

**ACCEPTANCE LEVEL OF ISLAMIC BANKING
PRODUCTS AND SERVICES: A CASE STUDY
OF PESHAWAR, PAKISTAN**

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ASIA e UNIVERSITY

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ACCEPTANCE LEVEL OF ISLAMIC BANKING PRODUCTS AND
SERVICES: A CASE STUDY OF PESHAWAR, PAKISTAN

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ABSTRACT

This study explores the consumer acceptance of Islamic banking products and services (IBP&S) in Peshawar, Pakistan, considering the moderating role of religious motivation. The deductive approach is employed, utilizing awareness of IBP&S, understanding of Islamic banking products and services, socio-political factors, and the 4Ps of marketing as independent variables. The dependent variable is customer acceptance of Islamic banking, and Bank Alfalah Islamic, Bank Islami Pakistan, MCB Islamic Bank, Soneri Mustaqeem Islamic Bank, and HBL Islamic Bank are considered. Data from 400 clients were collected through primary sources with verbal consent. The findings reveal that awareness, knowledge and socio-political factors of Islamic banking products and services have an insignificant effect on consumer acceptance. However, the 4Ps of marketing significantly influence customer acceptance. Religious motivation does not significantly moderate the relationships. The study concludes that consumer acceptances are influenced by various factors, and marketing plays a crucial role in enhancing customer satisfaction and the adoption of Islamic banking services. The lack of awareness and the presence of alternative choices affect the adoption rate. Future research should conduct in-depth interviews for further analysis. Islamic banks should focus on marketing practices, profitability, community service, unique services, and religion to attract customers. Policymakers in Pakistan should consider the cultural, economic, and social factors that impact banking service adoption, customizing measures to suit Peshawar's unique characteristics and increase residents' comfort in using financial services. Policy implications highlight the importance of policymakers understanding the cultural and social aspects that influence the adoption of banking services. Further research can help policymakers customize measures for Peshawar's urban environment, facilitating increased comfort and usage of financial services among its residents.

Keywords: Islamic Banking, Traditional Banking, Shariah, 4Ps of Marketing, Socio-political factors, Religious Motivation, Consumer Awareness, Consumer Acceptance, Religion, Knowledge

APPROVAL

This is to certify that this thesis conforms to acceptable standards of scholarly presentation and is fully adequate, in quality and scope, for the fulfilment of the requirements for the degree of Doctor of Philosophy.

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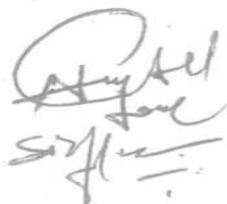
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DECLARATION

I hereby declare that the thesis submitted in fulfilment of the PhD degree is my own work and that all contributions from any other persons or sources are properly and duly cited. I further declare that the material has not been submitted either in whole or in part, for a degree at this or any other university. In making this declaration, I understand and acknowledge any breaches in this declaration constitute academic misconduct, which may result in my expulsion from the programme and/or exclusion from the award of the degree.

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Signature of Candidate:

Date: 17 April 2023

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TABLE OF CONTENTS

ABSTRACT	ii
APPROVAL	iii
DECLARATION	iv
ACKNOWLEDGEMENTS	vi
TABLE OF CONTENTS	viii
LIST OF TABLES	xii
LIST OF FIGURES	xv
LIST OF ABBREVIATION	xvi
CHAPTER 1 INTRODUCTION	1
1.1 Background of the study	1
1.1.1 Issues in Islamic banking from global perspective	2
1.1.2 Regional issues in Islamic banking	4
1.1.3 Issues in Islamic banking of Pakistan	6
1.2 Problem statement	6
1.3 Aims and objectives	10
1.4 Research questions	11
1.5 Research hypotheses	12
1.6 Justifications and significance of the study	12
1.7 Definition of key terms	15
1.7.1 Consumer awareness and knowledge	15
1.7.2 Religious motivation	15
1.7.3 Consumer acceptance	16
1.8 Research structure and summary	16
CHAPTER 2 REVIEW OF LITERATURE	18
2.1 Introduction	18
2.2 Conceptualising Islamic banking system	18
2.2.1 Products of Islamic banks in different countries	18
2.2.2 Services provided by the banking sector	20
2.2.3 Intranet banking products and services	22
2.2.4 Differences in conventional and Islamic banking sector	23
2.2.5 Trends of Islamic banking finances and services	31
2.2.6 Service products offered by Islamic banks in Pakistan and perceived by customers	38
2.2.7 Features of Islamic banking	41
2.3 Independent variables(s)	46
2.3.1 Consumer awareness on Islamic banking products and services	46
2.3.2 Consumer knowledge on Islamic banking products and services	51
2.3.3 Socio-politics	52
2.3.4 Marketing mix	56
2.4 Moderating variable: Religious motivation	61
2.4.1 Impact of religious motivation towards Islamic banking products and services	61
2.4.2 Influence of religious motivation on consumer acceptance on Islamic banking	64

