indicated that Kuwaiti, non-Kuwaiti and joint business firms can be discriminated significantly on the basis of determinant factors used in bank selection. Obviously the implication of this research is that Islamic banks have to enhance marketing strategies in order to capture larger trade customer market segment in Kuwait.

Haron and Ahmad (2002) also found that the products and services offered by Islamic banks were not popular among the corporate customers in Malaysia. They

conducted a survey among 45 persons who are responsible for the financial affairs of the companies listed in the Kuala Lumpur Stock Exchange. It was found that majority of the respondents have a limited knowledge on the Islamic banking products. As a result, the Islamic banking products and services were not popular among them. Out of 45 companies participated in the study, only 11 maintained banking relationships under the Islamic banking system. In consistent with previous study whereby size of bank is considered as the most important criteria, the study revealed that cost and benefit as the most important criteria. Perhaps, the lack of marketing effort among the Islamic banks could be the contributory factor towards the smaller market share among the trade customer in Malaysia.

Mansor and Halim (2005) examined factors that contribute towards preferences on Islamic banks between the Small and Medium Enterprises (SME). The study surveyed 357 firms from Terengganu in which majority of them operate in batik and textile industry. Consistent with the finding of previous studies only about 11 percent of SME surveyed obtained their initial capital from Islamic bank. The study also revealed that gender and educational level influenced insignificantly towards banking preferences. In other words, male and female owners of SME in Terengganu have about similar banking preferences. The same conclusion can be made in explaining the banking preferences of different educational backgrounds of SMEs' owners (e.g. primary school, secondary school, Diploma, Bachelor degree).

In conclusion, the literature demonstrate the low usage among trade customers on the Islamic banking products and services offered. This fact has profound implication for marketing to this bank customer segment. For marketing strategy development, however, research is required to study critical elements of the said target market. Hence this research is meant to fulfill the objective by focusing on SMEs as the sample.

2.3 Marketing Management in an Islamic Banking Environment

Shook and Hassan (1988) contend that Islamic banks particularly in the developing Middle East countries should implement their own unique marketing concept. This is because the implementation of Western marketing tools in an Islamic banking environment in the region was unsuccessful due to failure to recognize different cultural, priorities, lifestyles and the role of religion. For example, besides a strong Islamic belief, the Arab society views that individual possess property only within the family. Hence, marketing which emphasizes individual, as property owner generally will not be well received. Shook and Hassan (1988) view that the banks in the Middle East, in general were not proactive in search of an innovative marketing strategy. Despite having a lot of opportunities, they remain practicing shortsighted selling strategy such as focusing only high-income segment and neglecting the other segment of customers.

Habib *et. al* (1987) examine the bank marketing scenario in Saudi Arabia where Islamic banking was in the early stage of development. At the time the research was conducted, there were only two Islamic banks in the country namely Al-Baraka Islamic Investment Bank and Faisal Islamic Bank (Al-Rajhi was in the process of transferring from money exchanger to an Islamic bank). It is estimated that 50 percent of Saudis still do not have an account in any of the commercial bank. The main reason for such scenario is because majority of Saudis think that mixing their money with a conventional bank's money makes them sinful. Saudis also try to avoid from working in banks, as they want to stay away from *ribā* institutions. There are bank's branches that serve women exclusively especially in areas where schools and hospitals are located. Another distinctive characteristic of Saudis customers (especially old generation) is that they place much more emphasis on a bank representative rather than the bank itself. A branch manager located in a mid-western rural area related that when he was transferred to the city, the deposits of rural plunged to a low record, because people trusted him with their deposit, not the bank itself.

Several advertising activities such as sales promotion, publicity and personal selling have been implemented to attract bank customers. However, Habib *et. al* (1987) are in the opinion that the bank marketing practices in Saudi Arabia are out-of-date. In

contrast of Western banks that view marketing as a powerful tool for market positioning, analysis, planning and control, the banks in Saudi Arabia still view marketing merely as promotion activity. Therefore, it is strongly recommended to the banks to employ modern thinking of marketing in expanding their business and improving their profit.

