

## AN ECONOMIC ANALYSIS OF FACTORS AFFECTING CUSTOMER SWITCHING BEHAVIOR IN ISLAMIC BANKS: (A CASE STUDY OF PAKISTAN)

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### ABSTRACT

The Switching behavior of the customers in banking sector increases day by day in Pakistan. The main objective of the study was to investigate the different factors that affect the switching behavior of the customers in the study area. The sample size of the study was 1% of the total banks which were 260 sample respondents. Convenience sampling was also used for data collection. The binary logistic regression model was used for analysis. The results of the study concluded that the customers switch to Islamic banks when charged high fees, with a significant effect on pricing. Sharia compliance also influenced switching behavior, while technology level also affected it. Moreover, the findings indicate that there was a positive and statistically significant effect of pricing on switching behavior. Sharia compliance significantly affects switching behavior but has a negative relationship with it. The level of technology negatively affects switching behavior but has an insignificant effect on it. Switching cost also has a negative and statistically significant effect on switching behavior. Staff attitude and knowledge have a significant effect but have a negative relationship with switching behavior. The research findings recommended that Islamic bank managers must make sure that all bank operations and products adhere to Sharia rules in order to preserve their competitive advantage in the market. They shouldn't give up this competitive advantage to expand their product line or speed up their business. Therefore, it is suggested that every Islamic bank have a separate Sharia committee that examines and certifies all bank procedures and products before making them available to clients.

**Keywords:** Switching Behavior, Pricing, Sharia Compliance, Level of Technology, Switching Cost, Binary Logistic Regression Model.

### INTRODUCTION

There is a growing competition and incentives provided by Muslim banks in Pakistan, several clients have decided bank transfers. As a result, many banks have seen a reduction in their customer base, which has prompted the topic of why customers could choose to do business with other Islamic banks. Pricing has a favorable influence on switching behavior, as is well known. Customers switch to a competitor's product or service when they engage in customer switching behavior. Switching behavior of a customer is regarded as a

developing topic of investigation in the fields of finance, marketing, and economics. The factors influencing customers' switching behavior across many businesses and fields have been the subject of several studies (Garland, 2002). Pakistanis, are live in a predominantly Muslim nation, are very interested in Islamic finance. (Al-Ajmi et al., 2009) Islamic banks made a further case for basing their operations on instead of relying on interest, profit and loss sharing. Muslim country like Pakistan, customer's decision to use an Islamic bank may be

motivated by the need to adhere to Islamic Sharia. Technology level has a negative effect on switching behavior. Sharia, or Islamic law, is upheld by the majority of consumers of Islamic banks. If they believe a product or service does not adhere to Sharia values, they may elect to boycott it.

According to (El Manstrly, 2016), switching costs are correlated with specific expenses, such as costs of the transaction, costs of learning, search costs, discounts to customers, habits, costs of emotional, and cognitive effort, and hazards associated with money, society, and psychology.

The staff's attitude and knowledge, according to the earlier studies, have a negative effect on the switching behavior of Customers of banks are constantly concerned about the service employees, particularly their appearance, manners, and knowledge. The management of Islamic banks is currently having trouble retaining customers due to the recent developments in Pakistan's Islamic banking industry and the fierce competition. As a result, they become more interested in the primary factors that influence customers of Islamic banks to switch financial institutions thus they can pay attention to these aspects while making plans. As stated by (Ghamry, S. and Shamma, H.M., 2022) banks of Islamic in Kuwait are presently having trouble keeping their consumers due to increased contention as consumers can now choose to change from one bank to another. Consumers are more likely to change banks when they have a good offer from other banks as the banking business gives almost comparable products and services, mostly if the consumer is not satisfied with the existing bank. So, the purpose of the study is to pinpoint the key elements that influence consumers of Islamic banks to change their financial institutions. What are the most important variables affecting customer's decision to transfer to Islamic banks in Pakistan? The main goal of the study is to pinpoint the most important variables that affect consumers' decision to transfer to Islamic banks in Pakistan. Additionally, it wants to comprehend the steps clients take before making a switching decision, which is the process that underlies this relationship. Religion is the primary element that draws people to an Islamic bank, as evidenced by earlier studies. So as to foster the expansion of banks of Islamic