2.5	Dependent variable: Customer acceptance	66
2.5.1	Consumers acceptance of Islamic banking	67
2.5.2	Relationship between Islamic banking products, services and customer acceptance	69
2.5.3	Factors, attributes and domain that influence the acceptance of customers on products and services of Islamic banks	74
2.6	Consumer behaviour on Islamic banking's products and services	76
2.6.1	Customer experience from the products and services of Islamic banking	76
2.6.2	Consumer acceptance of Islamic banking products and services	78
2.6.3	Factors affecting consumer motivation for using Islamic banking services	79
2.7	Factors affecting customer acceptance and acceptance level of Islamic banking in Pakistan	83
2.7.1	Religiosity	83
2.7.2	Consumer awareness about Islamic banking services and products	86
2.7.3	Innovation and technology	87
2.8	The aspects about the knowledge and awareness created in consumers related to Islamic banking	89
2.9	Push and pull factors affecting consumer knowledge on Islamic banking products and services	91
2.9.1	Pull factors	91
2.9.2	Push factors	92
2.10	Impact of Islamic banking products and services on customer acceptance in Peshawar, Pakistan	94
2.11	Types of variables and constructs or models relevant to Islamic finance	96
2.12	Theoretical framework	97
2.12.1	Theory of planned behaviour	97
2.12.2	Theory of reasoned action	98
2.12.3	Theory of technology acceptance	98
2.13	Conceptual framework	102
2.14	Literature gap	103
2.15	Chapter summary	103

CHAPTER 3 METHODOLOGY 105

3.1	Introduction	105
3.2	Operational definitions	107
3.3	Scope of the study	108
3.4	Research approach	109
3.5	Instrumentation	111
3.6	Permissions, ethics clearance and informed consent	111
3.6.1	Permissions	111
3.6.2	Ethics clearance	112
3.6.3	Informed consent	113
3.7	Data collection	113
3.7.1	Translation	113

3.7.2	Content validity	113
3.7.3	Stability of measures	114
3.7.4	Data collection process	114
3.7.5	Questionnaire development process	116
3.8	Data analysis	117
3.8.1	Population	117
3.8.2	Sample	118
3.8.3	Coding the data	120
3.8.4	Internal consistency of measure	121
3.8.5	Data validity	121
3.8.6	Method of analysis	122
3.9	Findings of the pilot study	125
3.10	Chapter summary	131

CHAPTER 4 RESULTS AND DISCUSSION 135

4.1	Introduction to the Chapter	135
4.2	Number of participants and response rates	136
4.3	Demographic data of participants	137
4.4	Frequency	139
4.4.1	Statement 1	140
4.4.2	Statement 2	141
4.4.3	Statement 3	142
4.4.4	Statement 4	143
4.4.5	Statement 5	144
4.4.6	Statement 6	145
4.4.7	Statement 7	146
4.4.8	Statement 8	147
4.4.9	Statement 9	148
4.4.10	Statement 10	149
4.4.11	Statement 11	150
4.4.12	Statement 12	151
4.4.13	Statement 13	152
4.4.14	Statement 14	152
4.4.15	Statement 15	153
4.4.16	Statement 16	154
4.4.17	Statement 17	155
4.4.18	Statement 18	157
4.4.19	Statement 19	158
4.4.20	Statement 20	159
4.4.21	Statement 21	160
4.4.22	Statement 22	161
4.4.23	Statement 23	162
4.4.24	Statement 24	163
4.4.25	Statement 25	164
4.4.26	Statement 26	165
4.4.27	Statement 27	166
4.4.28	Statement 28	167
4.4.29	Statement 29	168
4.4.30	Statement 30	169
4.4.31	Statement 31	170

