

## A Study of cost effectiveness of Financial Services Marketed by Islamic Banks in Iran

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**Abstract** -Over the past three decades, Islamic banking has emerged as one of the fastest growing industries. Changes will augur well, catalysing innovative forces and bringing the Islamic banking industry in line with the changing dynamics of the global and regional financial market place. As a result, Islamic banking and finance will be refurbished, further strengthening the force of financial intermediation, which is spread over more than 75 countries.

The bank as a service provider comes under the services sector and, thus, the study of cost effectiveness of financial services is essential to meet the customers need at a profit to the bank.

Questionnaire has been used to collect data from 400 customers of 30 branches of different Islamic banks through a random sampling, the collected data was then tested by related statistical tools Results of testing the main hypothesis of this research indicated that financial services marketed by Islamic banks in Iran are cost effective.

**Keywords**-Financial services, Cost effectiveness, Islamic bank

### I. INTRODUCTION

The modern banking system was introduced into Muslim countries at a time when they were

politically and economically at a low ebb, the late 19<sup>th</sup> century. Interest free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest. With the passage of time, however, and other socio-economic forces demanding more involvement in national economic and financial activities, avoiding the interaction with the banks became impossible [1].

Although research on the financial services is present in the literature, a curious gap is the relationship between financial services and cost effectiveness. Further examination of this gap would help answer the question of why some organizations are better than others at providing financial services.

1) The story of interest-free or Islamic banking begins here and today the study of financial services in Islamic banking is one of the most important aims of any bank.

### II. NEED FOR THE STUDY

In the past banks had little understanding or regard for cost effectiveness of their financial services. Banks were supplied needed services with any cost. In the late 1950s, banks and other financial institutions were experiencing increased competition for the cost of their services. The banks soon found attracting people to a bank is easy; converting them into loyal customers with fair cost is hard. These banks began to formulate a larger concept of cost effectiveness.

The first banks to implement these changes began to outperform their competitors in attracting and holding new customers. Their competitors, however, quickly figured out what was happening and rushed into similar programs.

1) From what we know about banking we can say that costing strategies are also important in Islamic banking, because Islamic banking operations are not limited to Islamic countries, but are spreading throughout the world.

### III. REVIEW OF EARLIER STUDIES

A lot of literature is available on banks relating to their role in the economic development of a country, problems faced by them, challenges before them and strategies to tackle them. Though a number of research works have been undertaken on customer service, costing of services, business promotion etc., they are found to be narrow in their approach. The summary of some studies that survey Islamic banking, as follows:

Abbas Mirakhor (1999), in his study, shows that in general the process of implementation of Islamic banking in the Islamic Republic of Iran and Pakistan appears to be proceeding with relative success. However, number of problems have surfaced during the transition period, among which is a tendency for short-term assets to dominate commercial bank portfolios [2].

Luca Errico and Mitra Farahbaksh (1998) analyze the implications of Islamic precepts on bank structure and activities, focusing on banking supervision issues [3].

Abbas Mirakhor (2001) in his study shows that in an Islamic system, as interest is prohibited, banks are expected to operate solely on the basis of profit and risk sharing [4].

1) Sundararajan and Luca Errico (2002) show that the provision and use of financial services and products that conform to Islamic religious principles pose special

challenges for the identification, measurement, monitoring, and control of underlying risks [5].

2) Sundararajan et al (1998) outline the recent progress in developing Islamic financial instruments for the management of monetary policy and public borrowing requirements and provides details on new instruments currently being developed in the Islamic Republic of Iran and Sudan [6].

3) Bassam Maali et al (2006) in their study reveal that the last thirty years have witnessed the appearance and rapid expansion of Islamic banking both inside and outside the Islamic world. Islamic banks provide financial products that do not violate Shariat, the Islamic law of human conduct [7].

4) Nicoletta Ferro (2005) shows that internet resources, extended media coverage and international organizations' reports recently witness the increasing interest of western banks in new models of finance, particularly Islamic finance and microfinance [8].

