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TOPIC

Critical Analysis regarding Traditional and Islamic Banking in Pakistan

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Critical Analysis regarding Traditional and Islamic Banking in Pakistan

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ABSTRACT:

The basic aim of this research study is to investigate the performance of conventional and Islamic banking system in Pakistan. The study uses the descriptive method with qualitative design. This study basically relies solely upon secondary sources. The prime aim of this study was to highlight the performance of Islamic and Conventional banking systems in Pakistan in the light of previous research literatures.

Keywords: Islamic Banking, Conventional Banking, Pakistan, Performance etc.

Introduction:

Undoubtedly, from the very beginning, the human beings worked tirelessly to improve their standard of living and establish relationships in the society, which led to the emergence of economic and financial systems. According to historians and researchers, the idea of preserving wealth is centuries old. In ancient civilizations, wealth was stored in a variety of ways, including crops, livestock, and precious metals. The traditional banking system began with receipts given by goldsmiths on the goods they held in their custody. Whenever there was a need for a transaction, the holder would give it as a guarantee. The importance of these receipts began to be felt in the society as they came to be considered as an alternative to precious metals. From the beginning of the currency note, the traditional banking system came into existence. As time went by and through experience came wisdom and understanding, thus many changes took place in this system.¹

Historical Background of the Traditional Banking System:

Historians and researchers have differing views on the history of the traditional banking system, while the general impression is that the history of the traditional banking system is not very ancient. The word "bank" used in the banking system was used in Italy in the sixteenth century. As global trade grew, so did the institution, and the twentieth century could be called the era of the system's development and acceptance. In any case, the history of the banking system is divided into three stages by Syed Abu Ali Maududi in his book "Interest", which is described as follows.

The Era of Receipts issued by Jewelers:

Before the introduction of paper currency, people used to accumulate their wealth (cash) in the form of gold and silver. This is what Maulana Maududi writes in his book Sood: "In the West, it started with the fact that in the past, when paper notes were not in circulation, people mostly accumulated their wealth in the form of gold and kept it with goldsmiths for protection instead of keeping it in their homes. "In the West, it started with the fact that in the past, when paper notes were not in circulation, people mostly accumulated their wealth in the form of gold and kept it with goldsmiths for protection instead of keeping it in their homes. These receipts were circulating in the bazaar until someone himself needed gold, and whoever took the

receipt to the goldsmith would get gold when the need arose. It seems that in those days, goldsmiths' receipts became the gold substitute for all business purposes. The work that was done with gold as foreign exchange was now done with these light receipts issued by the goldsmith. Mentioning the same thing, Maulana Syed Abu Ali Maududi goes a little further: Now the goldsmiths have learned from experience that barely one-tenth of the gold they have in people's deposits is taken out, the other two parts lying idle in their coffers. Why not, so they lent this gold to the people and started charging interest on it and started using it as if it was their own property, although in fact it was the property of the people. They also received compensation for the protection of the gold from the owners of the gold and secretly borrowed the same gold and received interest on it. The goldsmiths, taking advantage of their experience, did not stop the counterfeiting market here as they realized that the receipts issued by them did all the work in the market that gold used to do in transactions. So instead of lending the real gold, they started running paper receipts in the market on the strength of real gold. Further deception was that the real gold, of which only one-tenth of the people used to come back, made fake receipts of 2 parts instead of 5 parts and started lending money on these fake receipts. This is what Maulana Maududi explains: "If a person deposited gold of one hundred rupees with a goldsmith, then the goldsmith made ten receipts of one hundred rupees, on each of which it was written that behind this receipt I have gold of one hundred rupees. He handed over one of the ten receipts to the gold depositor and lent the other nine receipts to the other people and started charging interest on them. The result of this fraud and forgery was that the goldsmiths had become the owners of 3% of the country's wealth and began to receive ten to twelve percent interest on it. This was not the money which he did not earn nor did he own in any legitimate way. In this regard Maulana Maududi says: "Obviously, this was a kind of deception and deception. Through this fraud and forgery, they made 5% of counterfeit rupee in the form of a completely baseless currency and even if they wanted to, they became its owners and at the head of the society they borrowed it as a loan. They started charging interest. Although they did not earn this wealth, their property rights did not reach them in any legitimate way, nor was it any real rupee which could be used in the market as a medium of exchange and in exchange for goods and services. It could have been legitimated in terms of ethics, economy and law. These goldsmiths had become the owners of 5% of the country's wealth due to this continuous forgery.