4.4.32	Statement 32	171
4.4.33	Statement 33	172
4.4.34	Statement 34	173
4.4.35	Statement 35	174
4.4.36	Statement 36	175
4.5	Descriptive Statistics	176
4.6	PLS-SEM	178
4.6.1	Factor Loadings and Construct Reliability & Validity	178
4.6.2	Discriminant Validity	181
4.6.3	Multicollinearity	183
4.6.4	Model Specification	184
4.6.5	Path Coefficients Analysis	185
4.6.6	Moderator Regression Analysis	186
4.7	Discussion	188
4.7.1	Different factors affect the Acceptance of Consumers of Islamic Banking Products and Services	188
4.7.2	Religious motivation in affecting consumer's acceptance on IBP&S in Peshawar	194
4.7.3	Consumer knowledge and awareness effect on their acceptance of using IBP&S within Peshawar	201
4.7.4	Socio-politics (gender, domicile, education) effect the consumer's acceptance on IBP&S in Peshawar	211
4.7.5	Marketing mix (product, price, place, and promotion) influence the consumer's acceptance of IBP&S in Peshawar, Pakistan	215
4.8	Chapter Summary	223
CHAPTER 5 CONCLUSION AND RECOMMENDATIONS		225
5.1	Discussion on finding relating to previous studies	225
5.2	Acceptance of Consumers of IBP&S	225
5.2.1	Religious Motivation	227
5.2.2	Consumer knowledge and its impact on their acceptance of IBP&S	230
5.2.3	Impact of socio-political factors on the consumer's acceptance of IBP&S	233
5.2.4	Impact of Marketing Mix on the consumer's acceptance of IBP&S	235
5.2.5	Policy Implications	240
5.3	Research contribution	242
5.4	Research Limitations	242
5.5	Further Research Suggestions	244
5.6	Conclusion	246
5.7	Theoretical contributions	257
5.8	Contribution to methodology	257
5.9	Summary of Findings	258
5.10	Chapter Summary	259
REFERENCES		261
APPENDICES		287
Appendix A		287
Appendix B		294

LIST OF TABLES

Table	Page
2.1 Overall deposits of the Islamic banking industry	19
2.2 Use of internet banking services	23
2.3 Profitability of the UK Islamic banks	28
2.4 Total assets of the banking sector in the United Kingdom (UK) from 2002 to 2018	29
2.5 Islamic finance assets growth 2012 – 2019	30
3.1 Accepted/rejected hypothesis	107
3.2 Variables code	120
3.3 Reliability and validity through PLS-SEM	125
3.4 Item statistics	127
3.5 Table of discussion	132
4.1 Gender	137
4.2 Age	137
4.3 Qualifications	138
4.4 Statement 1	140
4.5 Statement 2	141
4.6 Statement 3	142
4.7 Statement 4	143
4.8 Statement 5	144
4.9 Statement 6	145
4.10 Statement 7	146
4.11 Statement 8	147
4.12 Statement 9	148

4.13	Statement 10	149
4.14	Statement 11	150
4.15	Statement 12	151
4.16	Statement 14	153
4.17	Statement 15	154
4.18	Statement 16	154
4.19	Statement 17	155
4.20	Statement 18	156
4.21	Statement 18	157
4.22	Statement 19	158
4.23	Statement 21	160
4.24	Statement 22	161
4.25	Statement 23	162
4.26	Statement 24	163
4.27	Statement 25	164
4.28	Statement 26	165
4.29	Statement 27	166
4.30	Statement 28	167
4.31	Statement 29	168
4.32	Statement 30	169
4.33	Statement 31	170
4.34	Statement 32	171
4.35	Statement 33	172
4.36	Statement 34	173
4.37	Statement 35	174

4.38	Statement 36	175
4.39	Descriptive Statistics	176
4.40	Factor Loadings	179
4.41	Discriminant Validity	182
4.42	Multicollinearity	183
4.43	Model Specification	185
4.44	Path Coefficients	186
4.45	Coefficients	187
5.1	Conclusion	252