Dennis Olson et al, (2008) in their study, determine whether it is possible to distinguish between conventional and Islamic banks in the Gulf Cooperation Council (GCC) region on the basis of financial characteristics alone [9].

Beng Soon Chong and Ming-Hua Liu (2008) found that Islamic banking is not very different from conventional banking. Their study on Malaysia shows that only a negligible portion of Islamic bank financing is strictly PLS based and that Islamic deposits are not interest-free, but are closely pegged to conventional deposits [10].

Bashir (2002) in his paper indicates that the Islamic banking and finance system is recent in origin. Its special features preclude the application of modern finance theories [11].

#### IV. STUDY OBJECTIVES

This study surveys the cost effectiveness of Islamic banking financial services in Iran. Therefore the main objectives of this study are:

1. To evaluate the cost effectiveness of financial services of Islamic banks in Iran.
2. To evaluate the Islamic banks in Iran due to cost effectiveness of their financial services based on gender.
3. To analyse cost effectiveness of financial services provided in Iran Islamic banks based on the customer's age groups.
4. To review the cost effectiveness of financial services provided by Islamic banks in Iran based on educational level of customer.
5. To make suggestion for improving the cost effectiveness of financial services marketed by Islamic banks in Iran.

#### V. HYPOTHESES

The present study aims at testing a set of hypotheses on the basis of its findings. The following hypotheses are formulated keeping in view the objective of the study:

1) Main Hypothesis: "Financial services marketed by Islamic Banks in Iran are cost effective."

2) Sub Hypotheses:

3) **Ha:** Male and female respondents differ significantly according to their belief that financial services marketed by Islamic Banks in Iran are cost effective.

4) **Hb:** Respondents in different age groups differ significantly according to their belief that financial services marketed by Islamic Banks in Iran are cost effective.

5) **Hc:** Respondents with different educational qualification differ significantly according to their belief that financial services marketed by Islamic Banks in Iran are cost effective.

#### 6) Research Methodology

The data for the study were collected from two sources: primary and secondary. The secondary sources are comprised of the publications of the Central Bank of Iran, research publications relevant to the study, and some necessary data that have been collected directly from the banks.

The primary source is comprised of responses of the bank's customers. Interviews and questionnaires were used for collection of data. In the first step of data collection the interview was used. Analysis of the data collected in the first step and experience gathered from the interaction with the respondents were used to develop questionnaires.

With considering the budgetary and time constraints the opinion survey is concentrated on 30 branches of different Islamic banks through random sampling.

To select customers from each of the branches, stratified random sampling has been used. Four hundred customers are selected. Care was taken to include all types of customers in the sample.

The most important statistical tools which are used in this research are as follow:

**Independent-Samples T Test:** The Independent-Samples T Test Procedure compares means for two groups of cases. Ideally, for this test, the subjects should be randomly assigned to two groups, so that any difference in response is due to the treatment (or lack of treatment) and not to other factors so here this test was used to compare means for two groups [12].

**One-Way ANOVA:** The One-Way ANOVA Procedure produces a one-way analysis of variance for a quantitative dependent variable by a single factor (independent) variable. Analysis of variance is used to test the hypothesis that several means are equal. This technique is an extension of the two-sample t test. Here this test was used to compare variance for age groups, education levels, work experience status and occupational status which have more than two groups [13].

**Chi-Square Test:** Chi-Square is used to judge the significance of variance to compare variance of the overall difference between groups of frequencies [14].

**SPSS Software:** SPSS for Windows Version-16 (2007) was employed for statistical analysis.

## VI. STUDY LIMITATIONS

1) The researcher tried to distribute all the questionnaires himself in order to explain how to answer the questionnaire. Because of time limitations, however, this was not possible, so around 30 per cent of the questionnaires were distributed through branch managers, which might raise questions about the accuracy of the collected data. The second issue related to the sample selection: the procedure followed was to distribute the questionnaires randomly to customers of the Iran Islamic banks in one state. For that reason it is difficult to generalise the results of this research because the study did not cover other Iranian states, then sampling technique has its own limitations. The third issue is that because there is not much research about Islamic banking financial services in Iran, there was not enough background about this title.