Goldsmith Forgery:

The goldsmiths, after taking full control of the paper currency, started a new counterfeiting business aimed at controlling the wealth of those who were accustomed to saving themselves from their income by doing something. The fitna was even more dangerous than before. Maulana Maududi writes about this period: The ancient goldsmiths and the moneylenders of the modern age then took another step which was even more tempting than the first step. The trick was that they began to attract the capital of all those people who were saving more than they needed, or who were

accustomed to save something by withholding their needs. He saw that these people were investing their money in business and the money they had saved was being spent more on buying shares of companies instead of coming to us. Are there? That way, you'll be getting rid of clutter you don't need. You just have to be more discriminating with the help you render toward other people. And fluctuations in profits will continue to affect your income. Instead, deposit your money with us. We will protect them free of charge, keep their accounts free, and pay you interest instead of taking anything from you. With this deception and cunning, the goldsmiths and moneylenders lured the people to use the money collected by them instead of investing it in the affairs of the economy and civilization, and thus they gradually usurped the entire available capital. As a result, goldsmiths and moneylenders were already running their counterfeit capital on Tosud, but through this counterfeiting; they began to give other people's capital at a lower interest rate and at a higher interest rate. These goldsmiths and moneylenders subjugated the rich and the poor, the peasants and laborers, the commercial and industrial establishments, and even the governments and empires.

Start of a Joint Goldsmith's Business:

Goldsmiths and moneylenders took another step after taking control of paper money and investments which we can call the era of banking system. Instead of working individually, they started working together and thus bank companies came into being. Maulana Maududi writes in this regard: Goldsmiths and moneylenders took the third step and shaped their business into what is now called the modern system of moneylenders. Previously, these people worked individually. However, the financial business of some moneylenders had become increasingly large. Whose branches were established in distant places, but in any case, they were separate families and worked under their own names. Then he realized that just as joint venture companies are being formed in all sectors of business, companies of rupee business should also be formed and organized on a large scale. This is how these banks came into being, which today dominate the financial system of the whole world.²

The banking in the West began in such a way that in the beginning, when there were no paper notes, people used to accumulate their wealth in the form of gold or silver. Anyone who had more than enough money would deposit it with the goldsmith and take a receipt from him. It was easier for people to buy and sell on receipts than to pay for gold at every transaction. So, this style of business became popular. At present, banknotes, checks and drafts are advanced forms of this receipt. Gradually, these goldsmiths and moneylenders realized that there were very few people who demanded the return of all their money at once. A large amount of gold and silver is lying idle with them. He thought why not make a profit by lending a portion of this reserve. When this business proved to be profitable, they started bargaining on trusts in order to get more gold and silver from the people. In this way, he started earning profit by taking money at a low interest rate and lending to the needy at a higher interest rate. However, he further writes: "Today's banks are a developed form of this method, although the transactions in the banks are based on interest, which is certainly illegal,

wrong and haraam. There are and are also inevitable. For example, sending money from one place to another and arranging payments, facilitating transactions from foreign countries, protection of valuables, etc., because the bank saves time and capital by taking very little compensation. However, instead of eliminating these banks altogether, the system needs to be reformed. In this way, the banking system will be purified and many sins will become more profitable.³

(Usmani, 2007) Traditional Banking System Before Christ:

As can be seen from the above quotations, the beginning of the traditional banking system is associated with goldsmiths and moneylenders, but in some places its foundations can be traced back to ancient religious places of worship. According to the discussion on the history of the banking system, the history of the banking system is said to be at least two thousand years old, which is also mentioned in the Encyclopedia of Britannica. In fact, people of previous nations, such as Greece, Rome, and Egypt, used to deposit their money in the treasuries of synagogues. These funds were used to provide loans to the people and the state at moderate interest rates. Thus, the ancient temples began to serve as banks. In the fifth century AD, goldsmiths, moneylenders and money changers began to accumulate people's money at their desks and thus became bankers. In ancient times, these people were known as trapezite, which means "man of the table." Then gradually the system developed and reached Rome (Italy) and modern Europe and the word bank came to be used for it. Mufti Taqi Usmani further writes in this regard: Banking institutions were established centuries before Jesus in Greece, Rome, Egypt, etc., which used to collect money and issue interest-bearing loans. It was not the result of any individual or personal movement, but was a side service paid by wealthy and organized religious institutions. Thus, the banking system evolved from a religious institution to a private business institute, until in (575 BC) a banking institution was established in Babylon called Lgbi. The bank acted as its client's lawyer, lending on crops, mortgaging crops in advance to ensure payment, lending by signatures and mortgages, and opening accounts on interest.⁴

