FACTORS INFLUENCING THE GROWTH OF
ISLAMIC BANKS IN KENYA

BY

MOHAMED RIZWAN KASMANI

UNITED STATES INTERNATIONAL UNIVERSITY

FALL 2013
FACTORS INFLUENCING THE GROWTH OF
ISLAMIC BANKS IN KENYA

BY

MOHAMED RIZWAN KASMANI

A Project Report Submitted to the Chandaria School of Business in Partial Fulfillment of the Requirement for the Degree of Masters of Business Administration (MBA)

UNITED STATES INTERNATIONAL UNIVERSITY

FALL 2013
DECLARATION

I, the undersigned, declare that this is my original work and has not been submitted to any other university or academic institution other than United States International University for academic credit.

Signed: _________________________________                  Date: ____________

Rizwan Kasmani (ID 614879)

This project has been supervised for examination with my approval as the appointed supervisor.

Signed: _________________________________                  Date: ____________

Mr. Fred Newa

Signed: _________________________________                  Date: ____________

Dean, Chandaria School Of Business
COPYRIGHT©

All rights reserved. No part of this project should be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise without prior written permission of the copyright owner.
ABSTRACT

At the time this study was being conducted, Kenya had two fully fledged Islamic banks namely the First Community Bank and Gulf African Bank (GAB). The purpose of this study was to determine the factors influencing growth of Islamic banks. The study’s research questions were: What are the factors influencing growth of Islamic banks in Kenya?, What are the strategies adopted by Islamic banks to penetrate into the Kenyan market?, What are the challenges faced by Islamic banks in Kenya?

To achieve the above, the research was conducted in the form of a descriptive study. This design was adopted as the suitable research design because it identifies patterns or trends in a situation. The target population were existing customers of GAB. A simple random sampling technique was used to identify the 100 sample size elements. Questionnaires were used to collect the primary data from. The questionnaire was given to 100 customers drawn from the bank’s Westlands branch in Nairobi. The collected data was first coded statistically and then analyzed using the Statistical Package for Social Scientists (SPSS). SPSS and Microsoft Excel enabled the researcher to compute descriptive statistics such as percentages, frequencies, and ranges. Finally, the presentation of the results was done by use of graphs, charts, tables, cross-tabulations and pie charts for clarity and ease of understanding of the findings.

The results of the research were mostly in line with previous studies and existing literature on the topic of Islamic banking. The first section of the questionnaire addressed the factors contributing to the growth of Islamic banking. According to the study, religious considerations represented one of the main reasons the respondents offered for opening an account with an Islamic bank. Muslims constitute the majority of the bank’s customers with non-Muslims appearing to be underrepresented. The majority of the respondents were self-employed which is in line with contemporary thinking within the Islamic banking sector. Better product portfolio was another reason offered by the respondents for opening an account with GAB. More than 50% of the respondents rated the services they receive from the bank as excellent reflecting high levels of customer satisfaction among the bank’s customers.
The findings of the study in relation to the strategies used by Islamic banks showed that in addition to product innovation, the main strategies used by GAB to penetrate the Kenyan market are advocacy and civic education. Civic education which includes raising awareness on Islamic banking and advocacy including increasing political and financial commitment and sensitisation of policy makers at all levels including the Kenyan government.

The study found that the main challenges faced by Islamic banks in Kenya include stiff competition in what is a very competitive sector. A significant number of the respondents held parallel accounts with other banks. Some respondents felt that GAB staffs were not fully conversant with the concept of Islamic banking and that there was a shortage of professionals in the Islamic banking sector.

The study concluded that Islamic banks have made a remarkably successful entrance into the Kenyan financial market. People from different religions appreciate this form of banking that is free from the uncertainty of interest rate fluctuations, that is transparent, and offers caring partnership. The study also concluded that because a large majority of GAB customers were Muslims, this may prove that Islamic banking is still largely attracting customers on religion basis instead of its own features and simultaneously, it is being offered majorly to Muslims only. The study highlighted concerns about the familiarity of bank staff with the concept of Islamic banking. In addition to the training of personal qualified in Islamic finance, Sharia compliant banks will need to conduct promotion and marketing activities.

