

## **Contributing Factors Influencing the Acceptance of Islamic Banking in Malaysia**

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### **ABSTRACT**

This study aims to explore the factors influencing the acceptance of Islamic banking among Malaysian society. Despite the rapid growth and increasing awareness of Islamic banking, there remains a significant knowledge gap regarding Islamic banking products, leading to lower demand compared to conventional banking. This conceptual paper adopts a qualitative approach by synthesizing existing literature, highlighting factors such as consumer knowledge and understanding, service quality, religious beliefs, social influences, and bank reputation. Apart from that, the role of non-religious factors like trust, customer experience, and product innovation in shaping consumer preferences also included as contributing factors influencing the acceptance of Islamic banking in Malaysia. The findings indicate that while religious values play a significant role, non-religious factors such as service quality and customer experience also contribute to the acceptance of Islamic banking. Therefore, Islamic banking institutions are encouraged to enhance their service offerings and focus on customer satisfaction. This study provides valuable insights for stakeholders to improve promotional strategies for Islamic banking in Malaysia's multi-religious society. Future research is recommended to explore non-Muslim perspectives, social dynamics, and the impact of technological advancements on the acceptance of Islamic banking.

Keywords: Acceptance, Islamic banking

### **INTRODUCTION**

Islamic banking refers to financial institutions, products, and services designed in compliance with Shariah principles, which are derived from the Quran and the Sunnah of Prophet Muhammad (SAW). Gait and Worthington (2008) stated that Islamic banking is one of the most speedily growing segments of the global finance industry. According to Iqbal and Mirakhor (2007), Islamic banks are known as an interest-free institutions and organized financial intermediaries, which operate in accordance with Shariah law transactions rules and principles to carry out the business operation (Henry & Wilson, 2004; Iqbal & Mirakhor, 2007; Dusuki & Abdullah, 2007).

In Malaysia, Islamic banking has demonstrated exceptional growth, achieving a dynamic 10.3% increase in 2017. Such achievements imply an improvement in societal understanding of Islamic banking and its offerings. However, challenges persist due to common misconceptions about Islamic versus conventional banking systems. Research by Abdul Hamid and Mohd Nordin (2001) revealed that while 96.7% of respondents were aware of Islamic banking, a significant knowledge gap regarding Islamic banking products remained.

This highlights a discrepancy between awareness and comprehension of Islamic banking products and their unique principles. Their findings clarify those customers have high awareness, but they still lack of knowledge in Islamic banking products. They also found that respondents are lack of understanding the differences between conventional and Islamic banks.

There are numerous reasons behind the low of demand for Islamic home financing products as compared to conventional such as lack of customer's awareness towards Islamic banking, lack of competitiveness of Islamic financing products and lack of specialized officer at the branch level to educate the customer to understand more about the Islamic financing products. (Abdul Hamid et al., 2011). These findings emphasize the need for a deeper investigation into the acceptance of Islamic banking in Malaysia.

Due to the low demand for Islamic banking products and the widespread misconceptions between Islamic and conventional banking among society, thus the objectives of this study are to explore and discuss factors influencing society's acceptance of Islamic banking in Malaysia. Literally this paper is a conceptual paper where this research adopts a qualitative approach, synthesizing discoveries from existing literature to explore society acceptance of Islamic banking.

## **LITERATURE REVIEW**

Mirakhor (2000) disclose that the main principles of Islamic banks activities comprise of prohibition of interest (*riba*) in all forms of transaction undertaking business and trade activities, based on fair and legitimate profit. According to Bassir N.F et al., (2014) clarify that the operations of Islamic banking are based on the concept of mutual risk and profit sharing between parties, with assurance of fairness for all and transactions that are based on an underlying business activities or assets. Their research further highlights that Islamic banking transactions are governed by the principles of Shariah law, which include the prohibition of *riba* (usury/interest), *maisir* (gambling/betting), and *gharar* (speculative trading/uncertainty). These principles contribute to the uniqueness nature of the Islamic banking system in contrast to conventional banking.

In Malaysia, Islamic banking was started in 1983 where Bank Islam Malaysia Berhad as the first Islamic bank has launched and licensed besides regulated by Bank Negara Malaysia (BNM) under the Islamic Banking Act with a noble cause to assist the Muslims as a better banking system compared to the then Tabung Haji (the Pilgrims Management and Fund Board) saving scheme established in 1963. (Ching & Chee, 2014). Far ahead in 1993, the Malaysia government had liberalized the banking industry further by allowing the conventional banks to offer Islamic banking products through an "Islamic window" to boost the dual banking system to be more effective in promoting Islamic banking as a whole (BNM, 1999). The decision has compelled the entire banking industry in Malaysia becoming more competitive as a way to improve and increase the productivity of banking operations (A. S. Alias et al., 1993; A. Kaleem, 2000).