LIST OF FIGURES

Figure	Page
2.1 The rise in global assets of the Islamic fund assets	26
2.2 Islamic banking progress in Pakistan	27
2.3 Asset value of Islamic banks in Malaysia	28
2.4 Financial ratios of the conventional vs Islamic banking	31
2.5 Islamic banking industry 2016-2020	37
2.6 The acceptance of consumer regarding Islamic banking products and services	71
2.7 Acceptance of consumer presented through use of the services and products	72
2.8 Consumer acceptance about Islamic banking in Pakistan	73
2.9 Acceptance of non-muslims on conflict in religious beliefs with Islamic banking in Malaysia	84
2.10 Correlation of the included sample portraying the effects of religiosity	85
2.11 Aspects required for the knowledge and awareness created in consumers related to Islamic banking	90
2.12 Conceptual framework (self-made)	102
3.1 Model of analysis	106
3.2 Breakdown of Respondents by Bank	110
4.1 Breakdown of Respondents by Bank	136

LIST OF ABBREVIATION

US	United State
UK	United Kingdom
MENA	Middle East and North Africa
SECP	Securities and Exchange Commission of Pakistan
IBP&S	Islamic Banking Products & Services
IFSB	Islamic Financial Services Board
IIFM	International Islamic Financial Market
IFIAAO	Islamic Financial Institutions Accounting and Auditing Organisation
MCR	Minimum Capital Requirements
ROA	Return On Asset
NIM	Net Interest Margin
ROE	Return On Equity
ROCE	Return On Capital Employed
UAE	United Arab Emirates
TQM	Total Quality Management
GDP	Gross Domestic Product
TPB	Theory of Planned Behaviour
TRA	Theory of Reasoned Action
TAM	Technological Acceptance Model
TAM3	Technology Acceptance Model 3
UTAUT	Unified Theory of Acceptance and Use of Technology

CHAPTER 1

INTRODUCTION

1.1 Background of the study

Islamic Banking is a form of banking that adheres to the principles of Islamic law (Sharia) and guided by Islamic economics. It provides financial services to customers while avoiding activities such as interest-based transactions, speculation, and gambling. The core principles of Islamic Banking are based on the concept of risk-sharing rather than risk-transferring. It ensures fairness in transactions through profit sharing and loss bearing between the customer and the bank (Visser, 2019). According to Alam, Gupta & Shanmugam (2017), it is a type of banking that complies with Sharia law. This means that all transactions must adhere to Islamic principles, such as bans on Riba (usury) and Gharar (uncertainty). Islamic banking also often includes a profit-sharing component, in which the bank shares in the profits of the business it is financing.

The key distinction between Islamic banking and traditional or conventional banking is that Islamic banking must adhere to Sharia regulations, whilst conventional banks do not. Conventional banks charge interest (Riba), and they are often associated with trade of Shariah-prohibited components such as alcohol, pork, and so on, as well as elements such as Gharar (uncertainty) or Maysir (Gambling) (Todorof, 2018). Islamic banking is founded on Shariah Law principles. Interest is forbidden in Islamic banking; instead, it is asset-based finance in which ownership of actual assets is transferred from one party to another. Conventional banks only offer one type of loan financing, but Islamic banks offer several types of financing, including Murabaha, Mudaraba, Musharaka, Ijara, and Salam. Islamic banking is also considered as more

economic friendly and sustainable, because it encourages people to make modest loans rather than large ones (Arshed, Yasmin & Gulzar, 2020).

Islamic banking has seen tremendous growth over the past few decades, becoming an increasingly popular alternative to traditional banking. This is due to the increasing demand for financial services that are compliant with Islamic law. As a result, many countries have developed policies and regulations to support Islamic banking and its development. This is due to the fact that Islamic banking is based on the principles of fairness and honesty, which are attractive to many consumers in this sector. There has been a lot of development in the Islamic banking industry, and it is now one of the fastest growing industries in the world. Islamic banks are also utilizing latest technologies such as Big data, IoT and A.I to further improve the quality of their products and services (Belkhaoui et al., 2020). For this purpose, the study relied in quantitative research and collected data through respondent from various bank and survey questionnaire was used to collect data.