The study recommended the implementation by Islamic banks in Kenya of clear growth strategy, the establishment of a National Sharia Board and positive publicity for Islamic banks through corporate responsibility activities. For a future research activity, the study recommends the investigation of the quality of services available in fully fledged Islamic banks and in banks that only offer Islamic banking windows.
ACKNOWLEDGMENTS

Foremost, thanks to the Almighty; Allah (SWT), the most Gracious the most Merciful for making it possible for me to complete this project. Without His help, this would have not been possible. Secondly, I would like to express my heartiest appreciation and gratitude to my professor and supervisor Fred O. Newa for his dedication, patience, availability and unfailing encouragement. His suggestions and comments were invaluable and his vast knowledge has made such significant contribution to the outcome of this project. His guidance helped me in all the time of research and writing of this thesis. I could not have imagined having a better advisor and instructor for my project. May God bless and reward him abundantly.

I would like to express special thanks and appreciations to my family members especially my loving wife; Ms Asha Omar, my parents; Mr. Liyakat Kasmani and Ms. Khairunissa Kasmani, my siblings Ms. Aisha Ayyaz and Irfan Kasmani, my nephew and niece for their undying support, encouragement, prayers and mentorship.

My sincere thanks go also to all my professors and the staff of the USIU Library and Information Centre. Infinite thanks go to USIU, for giving me the chance to pursue both my undergraduate and postgraduate studies. Finally, I would like to forward my appreciation to my friend and mentor, Mr. Fredrick Ochieng for encouraging me and motivating me throughout my project.

Special appreciations go to Mrs. Yasmin Mohideen, Branch Manager at Gulf African Bank (K), Westlands Branch and all the respondents’ for their contribution and cooperation that enabled me to compile the data. I am grateful to you all.

To you all, I have nothing to offer but to pray to God to bless you and reward you all abundantly.
DEDICATION

To my 3 months old son, BILAL RIZWAN KASMANI
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>DECLARATION</td>
<td>iii</td>
</tr>
<tr>
<td>COPYRIGHT</td>
<td>iv</td>
</tr>
<tr>
<td>ABSTRACT</td>
<td>v</td>
</tr>
<tr>
<td>ACKNOWLEDGEMENTS</td>
<td>vi</td>
</tr>
<tr>
<td>DEDICATION</td>
<td>vii</td>
</tr>
<tr>
<td>LIST OF TABLES</td>
<td>x</td>
</tr>
<tr>
<td>LIST OF FIGURES</td>
<td>xii</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>xiii</td>
</tr>
<tr>
<td>LIST OF ABBREVIATIONS</td>
<td>iii</td>
</tr>
<tr>
<td>CHAPTER ONE</td>
<td>1</td>
</tr>
<tr>
<td>1.0 INTRODUCTION</td>
<td>1</td>
</tr>
<tr>
<td>1.1 Background of the Problem</td>
<td>1</td>
</tr>
<tr>
<td>1.2 Statement of the Problem</td>
<td>5</td>
</tr>
<tr>
<td>1.3 Purpose of the Study</td>
<td>6</td>
</tr>
<tr>
<td>1.4 Research Questions</td>
<td>6</td>
</tr>
<tr>
<td>1.5 Importance of the Study</td>
<td>7</td>
</tr>
<tr>
<td>1.6 Scope of the Study</td>
<td>8</td>
</tr>
<tr>
<td>1.7 Definition of Terms</td>
<td>8</td>
</tr>
<tr>
<td>1.8 Chapter Summary</td>
<td>9</td>
</tr>
<tr>
<td>CHAPTER TWO</td>
<td>10</td>
</tr>
<tr>
<td>2.0 LITERATURE REVIEW</td>
<td>10</td>
</tr>
<tr>
<td>2.1 Introduction</td>
<td>10</td>
</tr>
<tr>
<td>2.2 Factors that have Contributed to the growth of Islamic banks</td>
<td>10</td>
</tr>
<tr>
<td>2.3 Strategies Used by Islamic Banks</td>
<td>15</td>
</tr>
<tr>
<td>2.4 Challenges Faced by Islamic Banks</td>
<td>20</td>
</tr>
<tr>
<td>2.5 Chapter Summary</td>
<td>24</td>
</tr>
<tr>
<td>CHAPTER THREE</td>
<td>25</td>
</tr>
<tr>
<td>3.0 RESEARCH METHODOLOGY</td>
<td>25</td>
</tr>
<tr>
<td>3.1 Introduction</td>
<td>25</td>
</tr>
<tr>
<td>3.2 Research Design</td>
<td>25</td>
</tr>
<tr>
<td>3.3 Population and Sampling Design</td>
<td>26</td>
</tr>
<tr>
<td>3.4 Data Collection Methods</td>
<td>28</td>
</tr>
<tr>
<td>3.5 Research Procedures</td>
<td>29</td>
</tr>
<tr>
<td>3.6 Data Analysis Methods</td>
<td>29</td>
</tr>
<tr>
<td>3.8 Chapter Summary</td>
<td>30</td>
</tr>
<tr>
<td>CHAPTER FOUR</td>
<td>31</td>
</tr>
<tr>
<td>4.0 RESULTSAND FINDINGS</td>
<td>31</td>
</tr>
<tr>
<td>4.1 Introduction</td>
<td>31</td>
</tr>
<tr>
<td>4.2 Demographic Information</td>
<td>31</td>
</tr>
<tr>
<td>4.3 Factors Influencing the Growth of Islamic Banks in Kenya</td>
<td>35</td>
</tr>
<tr>
<td>4.4 Strategies Adopted by Islamic Banks to Penetrate into the Kenyan Market</td>
<td>42</td>
</tr>
<tr>
<td>4.5 The Challenges Faced by Islamic Banks in Kenya</td>
<td>46</td>
</tr>
</tbody>
</table>
4.6 Chapter Summary

CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
5.2 Summary
5.3 Discussion
5.4 Conclusions
5.5 Recommendations

REFERENCES

APPENDICES
LIST OF TABLES

Table 2.1: ICM Products and Services versus Conventional Market 18
Table 4.1: Questionnaire Response Rate 31
Table 4.2: Types of Accounts held by Respondents 37
Table 4.3: Respondents’ Perception of Bank Growth 43
Table 4.4: Quality of Staff in the Islamic Banking Sector 47
LIST OF FIGURES

Figure 4.1: Gender and Age of Respondents 32
Figure 4.2: Respondents Disaggregated by Occupation 33
Figure 4.3: Academic Qualifications of Respondents 34
Figure 4.4: Respondents’ Income Levels 35
Figure 4.5: Quality of GAB Services 39
Figure 4.6: Main Motivations for Opening Islamic Bank Account 40
Figure 4.7: Reasons for Transacting with GAB 42
Figure 4.8: Market Penetration Strategies Used by GAB 44
Figure 4.9: Future Strategies for GAB 46
Figure 5.0: Access to GAB Accounts for Non-Muslims 48
Figure 5.1: Challenges Faced in Operating GAB Account 49
ABBREVIATIONS

ATM: Automated Telling Machine

GAB: Gulf African Bank

ICM: Islamic Capital Market

IFS: Islamic Financial System

Kshs: Kenya Shillings

PSR: Profit Sharing Ratio

PTA: Preferential Trade Agreement

RoE: Return on Equity

SPSS: Statistical Package for Social Scientists
CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Problem

Islamic banking is banking according to the values and ethos of Islamic sharia. Sharia; is an Arabic word that means practicing as per the Islamic values and law. The Islamic law i.e. the sharia prohibits Muslims from dealing in riba (interest), which literally means increase, addition, rise or growth (Khattak and Rehman, 2010).

The main difference between Islamic banks and conventional banks is the prohibition of interest or usury. Gharar is also forbidden which means excessive uncertainty. Further down these lines Islamic banks are not allowed to engage in trading activities or investment that are forbidden in Islam, otherwise known as haraam activities; example trading in pork, alcohol, tobacco or financing the construction of a casino etc. Another distinct feature between the two banking systems is that money has no value in itself in Islamic banking, thus, implying that money cannot make money. According to Usmani (2007), money has no intrinsic utility, meaning that if one is stuck on a desert, he cannot eat, drink or wear that money, justifying the reason for money not having value in itself.

Traditional economics states that money has three main functions. It is a medium of exchange, a store of value and a unit of account. However, in Islamic economics, money is only a medium of exchange and a unit of account not a store of value. Islamic banking encourages sharing in profit and losses and forbids any reward without bearing a risk (Iqbal and Molyneux, 2005).