## VII. RESULT OF TESTING THE RESEARCH HYPOTHESES

1) Main Hypothesis: Financial services marketed by Islamic Banks in Iran are cost effective.

The total possible obtained scores were 55.00, however, the selected sample scores 46.4750, which amounts to 84.50%. Since more than 4/5 of the sample agree with the above statement as revealed by their respondents, one can state that customers believe that financial services marketed by Islamic Banks in Iran are cost effective. Hence main hypothesis is accepted.

TABLE 1: MEAN SCORES ON "COST EFFECTIVENESS OF FINANCIAL SERVICES MARKETED BY ISLAMIC BANKING" OF MALE AND FEMALE RESPONDENTS AND RESULTS OF INDEPENDENT SAMPLE 'T' TEST

Gen	N	Mean	Std. Deviation	t' value	P value
Male	234	46.7479	3.5631	1.712	.088
Female	166	46.0904	4.0792		

Source: Primary Data

From the above table it is clear that male and female respondents had mean scores of 46.7479 and 46.0904. When these scores are subjected to 't' test, a non-significant difference was observed ( $t'=1.712$ ;  $P<.088$ ). In other words, male and female respondents had statistically similar scores.

TABLE 2: MEAN SCORES ON "COST EFFECTIVENESS OF FINANCIAL SERVICES MARKETED BY ISLAMIC BANKING" OF DIFFERENT AGE GROUPS RESPONDENTS AND RESULTS OF INDEPENDENT SAMPLE 'F' TEST

Age groups	N	Mean	Std. Deviation	F value	P value
Less than 25	153	46.1111	3.9027	1.247	.291
25-30	171	46.7602	3.6760		
35-45	44	46.8409	3.9997		
45-55	6	48.1667	3.7103		
Above 55	26	45.7308	3.4935		
Total	400	46.4750	3.7948		

Source: Primary Data

From the above table it is clear that age groups of different respondents had mean scores of 46.1111, 46.7602, 46.8409, 48.1667, 45.7308. When these scores are

subjected to 'F' test, a non-significant difference was observed ( $F'=1.247$ ;  $P<.291$ ). In other words, the respondents from different age groups had statistically similar scores.

TABLE 3: MEAN SCORES ON "COST EFFECTIVENESS OF FINANCIAL SERVICES MARKETED BY ISLAMIC BANKING" OF DIFFERENT EDUCATION LEVELS RESPONDENTS AND RESULTS OF INDEPENDENT SAMPLE 'F' TEST

Education levels	N	Mean	Std. Deviation	F value	P value
Less than diploma	20	46.8500	3.3604	.405	.805
Diploma	11	45.5455	2.2962		
Association of arts	136	46.3088	4.1195		
Bachelor	209	46.5359	3.7621		
Master and above	24	47.0000	3.0928		
Total	400	46.4750	.7948		

Source: Primary Data

From the above table it is clear that different education levels respondents had mean scores of 46.8500, 45.5455, 46.3088, 46.5359 and 47.0000. When these scores are subjected to 'F' test, a non-significant difference was observed ( $F'=.405$ ;  $P<.805$ ). In other words, different education levels respondents had statistically similar scores.

2) **Ha**: Male and female respondents differ significantly according to their belief that financial services marketed by Islamic Banks in Iran are cost effective.

Ha is rejected, as the statistical tests revealed non-significant differences between male and female respondents. 't' value obtained for difference between male and female respondents in total scores revealed no difference. Hence Ha is rejected.

3) **Hb**: Respondents in different age groups differ significantly according to their belief that financial services marketed by Islamic Banks in Iran are cost effective.

Hb is rejected, as the statistical tests revealed non-significant differences between respondents in different age groups. 'F' value obtained for difference between respondents in different age groups in total scores revealed no difference. Hence Hb is rejected.

4) **Hc**: Respondents with different educational qualification differ significantly according to their belief that financial services marketed by Islamic Banks in Iran are cost effective.