1.1.1 Issues in Islamic banking from global perspective

According to Haseeb (2018), Islamic banking and finance growth has generated excessive interest from the past few years. The concept of Islamic banking was highly encouraged in different areas of the world. However, as per the study of Yas et al. (2020), one of the major issues of Islamic banking in the world is related to less effort in the industry for helping small organisations and trade. The Islamic banking industry is not able to deal with the inflation rates, late payment, lack of currencies, and funds for liquidity. Furthermore, a study conducted by Ishak (2019) stated that the compliance of Sharia includes different challenges of regulatory and prudential aspects. In addition to this, it also leads towards various misconception in the western

society in regard to the banking philosophies, lack of money, Islamic financial instrument and privacy aspect. The recent position of the Islamic banking is that there are more than 200 Islamic financial institutes around the world which has investment funds of around \$250 billion. In the words of Rehman et al. (2020), the growth of Islamic banking industry is 16% annually. However, in some Muslim countries such as Pakistan faced many challenges related to accounting aspect. In addition to this, there is a need to develop financial instrument which includes the number of practical stages of banking level is reduced to minimum which are required by the Sharia.

Haseeb (2018) stated that Islamic banking is facing financial and non-financial risk. It has been further stated by the author that the financial risk includes credit, liquidity and market risk whereas non-financial risk incorporates with the operational, regulatory, business, legal and banking risk factors. It has been claimed by some countries around the world which include Malaysia, Pakistan and vice versa that the Islamic banking is just a modernised name of conventional banking. In addition to this, they argue that the interest rate under conventional banking is just altered to the profit rates in the Islamic banking aspects. As demonstrated by Yas et al. (2020) the growth factors for increasing the values of Islamic banking includes population, time interval, and economic parameters. The author further demonstrated that there are some aspects which customers demand from Islamic banking such as deposits, financial services and investments. Furthermore, the aim of the study is to identify the Islamic banking, financial product & services and knowledge & acceptance of consumers in Pakistan especially in Peshawar. The main reason of selecting Peshawar from Pakistan was that the Islamic banking industry was not able to satisfy their customers and operate in an effective manner. However, there were very limited studies conducted on this area. Therefore, there was a need to address this issue (Rehman et al., 2020).

1.1.2 Regional issues in Islamic banking

The Islamic finance sector's regional span, as well as the diversity of goods it offers, has been quickly growing as the sector's essential growth factors propel the business forward in numerous locations (Sudarsono, Tumewang & Kholid, 2021). With the onset of the worldwide economic crisis that took place during the year 2008 to 2009 along with the European sovereign debt crisis in 2011–2012, which had a significant influence on prominent mainstream financial firms while leaving the Islamic banking system mostly unharmed, the practice received more popularity (Burgess, Yaoyuneyong & Gibbs, 2014). Considering the fact that Pakistan belongs to Asian region along with premise of this research centred on assessing the awareness or acceptance of consumers on Islamic banking product and service (IBP&S) in Peshawar, the regional issues pertinent to Islamic banking in Asia is discussed in the following section.

Malaysia is a regional leader in Islamic banking in several aspects. Pakistan, Indonesia, Bangladesh, and Brunei are other prominent industries. As of December 2019, Malaysian Islamic banking assets were USD 254 billion, with total money deposited with Islamic banks accounting for 38.0% of total banking sector deposits, accompanied by Indonesia (10.8%), Bangladesh (5.4%), Pakistan (4.9%), and Brunei (4.9%) (Ishak, 2019). Nevertheless, since the Islamic banking industry is still modest in comparison to the traditional financial industry, it has the capacity to penetrate these nations' local marketplaces significantly (Arshed, Yasmin & Gulzar, 2020). Islamic financial resources, for instance, accounted up 20.8% of overall financial sector holdings in Malaysia, 21.1% in Bangladesh, 9.5% in Pakistan, and 4.9% in Indonesia in the past few years (Global Financial Integrity., 2019). Aside from Islamic financial system, there has been tremendous growth in the Islamic investment administration

and Sukuk businesses, while Takaful is expanding at a moderate pace but with a bigger diffusion capability. At both the foremost and intermediate market segments, Asia – particularly Malaysia – is by far the largest developed economy for Sukuk (Farah Hanan Muhamad et al., 2021). Malaysia was accountable for USD148 billion in unsettled Sukuk, accounting for 60.4% of the entire world valuation. Indonesia, Pakistan, Singapore, and Brunei are among the Asian countries with significant Sukuk lenders. Indonesia contributed for 7.0% of worldwide financings in past few years, while Pakistan represented for 1.5% (Pitchay et al., 2019).