Islamic banking is one of the fastest growing industries in the Middle East and its history goes way back centuries ago, however the first Islamic bank was established in Egypt Mit-Ghamr from 1963 to 1967. This was a small project in a relatively poor area where Muslim’s needed banking services, and were provided to them on sharia compliant basis. From here on in 1975, the Islamic Development Bank was formed which boosted the growth of Islamic banks and whose main purpose was to foster economic development in the new Islamic banking world. The key question that arises here is that, if Muslim’s are prohibited to pay or consume interest, where will they keep their money? According to Siraz (1988), Muslims need banking and financial services as much as anyone else.
The Islamic banking phenomenon continues to rise. According to Pepinsky (2010), the industry is estimated to be worth more than 800 billion dollars and growing. As a matter of fact, its popularity has gradually grown towards the west. Prominent conventional banks such as Barclays bank, Citigroup, HSBC, UBS, and Standard Chartered among others have set up the so-called Islamic windows, where they provide sharia compliant products to clients. President Obama in his third day in office surprisingly instructed the US Treasury department to undertake an Islamic finance course led by academics at the department of Islamic Finance at Harvard University. In the past 30 years Islamic finance has really come a long way, receiving praise from leaders such as the Pope. Salman (2010), questions whether the rise of Islamic banking is down to its practices or due to the fact that Islam is currently the fastest growing religion in the world.

Not only has interest been forbidden in Islam, it has also been forbidden in the two other major world religions Christianity and Judaism. Islamic jurists and economists differ in their opinions of the interpretations of riba (Iqbal, 2002). Riba as explained earlier is an Arabic word, which literally means increase, addition, rise or growth. Does this directly relate to the modern day capitalist interest, where a creditor receives repayment of a loan from a debtor, with the principal amount as well as interest? According to Iqbal (2002), points of view among Islamic jurists and scholars vary.

The main instruments of finance used by Islamic banks are musharakah, mudarabah, murabaha and ijara (Karbhari et al., 2004). There are others but we will focus on these three main ones. According to Dixon (1992), musharakah means sharing and is a kind of partnership where the Islamic bank and a client, say an entrepreneur, jointly engage in business where a profit and loss sharing methodology is followed. A profit sharing ratio (PSR) is pre-agreed at the time of execution of the contract and in the case of profits made, they will be shared according to the actual profit earned by the enterprise and not as percentage of the partner’s investment (Dixon, 1992). In the case of a loss, partners will suffer the loss according to the ratio of investment. So both bank and entrepreneur will be aware that there is no room for complacency, as profit will be shared according to the total profit earned from the trade or business undertaken, rather than them working less hard as they would know that they had invested more and would hence get higher returns regardless of their effort and determination (Dusuki and Abdullah, 2007).
According to Farouq and Emadul (2008), an important aspect of musharakah financing is that the Islamic bank has the same protection as a conventional lender would have. Although profits are shared, if a loss is incurred to the enterprise due to the negligence and mismanagement of the entrepreneur, he has breached rules of the contract and will sustain the entire loss, and further more will also be required to pay the profits that the Islamic bank would have obtained (Farouq and Emadul, 2008).

Secondly, a very similar contract to the musharakah is the mudarabah contract. This is quite similar to a limited partnership in a conventional system. According to Iqbal (2002), in a mudarabah contract, the Islamic bank who is the investor in this case is known as the rabb-ul-mal, who provides the funds to an entrepreneur or manager, known as the mudarib, where the mudarib uses his managerial skills in search of profits.

The difference between the mudarabah and musharakah contracts is that in the mudarabah contract only one partner invests and the party works, whereas in musharakah both partners can work or contribute towards the business (Karbhari et al., 2004). Profits are shared at an agreed ratio just as the musharakah, however all losses are borne by the investor. The only loss the mudarib will incur is his time and effort. Shirazi (1988) writes that in the mudarabah contract the investor and the manager’s role should be completely separated. The investor should only supply the capital and should not be liable for the mudarib’s actions (Shirazi, 1998).

The third contract known as ijara which is the Islamic alternative for leasing. This is a mode of finance that is used by majority of the Islamic banks today perhaps because of the problems of adverse selection and moral hazard with the mudarabah and musharakah contracts (Ingram, 1986). While going through this mode of finance, it will be useful to keep the Islamic criteria in mind i.e. has any risk been taken and is there a fixed return. According to Ingram (1986), the term ijarah is used in two aspects. It could mean to employ services of a person example hire a porter at the airport to carry your luggage or to pay rent for the use of a property or an asset (Ingram, 1986). The latter is more relevant in financing used by Islamic banks than the former, so we will keep our focus on it. According to Usmani (2007), in this type of ijara, the lessor is called ‘mu’jir and the lessee is called ‘musta’jir. The lessee pays the lesser, the Islamic bank rent known as
‘ujrah’, and the usufruct of a particular good (Usmani, 2007). Property or asset is transferred to lessee i.e. the right to use the property.