Background

Due to the active involvement of international and local stakeholders, the Pakistani banking industry is constantly improving and exhibiting various patterns of ownership. As a result, there is now more rivalry among banks to draw in more clients by offering high-quality services that will pay off in the long run. Currently, 13 conventional banks and six fully operational Islamic banks in various parts of the country offer goods and services in accordance with Shariah law. In order to deliver high-quality services that meet customers' expectations, they must compete in a fiercely competitive environment. According to reports, Pakistani consumers of Islamic banks perceive the quality of their service as being higher than those of regular banks.⁵ The quality of services is becoming a major concern for bank consumers due to increasing awareness. Only when they are happy with their existing bank do they continue doing business with them; if not, they have no reluctance in switching to another bank. The goal of Islamic banks is to promote trade and business within the boundaries set out

by Shariah. Its network, size, and structure all saw growth as a result of the country's exquisite integration of conventional commercial banks, Islamic banks, and microfinance organizations. This information was provided (SBP) which was published in September 2010. It stated that during the quarter, Islamic banking's share increased by another 30 basis points to 6.4 percent due to a growth of 3.2 percent in its assets, while conventional banks' asset bases shrank. The network of Islamic banking branches has also increased by 5.4 percent, with the Islamic banking sections of conventional banks accounting for the majority of the increase with annual growth rates of 27.8 percent. The SBP also noted that an increase in non-performing loans, which rose by 27.3 percent to Rs 13.5 billion at the end of September 2010, has resulted in a decline in the asset quality of Islamic banks. In the September 10 quarter, year-to-date provision expense nearly quadrupled as well, this caused a reduction in most profit ratios, with ROA falling by 20 basis points to 0.6 percent. Islamic banks anticipate that the post-quarter tender for the Government of Pakistan Ijarah Sukuk (GIS) amounts to Rs 80 billion will make it easier for them to manage their asset-liability relationships, despite overall performance indicators showing slight drop.⁶ In recent years, banks have become increasingly concerned with and aware of the fact that customer' service-purchasing decisions are impacted by more than just the service's value. They are also aware of the importance of the service support provided after the service is rendered.⁷ Effectively providing high-quality service can aid in establishing and maintaining enduring relationships with clients. In order to manage effectively, it is crucial to comprehend how the customer perceives service quality.⁸ They claim that because service quality "is by nature a subjective notion. As a result, what matters most and ultimately affects competition is how customers perceive the quality of the services a company provides. In Pakistan, it is clear that Islamic banks have a higher and stronger positive influence on customer satisfaction than traditional banks, so bankers should focus on providing high-quality services to ensure that their customers are satisfied."⁹ Despite prior studies, the investigation of service quality in the Pakistani banking sector has received minimal attention. Although there has been a lot of research on service quality, the characteristics of service quality in the context of the Pakistani banking industry have received very little attention to yet.

Objectives:

Main Objective:

To analyze the performance of Islamic Banking and Conventional banking in Pakistan

Sub-objectives:

- 1.To determine several aspects of service quality from the viewpoint of the customers
- 2.To compare Islamic and traditional banking systems in order to determine the relationship between service quality and client happiness.
- 3.To investigate the relationship between customer satisfaction and service quality.

What is Customer Satisfaction?

Numerous studies, including those by Olshavsky and Miller¹⁰ have produced significant advances in theory and research on customer satisfaction since the early 1970s (1973).

During the 1970s, significant theoretical and empirical studies backed the claim that "satisfaction is connected to the size and direction of disconfirmation experiences, where disconfirmation experience is related with the person's original expectations."¹¹ Conceptually, satisfaction can be seen as the result of the customer weighing the costs and benefits of purchasing a product or service in relation to the expected results. However, in practical terms, satisfaction is similar to attitude and can be measured as the sum of a customer's experiences with the product's various attributes. The inclusion of an emotional response to the experiences offered by connected to specific items or services acquired^{12, 13} later in the 1980s introduced a new angle for the study of consumer happiness. To define customer satisfaction, a model based on the "confirmation/disconfirmation" paradigm predominated subsequent advancements in the 1990s and at the beginning of the year 2000^{14,15}. The gap between customers' expectations of the product or service and their actual perception of its performance determines whether they are satisfied or dissatisfied in this case. If the outcome meets client expectations, it is satisfied; if not, there is discontent^{16 ;17;18}. One question has mostly gone unanswered during the development stage of customer satisfaction research, with a few notable exceptions. Specifically, does "consumer satisfaction" differ or remain the same across goods and services? What metrics direct or indirect should be employed to adequately comprehend and assess the behavioral elements of consumer pleasure as a result of consumption experience? Is another related subject¹⁹. Some researchers like^{20, 21, 22, 23}, examined customer satisfaction using a variety of behavioural metrics. Additionally, a lack of literature on customer satisfaction in general services is evident in a number of research on customers' experiences using financial services, and these studies have made no effort to define any unique metrics of customer satisfaction analysis for these experiences.