and increase consumer knowledge about the Riba factor could not keep its position strong over time; Islamic banks must also take into consideration quality of service along with consumer behavior, which switches daily. So pricing, sharia compliances, level of technology, switching cost, staff attitude and knowledge are very important elements that affect the customer behavior of switching towards bank of Islamic. Abu Salim et al., (2017) studied that price reliability in the banking industry can be seen as the absence of hidden costs. Previous research studies provides empirical proof that perceived service costs, including any hidden charges, have an impact on how customers perceive service quality, which in turn affects customer satisfaction and behavioral intention. Rama, A., (2017) studied An Exploration of Consumer Changing Behavior in the Bank of Islamic Industry. Customers of banks of Islamic who frequently switch may endanger the existence of Islamic banks in the nation. Switching behavior typically results from a bad service experience, which may be caused by a number of circumstances. The aim of the study is to analyze the elements that affect a bank consumer decision to shift from one Islamic bank to other. The study used a questionnaire that was delivered to the bank of Islamic consumers in several regions of Indonesia's Banten Province. According to the findings of a statistical investigation, factors such as customer happiness, quality of service, compliance of shariah, costs, and forced change have a major impact on how frequently clients migrate between Islamic banks. Service mishaps and advertising, however, Kamiyama, H, Kashiwagi, K., (2019) analyzed the elements affecting consumers continued intentions to use banks of Islam. The investigation has not also established the spiritual motivations and behaviors that effect clients' ongoing desire to utilize the bank of Islamic, in addition to the significance of other characteristics and features connected to standard financial services. Based on information from Jordanian interview surveys, this study investigates the variables influencing consumers' perceptions of Islamic banks. The results indicate that customers desire to use banks of Islamic going forward was positively influenced by their religious motivations, their assessments of a banks

adherence to Islamic law as a sign of their spiritual mindedness towards banks of Islamic, and the simplicity of obtaining debt. More particular, it also shows that the consumers regularly conduct business with banks of Islamic place a greater force on shariah views than on credit restrictions. Baber, H., (2020) highlighted that the FinTech, Crowd funding and Customer Retention in Islamic Banks. The Statistical Report 2018 estimates that the crowd funding market's transaction value was \$5,250 million. The main goal of this study is to look into how crowd funding and FinTech apps affect the retention of client in banks of Islamic in the United Arab Emirates and Malaysia. To collect information from 535 customers of particular banks in both countries using stratified sampling, a structured questionnaire with 31 items was developed. The findings show that FinTech applications such as crowd funding and customer retention were related. Ghamry, S and Shamma, H.M., (2022) intended "Elements affecting consumer behavior of switching banks of Islamic: evidence from Kuwait". The study has found that consumers can now choose to migrate from one bank to another has boosted rivalry among Kuwait's Islamic banks, making it difficult for them to retain their clientele. Lestari, D., Haryono, S., & Furwanti, R., (2022) studied the role of competitive exploration and advantage of religiosity to decrease consumer behavior of switching in Bank of Islamic. The study estimate and quantify the effect of the bank of sharia competitive advantage on consumer behavior of switching. This study investigates religion as an intervening variable as a fundamental human characteristic that influences people's attitudes, values, and behaviors in the consumption of things. Furthermore, it has occurred as a result of the facts of consumer behavior of switching, which drives banks of sharia to stay and sustain its customer, due to the fierce competition that exists today between banks of Islamic and conventional banks. The study was quantitative in nature and polled 102 consumers of Islamic banking for its primary data, which was gathered from a questionnaire. Additionally, a path analysis model was used to

evaluate the data in order to determine the indirect and direct relationships between each variable of research. The main aim of this study was to find out what factors affect customer switching behavior in Islamic banks.