A simple illustration of how the ijara works is as follows; say a customer requests financing for a tractor, costing 10 million dollars. The Islamic bank agrees to provide the funds and the contract lease is signed. The Islamic bank then makes a payment to the tractor supplier and takes possession of the tractor. The bank and the customer sign the agreement for say 4 years. The customer then uses the tractor and pays rent for the next 4 years. As the customer continues to pay rent his ownership increases, until the end of the 4th year, the customer buys the truck and ownership is transferred to him. The ownership of the leased asset remains in with the lesser or Islamic bank however, the usufruct is passed onto the lessee. Important rules in conducting this mode of finance stipulate that the terms of agreement should clearly be stated in the contract and the Islamic bank cannot increase the rent unilateral. The leased asset will remain in ownership with the bank and any loss incurred will be borne by the bank alone. Thus, the Islamic bank assumes the risk here, which satisfies the criteria of risk taken in order to obtain a reward (Mahmod, 2005).

Further in Islamic economics, anything that cannot be used without consuming it cannot be leased (Usmani, 2007) and refers in respect to money. Normal maintenance is the lessee’s responsibility, and if the leased asset is destroyed the lease will be terminated. In the conventional setting, if there is late payment of rent, a penalty is usually imposed on the lessee and he may be charged extra.

Finally, a quite commonly used sale method, as the murabaha contract is not really a mode of finance as the others mentioned above; it is just a particular kind of sale done on a cost plus profit basis; say a customer asks the Islamic bank to help it purchase steel from a steel supplier (Carlson, 1986). According to Carlson (1986), the Islamic bank will purchase the steel from the producer, take physical possession of the steel at then sell it to the client at a mark up, say to be paid after 6 months. The unique feature here is that the bank must disclose the cost to the client and a known profit is added and that the asset sold must exist (Carlson, 1986). The profit may be decided mutually either to be paid in lump sum, or through an agreement of a ratio. According to Kutty (1995), murabaha is commonly used in assisting small medium enterprises although in many cases, the
customer purchases the goods from the supplier directly as the customer usually has a
better relationship with the supplier, and thus acts as an agent on the banks behalf. This
may give rise to problems associated with principal agent theory.

The above instruments of finance have great potential, but are subject to various
problems. Islamic banking relies on the assumption that all operations taking place are in
accordance with Sharia and every client is complying with this rule (Sudin et al., 1994).
Currently, in Kenya there are two fully fledged Islamic banks namely the First
Community Bank and Gulf African Bank (GAB) which form part of the country’s
banking network.

1.2 Statement of the Problem
The concept of Islamic banking in Kenya is relatively new. In addition, the research
studies that have been done in this area are few and far between. There was a need to
know as to how the Islamic banks are penetrating into the Kenyan market and competing
head on with conventional banks for the same customers. Is the success of Islamic banks
as a result of the strict Islamic sharia and values that these Islamic banks follow or is it
because of the innovative products being offered by these banks.

The two banks that have been licensed have so far made a successful entry into the
Kenyan financial market. The Kenyan banking industry has changed drastically over a
relatively short period of time with a very competitive market. As of 2011, there were 44
banks licenced by the Central Bank of Kenya, the national banking regulator (Central
Bank of Kenya, 2011). The rapid development has followed the deregulation of the
financial sector which has brought new players leading to increased competition and
important transformation and innovation taking place in the country’s banking sector.

Many mainstream Kenyan banks have also adopted and are now offering Islamic banking
services. Because they are not fully-fledged Islamic banks, the conventional banks are
offering services that are limited to Islamic banking windows. Islamic banks are based on
a different set of objectives, beliefs, and assumptions from conventional institutions.
These assumptions lead to different types of transactions.
In many countries including Kenya, there is a lack of knowledge and awareness of the advantageous features of the Islamic form of banking by people and even some governments. Recent research carried out by Dusuki (2008) concluded that precepts of Islamic banking could assist in the alleviation of poverty by giving the poor access to microfinance facilities based on the concepts of risk sharing and free – interest. If well understood, Islamic banking is a key motor of economic development (Osman, 1999).