Naser and Moutinho (1997) assess the effectiveness of marketing strategies adopted by Islamic banks, which appeared on the list of top 100 Arab banks for the period of 1985-1994. The study adopted quantitative technique that measures the effectiveness of bank marketing tools based on three characteristics namely size, strength and soundness, and profitability and performance. It was found that the Islamic banks were inconsistently included in the list of top 100 Arab banks. For instance only two Islamic banks appear on the list between 1984 and 1987 but since then the number had fluctuated and had reached a peak in 1994 when nine Islamic banks made it to list.

As pointed out by the researchers, the inconsistency may highlight the need to enhance the Islamic banks marketing strategy. Of importance marketing implication is that the need to attract more users in Islamic banking facilities. This was based on the fact that none of the Islamic banks on the list showed steady growth in assets and capital in comparison with the country's average private bank assets as well as the country's private bank capital. On the other hand, Islamic banks in the study were reported as having no problem in their investment and operation since they managed to sustain the growth of profit over the period under investigation. The study also suggest that several marketing issues such as measuring brand equity, measuring marketing's effectiveness, a better new product innovation process and measuring customer satisfaction need to be given serious attention.

Othman and Owen (2001) have developed CARTER model to measure customer satisfaction in Islamic banks. CARTER is an extended model of SERQUAL which was developed by Parasuraman *et. al.* (1985). In developing the CARTER model, a new dimension, which is compliance with Islamic law, has been inserted to the SERQUAL five dimensions. The model is recognized as the first tool to measure service quality where it includes the customers' religious belief and cultural value

with other quality dimensions. It also provides information of customers' needs and wants. Given such information, Islamic banks can strategize their marketing plan to identify areas where improvement should be made and resources can be allocated.

Moreover, the model had been proved as valid and reliable. In order to test the model, a survey had been carried out at the Kuwait Finance House (KFH). 500 customers of KFH were participated in the survey but only 360 responses were found to be suitable for statistical analysis. Of important findings for Islamic banks, marketers need to be aware of religious dimension in product innovation and also the need for a balance between general understanding of customer's need and an internal understanding related to the bank's operation, specific services, geographical location or counters' design.

Using the CARTER model, Shafie *et. al* (2004) investigated the service quality provided by Bank Islam Malaysia Berhad (BIMB). Sums of 200 questionnaires were distributed to the BIMB's customers with 100 percent respond rate. Amongst all six dimensions included in the model, the compliance to the Islamic law was reported to be most important by BIMB's customers. The result of the study also supports the work of Othman and Owen (2001) when it reveals the strong link between service quality and customer satisfaction by taking into consideration cultural differences. As a result, Islamic banks can adopt the model to enhance their marketing plan.

2.4 Conclusion

The prior studies reveal that there is significant difference of perception between retail and trade customer towards Islamic banking. The prior studies also highlight the need to enhance marketing strategy of Islamic banking institutions in order to capture larger market share among trade customers. The current marketing techniques of Islamic banks are seen to be less effective and inconsistent. In addition to that, the Islamic banks also have to develop their own marketing approach as the implementation of Western marketing tools fail to recognize the different culture, priorities, lifestyles and the role of religion.

CHAPTER THREE

RESEARCH METHODOLOGY

3.0 Introduction

This chapter explains on the methodology employed in conducting this study. The discussion is organized according to several sub-topics which are research design, instrument design, sampling and sample size, data collection method and statistical analysis.

3.1 Research Design

The study adopted a survey-based approach in collecting the data by distributing a set of self-administered questionnaires to the potential respondents. The qualitative method is employed, as this study is exploratory in nature. The questionnaire is designed in specific manner based on the goals of the study. The research began by establishing the objectives of the study after an extensive review on the relevant literature. The process was followed by designing questionnaire, collecting and analyzing the data and finally preparing the research report starting from May 2005 to February 2006. The detailed schedule of the study is presented in the table 3.1 below.