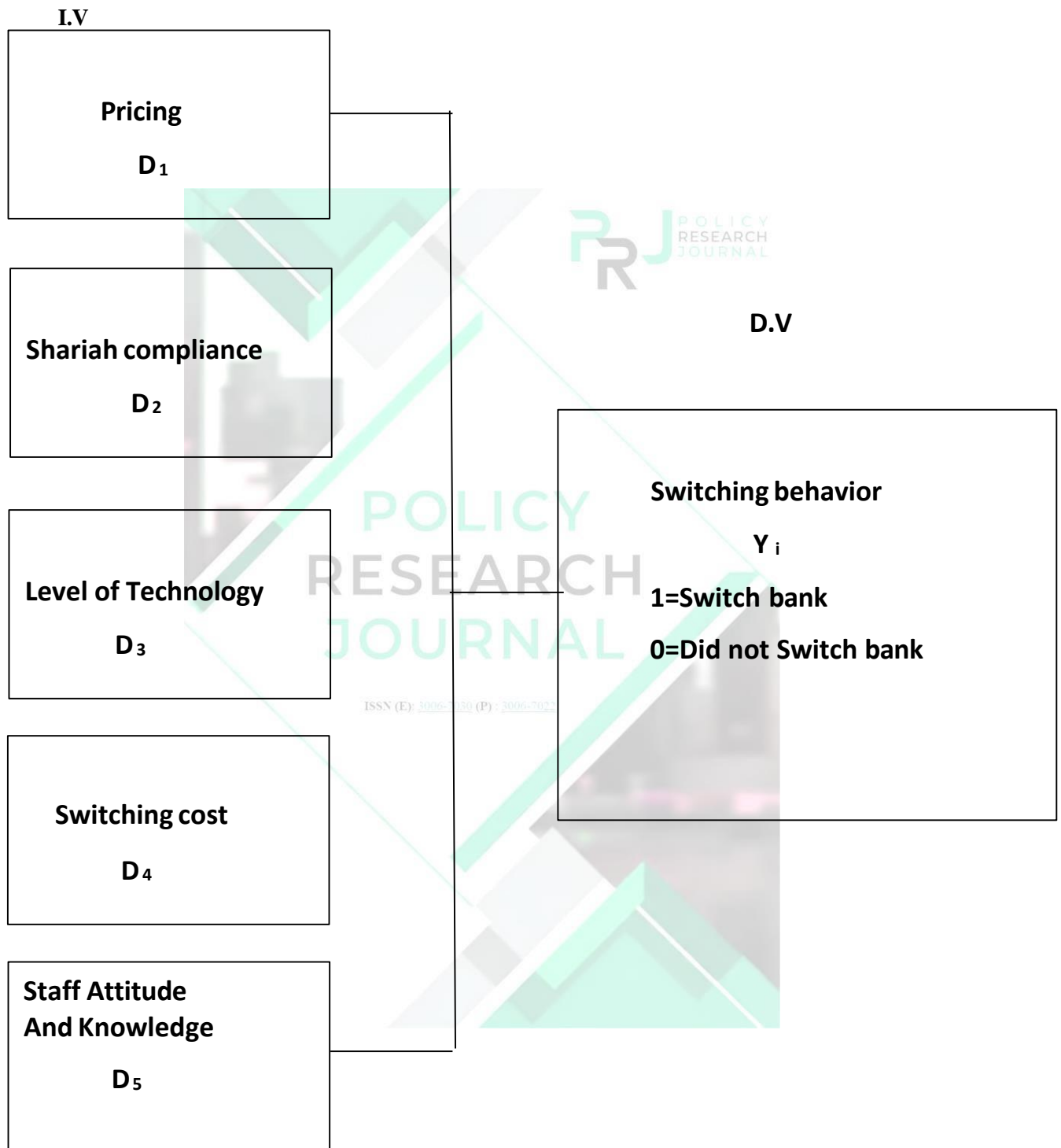
## **MATERIALS AND METHODS**

### **SAMPLING DESIGN OF THE STUDY**

This research study investigated that what factors affect the customers switching behavior in the study area. The primary motivations for such switches include religious considerations, the availability of interest-free loans, and the notion of profit and sharing losses embraced by Islamic banks. A standardized questionnaire was used to collect primary data for the study, which was based on a random sampling as well as convenient sampling. The study was conducted in District Peshawar which is an important banking area of Khyber Pakhtunkhwa in Pakistan. There are 18 total Islamic banks in Pakistan. The district Peshawar was population of the study. The study selected 1% of the total Islamic banks. The sample size was 260 respondents. In this study the data was categorical, so it used binary logistic regression model. The dependent variable (switching behavior) is binary and the logistic regression method has only two possible results (0=Not switched and 1=Switched) were be utilized to forecast the dependent variable based on the independent variables.

The nature of the study was quantitative and descriptive which was based on the facts, empirical findings, and hypotheses that have been drawn from literature, and then it was testified on the econometric models. The current study was mainly based on primary data which was collected through pre tested questionnaire. The domain of the data which, were used in this study were obtained only from Islamic bank customers through a self-administered questionnaire. The computer software SPSS were used for data analysis. Binary Logistic regression was to assess the effect of each aspect on the consumer behavior of switching using data that has been collected.