In her study on the factors that affect the adoption of Islamic banking in Kenya, Hemed (2009) recommended further studies be conducted on the features of Islamic banking especially on the few Islamic banking windows and the fully-fledged Islamic banks in Kenya. As she discovered that these features and their advantages were not well understood by people.

The motivation for undertaking this study was to investigate the Islamic banking sector in Kenya with emphasis placed on the growth of the sector and to investigate how these new entrants can grow further. The study will also investigate the strategies that Islamic banks such as GAB can adopt to penetrate the Kenyan finance market. This is in light of the fact that the features of Islamic mode of banking are quite not understood by many people in a non-Muslim country like Kenya. The challenges, which are present despite the rapid growth of the Islamic banks in this country, also present an important and interesting area for investigation. This study therefore, sought to address an existing knowledge gap. It identified the features of Islamic banking and their implications

1.3 Purpose of the Study
The purpose of this study was to determine the factors influencing growth of Islamic banks. In addition, it also examined on the strategies adopted by Islamic banks and the challenges faced by Islamic banks.

1.4 Research Questions
In order to meet the purpose of the study, there was need to collect data and to gain an in-depth understanding of the following specific objectives including:

1.4.1 What are the factors influencing growth of Islamic banks in Kenya?
1.4.2 What are the strategies adopted by Islamic banks to penetrate into the Kenyan market?
1.4.3 What are the challenges faced by Islamic banks in Kenya?

1.5 Importance of the Study
As far as research on Islamic banking or finance is concerned, there is very little information available in relation to the Kenyan market. Hence the information from this study can be used by various groups of people.

1.5.1 The Management and Employees of Islamic Banks
This study will be of benefit to the management of Islamic banks currently operating in Kenya. The study will prove useful in determining the important underlying factors that influence customers in their choice of banks. For the employees of Islamic banks, this study will be of importance especially in determining the role they have to play towards successful customer retention and customer satisfaction. It will help them identify areas where their institutions are performing well as well as the areas in which improvement is required in order to keep the services that they offer competitive.

1.5.2 Customers of Islamic Banks
This study will be useful in highlighting the various problems faced by the customers. It will identify where the Islamic banks’ strengths and weaknesses lie in terms of the factors influencing the selection criteria of banks.

1.5.3 The Management of Conventional Banks
For the conventional banks, this study will be important in determining the factors that influence customers in selection of Islamic banks as their preferred banking partner. It will also help them know the strategies used by Islamic banks in penetrating into the Kenyan market.

1.5.4 Researchers
Lastly, this study will be important to those researchers who wish to contribute further to the topic or look at the topic from a different perspective. Pertinent questions not addressed by this study can be explored in future research studies.
1.6 Scope of the Study
The study focused on how Islamic banks have managed to penetrate into the Kenyan market and the strategies adopted by them and the challenges faced. The study was carried out in Nairobi (Kenya) and was aimed to focus specifically on one of the two fully-fledged Islamic banks; Gulf African Bank. The study focused on a sample size of 100 customers who operate their accounts with GAB. Structured questionnaires were used to collect primary data from the selected respondents. The study took a cross-sectional approach and data was collected from the key respondents only once. There are also limitations and weaknesses in using questionnaires to conduct research activities. This is especially true when they are used remotely as was the case in this study. According to Ireland and Williams (2012), these include the fact respondents may interpret the questions in their own ways without the direction of the interviewer meaning that questions may have different meanings for different respondents. A time frame of two and a half months was required to complete this study.

1.7 Definition of Terms
The following terms are frequently used in Islamic banking. They form the concept of Islamic banking and constitute what differentiates Islamic banks from conventional banks.

1.7.1 Riba
This is an Arabic word which literally means increasing or adding your money by using money as a commodity. It is loosely translated into English as interest (Farouq and Emadul, 2008).

1.7.2 Sharia
The Islamic law which is usually governed by the teachings of Islam (Khattak and Rehman, 2010).

1.7.3 Musharakah
The relationship between two or more parties. Each of the parties contributes capital to a business or a business activity. They contract to share profits based on a profit-sharing ratio (PSR).
1.7.4 Mudarabah
A concept similar to Musharakah, except in the case of Mudarabah, one partner contributes capital and agrees to compensate an entrepreneur or investment manager through profit sharing (Iqbal, 2002).