In the Middle East and North Africa (MENA) sector, Islamic banking has expanded significantly over the past decade. About five hundred Islamic financial institutions are currently operating in the sector, and Islamic banks in the region have expanded in number and scope (Sidlo, 2017). In 2017, it was predicted that the MENA area accounted for about thirty-five percent of the worldwide Islamic financial sector; in the coming years, this percentage is anticipated to increase (Alamgir et al., 2020). The MENA region is also home to a number of Islamic financial hubs, notably Dubai, the biggest and most advanced Islamic business district in the globe. The Monetary Authority and municipalities in every country the MENA region along with Central bank and local banks usually oversee the financial system (Hanieh, 2020). The Islamic banking business in the area is governed similar to conventional banking, with certain extra Islamic banking-specific laws and regulations. Islamic banks in the region provide a variety of financial services, including checking and savings accounts, investments, mortgages, and financing. Islamic banks have been effective in delivering Sharia-compliant financial services to people and companies (Khavarinezhad & Biancone, 2019).

1.1.3 Issues in Islamic banking of Pakistan

Pakistan is aiming to grow its Islamic financial industry even further. The unveiling of the Islamic financial strategic framework, which intends to raise Islamic financial industry's proportion of overall banking holdings to 20 percent by the end of 2018, raising from 10 percent of the year 2014 within Pakistan (Shaikh, 2020). The state passed measures in recent years to abolish interest by offering a 2% tax refund for Shariah-compliant production enterprises. The Securities and Exchange Commission of Pakistan (SECP) also announced the 2015 release of Sukuk guidelines, which are likely to speed up Sukuk issuing in Pakistan (Shaikh & Shah, 2019). SECP also formed an Islamic financial unit with a specific duty to publish Shariah rules, conduct research on Shariah conformity, offer new Shariah compatible commodities, and enhance market knowledge. The Sharia'ah legislative framework for Islamic financial institutions was also released by the State Bank of Pakistan in 2015, with the principal goal of improving the entire Shari'ah compliance ecosystem (Salman et al., 2018). However, during 2011 and 2020, Pakistan has to contribute up to \$165.2 billion in construction. Given the government's insufficient funds to meet this demand, Islamic investments might be a viable solution to bridge the infrastructural funding shortfall (Saqib, Farooq & Zafar, 2016). With one of the world's largest Muslim demographics and roughly 7.2 percent of Pakistan's senior populace staying unbanked for religious considerations, Islamic finance has the potential to expand financial inclusiveness by offering banking services to this overlooked segment of the nation (Tara et al., 2014).

1.2 Problem statement

The research of Louhichi and Boujelbene (2017) represented that there are two different types of banks working in the developing country of Pakistan. These banking

structures include the conventional and the Islamic banking sector. Similarly, Asadullah (2017) comprehended that the Pakistani Islamic banking sector stimulates the services and products such as deposits and investment projects. Despite being a Muslim state, there has been close competition between the conventional and the Islamic banking sector. The two banking sectors as per the identification of Butt et al. (2018) have been in a rivalry for attaining a large number of customers as the means of maximisation of profitability through offering high-quality contributions that equate to or surpass consumer standards. As a result of this competition, Islamic banking in the country of Pakistan irrespective of its introduction in 1985, continues to remain insignificant which has obstructed the broadening of the current financial network. Salman et al. (2018) in their research presented that due to the recent rise in the financial institutions which include both Islamic and non-Islamic banks, the banks provide their services and products to both Muslims and non-Muslims. This is done by influencing the selection of the consumers regarding their banking products and service. However, there are differences that are present between the two banking sectors which are present in the market, Sharia supervisory board, the tax rate in Islamic banking (Ayyub et al., 2019). This difference has led to no prominent success for the Islamic banking sector in developing countries such as Pakistan. In contrast to this, Islamic banking has shown rapid growth in Iran whereas, further deterioration has been observed in the Islamic financial system performance in Peshawar (Shaikh & Shah, 2019). Study of Loo (2010) was pertinent in this case, since it examined the viability of Islamic banking system among Muslims and non-Muslims.

In the context of Malaysia, it showed that non-Muslims usually perceive this system as relevant to the Muslims. However, it also indicated positive acceptance of Islamic banking among X-generation of non-Muslims compared to baby boomers.