Hc is rejected, as the statistical tests revealed non-significant differences between respondents with different educational qualification. 'F' value obtained for difference between respondents with different educational qualification in total scores revealed no difference. Hence Hc is rejected.

## VIII. MAJOR FINDINGS

Eighty percent of people from the sample agreed with the statement that the financial services marketed by Iranian Islamic banks are cost effective. Due to this high ratio, one can generalize the opinion of the customers and say that all believe such financial services are cost effective, therefore accepting the main hypothesis.

Through statistical tests on the responses of those questions it has been revealed that there are no significant differences in regard to the opinions of men and women about the cost effectiveness of the financial services marketed by the Islamic banks in Iran.

Through statistical tests it has also been revealed that there are no significant differences with regard to the opinions of varying age groups about the cost effectiveness of such services provided by the Iranian Islamic banks.

Through statistical tests on the respondent's feed back , it has been revealed that there are no significant differences regarding the opinions of those of differing levels of education about the cost effectiveness of the marketed financial services by the Islamic banks in Iran.

#### IX. SUGGESTIONS

In the light of the observations made in the present study a few suggestions may be offered for improving the financial services of Islamic banking in Iran.

1. The Islamic banks should improve their sophisticated technology-based products like Internet banking, electronic bill payment, web enabled ATM smart card, etc., in order to increase the level of customer satisfaction.

2. In the present context it is not possible to serve all the needs of every customer. It is essential to specialize and open specialized branches to cater to the specific needs of a particular target group. Islamic banking should keep up the strategy adopted in this regard.

3. Educating the public about the concept, services, and benefits of this unique Islamic financial system will allow to raise the efficiency and effectiveness of Islamic banking.

4. Islamic banking in Iran, being information intensive and having effective marketing management, needs a well designed management information system (MIS). Islamic banking should learn to use the available information with an open mind set along with modern attitudes and approaches to work.

#### X. CONCLUSION

Islamic banking has been defined as banking in congruence with the ethics and value systems of Islam and governed, in addition to the conventional good governance and risk management rules, by the principles laid down by Islamic Shariat. Interest-free banking is a narrow concept denoting a number of banking instruments or operations, which avoid interest. Islamic banking, in general, is expected not only to avoid interest-based transactions which are prohibited in the Islamic Shariat, but also to avoid unethical practices and to participate actively in achieving the goals of an economy based on Islamic laws.

Islamic banking financial service is a core component of Islamic finance for the world's 1.2 billion Muslims. With holdings in excess of \$100 billion and an annual growth rate of 25 percent, the Islamic finance sector is quickly becoming an unstoppable force in international markets. Education and a willingness to explore this topic will allow

financial institutions not only to grow market share and demonstrate leadership but also to help Islamic communities realise their dreams of economic enfranchisement.

This study shows that cost effectiveness of financial services in Iran Islamic banking industry is adequate and appropriate and that customers are satisfied with bank's services. The Islamic banking system in Iran is linked with Shariat principals and financial instruments properly and adequate marketing strategies includes factors like banking based on Shariat standards, adequacy and quality of financial services, cost effectiveness, staff ability to convey trust and confidence, efficiency and effectiveness in handling any transaction treating customers with courtesy and respect has been adopted to make customers satisfy as Islamic banks in Iran have the potential of being marketed to various segments of customers extending beyond those who are concerned with the legitimacy of the facility from Islamic point of view and those who seek for services quality, convenience and efficient transactions.

#### XI. SCOPE FOR FURTHER RESEARCH

The present study has exposed some aspects of financial services in Islamic banking in Iran, but it does not cover all the upcoming aspects of that. Although there is vast amount of literature regarding Islamic banking, there is myriad space in the future to improve the financial services in Islamic banking. Further research should particularly focus on international banking because if Islamic banking wants to remain integrated globally it should comply with international standards.

To benefit from the well developed financial system, a study should focus on financial innovations within the financial instruments to determine how to reconcile them with Islamic principles in order to be practiced by Islamic financial institutions.

An obvious avenue for further research is to compare financial services in Islamic banking with non-Islamic banking systems in order to benefit from their strengths.

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