1.7.5 Murabah
A sale in which the seller’s cost and profit are disclosed to the buyer (Kenya Bankers Association, 2013).

1.7.6 Ijara
The Arabic word for a wage or a leasing contract. Under Ijara contracts, the owner of an asset allows the use of sharia-compliant assets by the user for sharia-permissible purposes (Salman, 2010).

1.7.7 Ujrah
The Islamic bank rent, which is paid by the lessee to the lesser (Usmani, 2007).

1.7.8 Gharar
Uncertainty which is one of three fundamental prohibitions in Islamic finance (the other two being riba and maysir). Gharar is a sophisticated concept that covers certain types of uncertainty or contingency in a contract (Usmani, 2007).

1.8 Chapter Summary
The first chapter provides background information of the study discussing the background of Islamic banking and its concepts. The problem statement was given. The general objectives of the study, the research questions, and the importance of the study and scope of the study have also been highlighted.

The next chapter provides a detailed literature review of previous research work relevant to this study. The third chapter will discuss the research methodology that will be used in conducting the research. The fourth chapter will present the results from the research conducted while the fifth chapter will provide the discussions, conclusions and recommendations based on the results presented in chapter four.
CHAPTER TWO

2.0 LITERATURE REVIEW

2.1 Introduction

The following sections begin by investigating literature that has been written in the area of Islamic banking and finance. The study will examine the factors that have attributed to the rapid growth and acceptance of Islamic banking and financing methods in Kenya. The literature also explains the strategies that are used by Islamic banks to penetrate into Kenyan markets. Lastly, the study also describes the challenges that are faced by Islamic banks in conducting their operations in Kenya.

2.2. Factors that Have Contributed to the Growth of Islamic Banks

2.2.1. Islamic Values (Shari’ah)

Muslim scholars have unanimously agreed that, when examining any new subject or incident that has no rule or legal value, the provisions of the primary bases of Islamic law must be referred to. These are the Quran and the Sunnah that include the Prophet Muhammad’s (peace be upon him) words, deeds, and tacit approvals. According to Gait and Worthington (2007), in a case where there is no equivalent rule provided by these two non-arguable sources, usually Islamic scholars will subsequently resort to the secondary or dependent sources of law, the Ijma’ (general public consensus), the Qiyas (reasoning by analogy), the Maslahahmursalah or Istislah (reasoning by public interest), the Istihsan (preference), the Urf (customs or common practice) and Sadd al-dhara’i (blocking the means). Thus, when a jurist wants to know the status or legal rule of certain issue or problem, he must refer to the primary sources first, according to the order of the sources. Unless he could not find the legal rule or the right solution to the issue concerned, he may then refer to the secondary sources, whichever relevant. (Quran 4:26)

The Islamic Financial System (IFS) is a product of Islamic principles and philosophy and is thus based on Sharia functions. Since this system is part and parcel of Islam, IFS recognises man as the vice gerent of God on earth. According to Loqman (1999), any wealth earned by a man is seen to be merely entrusted upon him and he holds the wealth as a trust from God, and does not have absolute ownership of the wealth. As such, in IFS, freedom of enterprise as well as financial decisions made either by individuals or corporations should be on the basis of guidelines provided by Islam which do not prohibit profit making as the target, as long as the interest of society and the nation as a whole are
protected and preserved meaning that profitable undertaking is permissible under Sharia (Loqman, 1999).

Islamic banking is more complex than traditional banking in that products must conform not only to the secular laws of a country but also to interpretations of the holy Qur’an by local Islamic scholars (Ali, 2005). According to Ali (2005), a central tenet of Sharia is riba, the prohibition of interest, moreover, Islamic law does not permit use of funds for investments or purchases related to activities it deems impermissible (haram), such as alcohol consumption or gambling. Hunt (2007) writes that in general, anything not defined as haram is considered permissible (halal) under Sharia.

According to Sudin et al., (1994), Due to interest, Islamic financial institutions have had to develop products and services which are not contradictory with the Islamic law. The products and services that are offered by conventional banks are then tailored to fit the Sharia. According to Ali and Ali (1994), this has been accomplished by innovating various types of financial products and services, whereby both the borrowers and depositors are considered to be operating in an alliance where an element of risk is attached. The rate of return or profit is based on the performance of the borrowers and depositors.