**CONCEPTUAL FRAMEWORK**



Source: Clemes et al. (2010)



**ECONOMETRIC MODEL FOR EMPIRICAL TESTING**

In this study binary logistic regression model was used for empirical testing, because the dependent or response variable was categorical. The nature of the econometric model was qualitative and the respondents answer in "yes" or "no". The response variable was coded with the numbers "1" and "0." Binary logistic model distribution is a binomial

distribution. The binary logistic regression model is analyzed using the maximum likelihood method. The maximum probability estimate is denoted as  $\beta$ . Due to its relative mathematical simplicity, the binary logistic regression model is simple to use and understand. Moreover, it has demonstrated that regression analysis fails when a binary outcome variable is used. Binary logistic regression model has written as;

$$Y_i = \log \left( \frac{p}{1-p} \right) = \beta_0 + \beta_1 D_1 + \beta_2 D_2 + \beta_3 D_3 + \beta_4 D_4 + \beta_5 D_5 + \varepsilon_i$$

Where Y = (1, Switch to Islamic banks (0, not Switch to Islamic bank)

$\beta_i$  = coefficients of the parameters

D<sub>1</sub> = Pricing

(Bank charge high fees 1=Yes, 0=No)

D<sub>2</sub> = Sharia compliances

(All bank products adhere to sharia law. 1=Yes, 0 = No)

D<sub>3</sub> = Level of technology

(Effective online banking services are offered by the bank. 1 = Yes, 0 = No)

D<sub>4</sub> = Switching cost

(It cost too much to switch to another bank 1=Yes, 0=No)

D<sub>5</sub> = Staff attitude and knowledge

(Bank staff provide prompt service 1=Yes, 0=No)

$\varepsilon_i$  = error term.

**RESULTS AND DISCUSSION**

Table 1 shows the results of descriptive statistics of the study variables. The mean of switching behavior of the Islamic banking customers is 0.5154 and their standard deviation is 0.50073. The results also indicate that the mean of pricing, sharia compliance, and level of technology, switching cost and staff attitude and knowledge are 0.6462,

0.4385, 0.8962, 0.2577 and 0.7346 respectively. The standard deviation of the pricing is 0.47908, sharia compliance is 0.49716, the level of technology is 0.30565, switching cost is 0.43821 and staff attitude and knowledge is 0.44239. In this study all the variables are categorical therefore their minimum and maximum values are 0 and 1.

**Table 1: Descriptive Statistics of the Study Variables**

Variables	No. of Observations	Mean	Standard Deviation	Minimum	Maximum
Switching Behavior	260	0.5154	0.50073	.00	1.00
Pricing	260	0.6462	0.47908	.00	1.00
Sharia Compliance	260	0.4385	0.49716	.00	1.00
Level of Technology	260	0.8962	0.30565	.00	1.00
Switching Cost	260	0.2577	0.43821	.00	1.00
Staff Attitude & Knowledge	260	0.7346	0.44239	.00	1.00

Source: Primary Survey (2024)

Table 2 indicates the estimated coefficients of a binary logistic regression model. In this study binary logistic regression model was used because the dependent variable was customer switching behavior, which was a categorical variable. It has two categories 0 and 1, which means that 0 represents the customers who did not switch to Islamic banks from commercial banks and 1 represents the customers who switched to Islamic banks in the study area. The results of the given table show that when the banks charge high fees from customer instead of low charge fees, then the switching behavior of the customers of Islamic banks increases by 0.174 instead of other banks. It means that when other banks charge a high price, then customers switch to the Islamic banks and this affect was found significant, which was 0.034. (Keaveney, 1995), (Gerrard and Cunningham, 2000), (Gerland, 2002) and (Clemes et al., 2007) have suggested that pricing has a significant effect on customer switching behavior. However, according to the research result pricing factor is also significant. The coefficient of sharia compliance shows, when other banks adhere to the sharia law, the switching behavior of the Islamic bank customer's decreases by -0.914. It means that there was an inverse and significant relationship between adhere sharia law and the switching behavior of the customers. The results of the level of technology indicate that all other banks provide increased online services to the customers the switching behavior of Islamic banks has been decreased by -0.104 instead of not switching. It has been found insignificant affect. This finding differs from the research result of (Al-Ajmi et al., 2009) suggested that the level of technology has a significant effect on customer switching behavior. The coefficient of switching cost was -0.745. It indicates that other banks increase high costs instead of low cost from the customers, the