Shariah Advisory Council of BNM (SAC-BNM) was established in 1997 in order to achieve uniformity of Shariah decisions and to advise BNM of any Shariah issues relating to Islamic financial business (Muhammad & Ahmed, 2016). In 2003, the role of the SAC-BNM was enhanced when it was accorded to the sole authoritative body on Shariah matters pertaining

to Islamic banking, takaful and finance in Malaysia (Muhammad & Ahmed, 2016). Later, Islamic Financial Services Act (IFSA) 2013 has been in effect since 30 June 2013 and demonstrate the further development in the regulatory frameworks for the Islamic financial institutions in Malaysia. The Act provides a legal foundation for the Islamic banking system to shift towards a regulatory framework that reflects the specificities of the several types of Shariah compliant contracts. Nowadays, Islamic banking is complementing with the conventional banking in the economy successfully and Malaysia once again proves to the world that executing dual-system is attainable (Seethaletchumy et al., 2011).

## **RESEARCH METHODOLOGY**

To complete this study, the researchers employed a qualitative approach using secondary data. This methodology involves utilizing data previously collected and documented by earlier researchers, which is then analyzed according to a nominated theme. For this study, ten (10) relevant studies on the acceptance of Islamic banking were gathered. The data collected from these prior studies did not require direct access to respondents or subjects, as it primarily consists of historical data previously assembled by other researchers. The data collection for this conceptual paper is based on a review of earlier research regarding society's acceptance and intentions towards Islamic banking products and systems.

## **DISCUSSION**

The findings from various studies indicate that a combination of both religious and non-religious factors significantly influence the acceptance of Islamic banking in Malaysia. These factors range from individual knowledge and understanding to social influence and service quality, reflecting a diverse range of customer priorities in the decision-making process. This section elaborates on these factors, presenting a comparative analysis across different studies.

### **Knowledge, Understanding, and Perception**

The importance of customer knowledge and understanding in shaping attitudes toward Islamic banking is highlighted in multiple studies. Juwairiah Mohamad & Muhammad Fakhirin Che Majid (2016) revealed that for non-Muslim customers, knowledge, understanding, perception, and awareness of Islamic banking products significantly influence their decision to accept Islamic banking offerings. Among these, perception was identified as the most critical factor, suggesting that customers who perceive Islamic banking as a viable and effective option are more likely to adopt it. Similarly, Malisah Latip et al. (2017) found that compatibility and relative advantage are significant factors influencing Islamic banking adoption, indicating that both Muslims and non-Muslims prioritize ease of integration with their values and lifestyles.

However, despite the general awareness of Islamic banking, a lack of in-depth understanding remains a barrier. This gap is particularly noticeable in the study by Mohd Azizi Ibrahim et al. (2017), where religiosity was found to be the most significant factor influencing consumers' intentions to choose Islamic home financing products. It suggests that while knowledge is critical, religious beliefs often act as the primary motivator for Muslim customers, highlighting the unique role of faith-based factors in Islamic banking adoption.

### **Social Influence and Religious Beliefs**

The study by Hafidzah Idris et al. (2014) emphasized the role of social influence as the most significant determinant for Malay Muslim customers' intention to use Islamic banking products. This finding is supported by Nelson Lajuni et al. (2017), who also found that social influence significantly affected customers' intention to use Islamic banking products in an emerging market. Social influence encompasses peer pressure, family recommendations, and community leaders, all of which can play a crucial role in determining customer preferences.

Moreover, religious beliefs remain dominant to the decision-making process for many Muslim customers. Studies by Mohd Azizi Ibrahim et al. (2017) and Mohamed et al. (2019) show that religiosity strongly influences the decision to adopt Islamic home financing and Islamic banking products, indicating that the adherence to religious principles such as avoiding *riba* (interest) is a priority for many customers when selecting financial products.

### **Service Quality and Reputation**

A significant focus of several studies is the role of service quality and reputation in customer acceptance. Shafinar Ismail et al. (2014) identified reputation, service quality, religious advertising, and social influence as key factors in the selection of Islamic home financing products, with reputation emerging as the most significant. Similarly, Chung et al. (2013) and Mohamed et al. (2019) found that service quality was one of the most critical determinants of consumer satisfaction and acceptance of Islamic banking. The importance of service quality reflects the need for Islamic banks to compete not just on compliance with Shariah law but also on customer experience, including the efficiency, responsiveness, and professionalism of the bank.

Furthermore, bank reputation can greatly impact customers' perceptions and trust. For example, the study by Shafinar Ismail et al. (2014) found that consumers were more likely to choose Islamic financing options from recognized banks, which reflects the growing importance of trust and institutional credibility in an increasingly competitive financial market.