Table 3.1: Study schedule

Task	Duration
Literature review and objectives clarification	May 2005
Designing questionnaire	June
Conducting pilot test	June
Revising and reviewing questionnaire	June
Sending mails and emails to potential	July

respondents	
Deadline for receiving mails and e-mails from respondents	August
Meeting potential respondents personally	September- November
Data entry and verification	November
Analysing the data	December
Preparing the report	January-February
Printing & distribution of the report	February

3.2 Instrument design

With some modifications, the questionnaire was designed primarily based on the study of Sudin and Norafifah (2002). Their study had investigated the perception of Malaysian public listed companies towards Islamic banking products. In their study, four aspects had been examined namely the usage, knowledge and awareness, roles of respondents and potential of Islamic banking in the corporate sector. In this study however, SME sector was chosen as the sample with the concentration on four aspects namely selection criteria, degree of satisfaction, knowledge and awareness as well as marketing strategy.

The questionnaire was designed in three sections with simple sentences to increase the response rate. Section A is pertaining to company's background, Section B is related to the company's perception towards the four aspects mentioned previously and Section C extracts information on the banking products being used by the company. Next is the discussion on the contents and the justification of all the three sections.

3.2.1 Section A of the questionnaire

Section A attempts to gather some information on the background of the company. In order to increase its reliability, the SMIDEC's definition of SME is incorporated in this section. The purpose of this section is to collect data on the background of the business; including main business operation, volume of staffs employed, ownership, level of business operation, initial capital and the banking scheme used by the respondent's company. The SMEs are divided into 23 different types of businesses such as foods and restaurant, paper and printing, machinery, textile, Information Communication Technology (ICT) and education services. Realizing that majority of the SMEs are operating in various business activities, the respondents are allowed to state more than one type of businesses.

In terms of number of full time and full time equivalent employees, the companies are divided into four categories. The first category is a company with less than 5 people, secondly, a company with a number of staffs between 5 and 19 people, the third category is a company with a number of staffs between 20 to 50 people and the last category is a company with staffs of between 51 and 150 people. Another significant category in this section is the duration of their existence in the business. The first sub-category is for those companies which have been operating for less than a year. Secondly is the sub-category for companies which have been established between 1 to 5 years. The third sub-category is for companies with business experience between 6 to 10 years and the fourth sub-category refers to companies which have been established for more than 10 years.

In terms of ownership, the company is categorized whether they are owned by Muslim or non-Muslim. The categorization of ownership is important to examine the distinction between the perceptions of both groups towards Islamic banks.

The companies are also divided into three categories in respect of their level of operation. The first category is for companies that operate locally such as in housing area, town and district. The second category satisfies those companies which operate at the national level and the third category is for those companies that involve themselves in international trade. The study also suggests six capital sources that the

companies might seek for when they want to commence their business. The sources are from Islamic banks, conventional banks, Islamic and conventional banks, government financial assistance, self-financing and others. Respondents are allowed to choose more than an answer for questions pertaining to the level of operation and sources of initial capital.

The last question in Section A refers to the usage of Islamic banking scheme. Respondents were inquired about the banking scheme that their companies use in performing their daily business transactions. They were also required to identify whether their companies are either users of both Islamic and conventional banking schemes or fall under either extreme: users of Islamic scheme only or users of conventional scheme only.

3.2.2 Section B of the questionnaire

This section attempts to gather information on the perception of SMEs towards Islamic banking products. The respondents are required to answer twenty questions regarding four aspects that measure their perception towards Islamic banking products. There are twenty questions in this section with five questions each pertaining to selection criteria and degree of satisfaction, four questions on knowledge and awareness and six questions pertaining to the current marketing strategy as implemented by Islamic banks. The questions are designed using Likert scale ranging from 5 which denotes strongly agree to 1 which implies strongly disagree.

Questions related to selection criteria are designed based on information obtained from the prior studies such as Erol and El Bdour (1989), Haron *et. al* (1994), Gerrad and Cunningham (1997) and Metawa and Mossawi (1998). Even though the prior studies had listed numerous criteria in the selection process, only five criteria are included in the questionnaire. These five criteria are included since prior studies have highlighted them as the most influential factors perceived by the customers in selecting banks. The five criteria are religious factor, economic profit factor, environment factor e.g. parking space, friendliness of bank personnel and reputation and image of the banks.

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