switching behavior of Islamic banks decreases by -0.745 and also affects significantly. (Lee and Huang, 2014) also suggested that switching behavior is negatively impacted by switching cost. Staff attitude and their knowledge have found the significantly affect the switching behavior of the customers of Islamic banks in the study area. The slope of staff attitude and knowledge shows that other banks increase and provide prompt service to the customers instead of not providing prompt service to the customers; the switching behavior has been decreased by -0.896. It highlighted that there was an inverse relationship between staff attitude and knowledge and the switching behavior of the customers of Islamic banks instead of commercial banks in the area. According to (Colgate and Hedge, 2001) and (Gerrard and Cunningham, 2004) staff attitude and knowledge have also a negative relationship with switching behavior. The table also shows the results of exponential beta ( $\beta$ ), which indicates the odd ratio of the study. It means that when the value of odd ratio exceeds one, it shows a positive relationship between dependent and independent variables and when the odd ratio is less than one, it means that there is an inverse relationship between the explanatory and explained variables of the study. In table 2 only the pricing odd ratio is greater than one which was 1.190 and the rest of the independent variables are; sharia compliance, level of technology, switching cost and staff attitude and knowledge have less than one odd ratio such as 0.401, 0.901, 0.475 and 0.408 respectively. The value of Nagelkerke R square was 0.115, which shows that explanatory variables such as pricing, sharia compliance, level of technology, switching cost and staff attitude and their knowledge have explain the dependent variable, which was switching behavior of the customers by 0.115 percent.

**Table: 2 Estimated Coefficients of Binary Logistic Regression Model**

Explanatory Variables	$\beta$	S. E	Wald Test	DF	Sig	Exp( $\beta$ )
Constant	1.268	0.931	10.50	1	.001	3.552
Pricing High Fees (1) Low Fees (0)	0.174	0.280	.386	1	.034	1.190
Sharia Compliance Adhere Sharia Law(1) Not Adhere (0)	- 0.914	0.266	11.8	1	.001	0.401
Level of Technology Online Service (1) Not Online Service (0)	- 0.104	0.447	.054	1	.815	0.901
Switching Cost High Cost (1) Low Cost (0)	- 0.745	0.335	4.94	1	.026	0.475
Staff Attitude & Knowledge Prompt Service (1) Not Prompt Service (0)	- 0.896	0.321	7.77	1	.005	0.408

Source: Primary Survey (2024) Nagelkerke  $R^2 = 0.115$

### CONCLUSION

The study concluded that factors such as pricing, sharia compliance, technology level, switching cost, and staff attitude significantly influence customer switching behavior in Islamic banks in Khyber Pakhtunkhwa. The study found that customers switch to Islamic banks when charged high fees, with a significant effect on pricing. Sharia compliance also influenced switching behavior, while technology level also affected it. Staff attitude and knowledge also had an impact, with an inverse relationship. The findings indicate a positive and statistically significant effect of pricing on switching behavior. Sharia compliance significantly affects switching behavior but has a negative relationship with it. The level of technology negatively relationship with switching behavior and has an insignificant effect on it. Switching cost also has a negative and statistically significant effect on switching behavior. Staff attitude and knowledge have a significant effect but have a negative relationship with switching behavior. The rising level of competition is currently making it tough for Islamic banks in Pakistan to keep their clients. Customers can transfer to a different bank, particularly if they are unhappy with their present bank or find a better deal elsewhere. For Islamic bank managers to concentrate on these aspects while developing their profitability targets and strategies, the primary goal

of this study is to determine the most important elements that lead clients to transfer banks. The study's findings indicate that, while other aspects have little impact, pricing has a major impact on customers' decision to transfer to Pakistani Islamic banks.

### RECOMMENDATIONS

- The research findings indicate that Islamic bank managers must make sure that all bank operations and products adhere to Sharia rules in order to preserve their competitive advantage in the market. They shouldn't give up this competitive advantage to expand their product line or speed up their business. Therefore, it is advised that every Islamic bank have a separate Sharia committee that examines and certifies all bank procedures and products before making them available to clients.
- To prevent any conflicts of interest, this committee needs to be independent of the executive management and comprise professionals in the subject of Sharia. All bank branches and divisions should undergo routine Sharia audits even after the release to ensure that no Sharia laws were broken during implementation. Customers will feel more certain that the products offered by their



Islamic bank completely adhere to Sharia rules thanks to these regulations.

- On the other hand, to guarantee that clients have no trouble reaching the bank, Islamic bank management should make sure that their network of branches is widely dispersed and encompasses the majority of Pakistan's regions. To ensure that services are rendered quickly and that clients do not have to wait an excessive amount of time for their needs, traffic patterns at all bank branches should be closely observed. Islamic banks ought to offer similar services as stated in the interim.

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