### **Perceived Advantages and Innovation**

The perceived advantages of Islamic banking, such as its ethical investment practices and the avoidance of interest, are important factors influencing acceptance. According to Nurul Shahnaz Mahdzan et al. (2017), perceived advantages and understanding were significant predictors of Islamic banking adoption among students. The results highlighted that, apart from religious motivations, consumers are also attracted to Islamic banking for its ethical principles and perceived fairness.

Malisah Latip et al. (2017) further highlight the importance of compatibility and relative advantage, showing that these factors significantly influence both Muslim and non-Muslim populations in Sarawak, Malaysia. Their findings underline that customers are more likely to adopt Islamic banking when the products align seamlessly with their needs and expectations, highlighting the practical benefits of Islamic banking beyond religious considerations.

## **Non-Muslim Consumer Acceptance**

The issue of non-Muslim acceptance of Islamic banking has gained attention in recent years. Juwairiah Mohamad & Muhammad Fakhirin Che Majid (2016) found that non-Muslims were influenced by factors such as knowledge, understanding, perception, and awareness when choosing Islamic banking products. Perception was yet again the most influential determinant, suggesting that non-Muslim consumers who perceive Islamic banking products as beneficial are more likely to use them. This is crucial, as the future growth of Islamic banking in Malaysia depends not only on attracting Muslim customers but also on increasing participation from non-Muslim communities.

Chui et al. (2017) further explored the relationship between knowledge, service quality, and product reputation in non-Muslim consumers' acceptance of Islamic banking. Their findings indicated that non-Muslim consumers are also increasingly open to Islamic banking services, particularly when they are made aware of the benefits and ethical standards associated with Islamic finance.

## **RECOMMENDATIONS FOR FUTURE RESEARCH**

### **Addressing the Knowledge Gap**

While awareness of Islamic banking has enhanced, there is still a significant knowledge gap among consumers regarding the unique features and benefits of Islamic banking products. Future research could focus on educational involvements and consumer literacy programs to explore how these efforts can improve customer understanding of Islamic banking, specifically in comparison with conventional banking. Research could also examine the effectiveness of targeted marketing campaigns in enhancing awareness among different demographic groups.

### **Investigating Non-Muslim Consumers**

As the Malaysian banking system is multi-religious, there is a lack of comprehensive studies on the acceptance of Islamic banking among non-Muslim populations. Future studies should explore the motivators and barriers specific to non-Muslim consumers, including their perceptions of Islamic banking products and services. This could involve cross-cultural studies to compare the acceptance levels between Muslim and non-Muslim consumers. Understanding these factors would be valuable in broadening the customer base of Islamic banking.

### **Deepening Insights onto Social Influence**

The role of social influence was highlighted as a significant determinant by several studies, including Nelson Lajuni et al. (2017). Future research could probe deeper into the specific social factors that influence Islamic banking adoption. For example, peer influence, family preferences, and community leaders' views could all play a role. Research could examine how these social dynamics vary across different ethnic and religious communities within Malaysia.

## Exploring The Role of Technology in Islamic Banking

With the rise of digital banking and fintech in Malaysia, research should investigate how technological advancements influence the acceptance of Islamic banking products. Future studies could examine how digital platforms, mobile banking apps, and blockchain technology are transforming Islamic banking services, particularly in terms of convenience, transparency, and trust. Understanding how technology can enhance customer experience and attract younger generations could also be a valuable path for future research.

## CONCLUSION

The review of literature on the factors influencing the acceptance of Islamic banking in Malaysia reveals a complicated landscape where both religious and non-religious determinants play crucial roles. Important factors identified across studies include consumer knowledge and understanding, service quality, bank reputation, religious beliefs, and social influences. The findings highlight the importance of an experienced approach to Islamic banking, where not only religious values but also service excellence, innovation, as well as customer experience that contribute to customer adoption.

Despite the significant progress in promoting Islamic banking awareness, an apparent knowledge gap remains among consumers regarding the specific features of Islamic banking products. This insufficient knowledge emphasizes the need for better educational initiatives and more targeted communication strategies to linkage the gap. Moreover, while religious beliefs certainly influence decision-making for many Muslim consumers, non-religious factors such as service quality, trust, and customer experience are also critical for Islamic banks to compete with conventional banking institutions.

The research further highlights the need for future studies to address non explored areas, particularly the perspectives of non-Muslim consumers, in addition to investigate the impact of innovations in the acceptance of Islamic banking. In conclusion, for Islamic banks to succeed in Malaysia's diverse market, they must prioritize not only the religious appeal of their products but also focus on enhancing service quality, customer satisfaction, and technological advancements. Future research should continue to explore the evolving dynamics between religious adherence, consumer preferences, and market competitiveness to provide insights that will support the growth and development of the Islamic banking sector in Malaysia and elsewhere.

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