Quality of Service and Client Satisfaction

Only a few studies have explored the idea that customer satisfaction can be influenced by any factor (whether or not it has anything to do with quality), and that non-quality problems can influence how customers perceive a service or provider^{24,25}. Given the pervasiveness of customer satisfaction phenomena and the literature's widespread recognition of customer satisfaction as primarily a "behavioural reaction," research directions guide us to the widely used concept of "service quality" as a means of better understanding customer satisfaction. But there is still disagreement about whether customer satisfaction precedes perceptions of service quality or whether service quality before customer pleasure^{26,27}.

Quality of Banking Services

In the banking sector, service quality is becoming increasingly important, and it is important to assess the benefits of enhancing service quality. Strong customer-financial institution relationships may serve as incentives for consumers to stick with them and, as a result, give financial institutions a competitive edge, according to²⁸. In a similar vein,²⁹ discovers that the nature of the long-term connection that forms with the bank is a crucially significant part of a commercial customer's dealings with the bank. In 31

significant UK firms encompassing financial services, retailing, and leisure,³⁰ studied service quality programmes and the ways in which the customer care philosophy pervaded organizations from top management to customer contact workers. The research included a section on determining what the management believed to be the essential components of successful customer service, or what the company's external clients should expect from it.

Although there has been much examination into service quality in the field of services marketing over the past few decades, it is clear from the literature analysis that research and discussion are currently ongoing. Additionally, very little has been done to comprehend the factors that affect service quality in the banking industry. Most studies view consumer satisfaction as an attitude established by contrasting expectations before consumption with views of the results after consumption. The widely accepted paradigm for using to understand and explain satisfaction as a construct is the discrepancy method. It has been successfully argued that satisfaction is a multifaceted notion, with different dimensions depending on the consuming experience being studied.

Research Methodology

The relationship between service quality and customer satisfaction in the context of Pakistan's banking industry is established by this study using the aspects of service quality developed by a thorough literature review. Making a comparative analysis of consumer feedback regarding service quality and customer satisfaction from clients of Islamic and conventional banks is the primary research question for this study. Despite the fact that this study is descriptive, once the dimensions and interactions have been identified, further research may aim to comprehend and establish causality.

Conclusion

Undoubtedly, from the very beginning, the human beings worked tirelessly to improve their standard of living and establish relationships in the society, which led to the emergence of economic and financial systems. According to historians and researchers, the idea of preserving wealth is centuries old. In ancient civilizations, wealth was stored in a variety of ways, including crops, livestock, and precious metals. The traditional banking system began with receipts given by goldsmiths on the goods they held in their custody. Whenever there was a need for a transaction, the holder would give it as a guarantee. The importance of these receipts began to be felt in the society as they came to be considered as an alternative to precious metals. From the beginning of the currency note, the traditional banking system came into existence. As time went by and through experience came wisdom and understanding, thus many changes took place in this system.

Over the past twenty years, a wealth of literature on service quality and customer happiness has developed and multiplied. In order to contextualize the research problem at hand and to identify gaps in the corpus of existing knowledge, many areas of the literature are explored in this study. In an effort to characterize total service quality and customer satisfaction, portions of the numerous alternative conceptualizations of service quality are examined for their theoretical and practical applicability before

being merged into the research. The following are the main ways that this study adds to the literature on service quality and customer satisfaction. This study's main contribution is to provide an understanding of service quality and customer satisfaction in Pakistan's banking sector, where the majority of past research on service quality has been undertaken. This study adds to the body of knowledge by offering a thorough comprehension of overall service quality and customer satisfaction in the Pakistani banking sector, which is systematically measured on a multidimensional analytical framework (AHP). This helps gain more clarity and understanding of how service quality-related factors can be distinguished from customer satisfaction, as well as how management can combine them based on the priority endorsed by the organization. The study looks at the connections between several factors of customer satisfaction and service quality within conventional banks and Islamic banks both separately and collectively. Customer loyalty, return intent, and referral intent are not mentioned or looked at, though. Future study in these areas is still beneficial. It is also possible to look at corporate image and customer relationship management.

The direct disconfirmation scale is used in this study to measure perceived service quality in relation to client expectations. The same questions may be used in replication studies, but they may also use a "perceptions alone" scale to compare the predictive power of perceptions-only scores to disconfirmation scores. This would add to the ongoing discussion in the literature on services marketing about the relative advantages of each approach. The constraints listed above can be addressed through further research.

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