Furthermore, According to Patel (2009) the PLS principle creates a clear engagement among the parties involved in a transaction. All business transactions should be based on this principle. Islamic financial institutions try to ensure that their business activities avoid prohibited activities and that their financial products permit the financing of individuals or commercial enterprises through the profit and loss sharing principle (Augustinus, 2005). Because interest is forbidden, suppliers of funds become investors instead of creditors. The provider of financial capital and the entrepreneur share the business risks in return for a share of the profits. The relationship between the investors and the financial intermediary is based on PLS principle, and the financial intermediary shares the risks with the investors (Greuning and Iqbal, 2008).

Clearly, as Islamic products and services enter these markets, an important consideration is the attitudes, perceptions and knowledge of market participants towards these new methods of finance (Farah, 2007). According to Farah (2007), for individual consumers
and business firms, these factors determine the extent to which they choose to patronise these alternative products and services. Key concerns include the influence of religious persuasion and the relative pricing, costs and benefits, convenience and access of Islamic products and services vis-a-vis conventional bank products and services (Iqbal, 2002).

All Islamic banks have either an advisory sharia board or sharia advisor(s), and as a result all the products they trade are sharia compliant because they have been approved by the sharia board or advisor. However, there has been criticism of some practices of Islamic banks. Dusuki and Abozaid (2007) called for the revitalisation of Islamic banking and finance practices based on a proper understanding and implementation of the maqasid of sharia. According to Wilson (1995), Islamic banks, as business entities that strive to meet religious obligations, need to compete with other banks to win customers. Therefore, Islamic banks need to meet two objectives: run profitable operations for investors and satisfy religious obligations. According to Musa (2007), it is necessary that Muslims in Kenya are able to access financial services that do not violate their principles and beliefs. The way Islamic banks conduct their business may motivate clients to choose a bank that uses Islamic sharia principles as a base for all products and services (Wilson, 1997).

2.2.2. Customer Satisfaction
Customer satisfaction is the feeling or attitude of a consumer toward a product/service after it has been used (Solomon et al., 1996). A satisfied consumer will repeat the purchase of the product and convey positive messages about it to others while in contrast, a dissatisfied consumer is more likely to switch to an alternative product or service the next time he or she recognises the same need (Dispensa, 1997). Not only this, according to Janmohmed et al (2011), the client’s dissatisfaction will be reflected in a negative word of mouth which might have a serious damaging effect on the business. It is therefore crucial that firms ensure customer satisfaction for their products and services leading to the increasing popularity of measuring customer satisfaction in recent years (Gulledge, 1996).

The establishment of Islamic banks has grown rigorously for the past four decades. Islamic banking has spread across the world, and people from all religions have warmly accepted Islamic financial institutions (Iqbal and Molyneux, 2005). Islamic banking can no longer regarded as a business organisation which is established solely to fulfill
religious duties but what is more important, to be as competitive as possible side by side with the conventional system in alluring more customers and retaining them. Inevitably, Islamic banks need to understand the perceptions of their customers towards their business operations particularly their quality of service rendered to increase customer satisfaction and ultimately their loyalty (Dusuki and Abdullah, 2007).

Service quality is the customers’ judgment about an entity’s overall excellence or superiority is and is a form of attitude and results from a comparison of expectations to perceptions of performance received (Schilke et al, 2009). Service quality should therefore be defined as a measure of how well the service level delivered matches customer expectations. Delivering quality service means conforming to customers’ expectations on a consistent basis and revolves around customers’ expectations and perceptions of the services performed (Yousuff and Azurah, 2006).

Customer satisfaction often depends on the quality of product or service offering. Service quality is thus related, though not equivalent, to satisfaction. Hence research on customer satisfaction is often closely associated with the measurement of quality. Service quality has been described as a form of attitude that results from the comparison of expectations with performance (Khattak and Rehman, 2010).

A study by Khattak and Rehman (2010), found that religion did not play significant role to select an Islamic bank in Jordan but profit motivated criteria was an important factor to choose a bank opening new branches. Islamic banking products are often more complex than the products that conventional banks offer, this is because they have to follow the strict sharia guidelines that have been set out by the local sharia board or the product fatwas. According to Radi and Erol (1989), due to the complexity of the product, the sale of a sharia compliant product/service requires a sales team that has the technical know-how of the product/service. Leading Islamic financial institutions across the world, offer their staff intensive training that covers the features of the product/service as well as on how a transaction is carried out. This results in the sales team satisfying the customers, as the customers are assured on the features of product/service they are engaging in. (Okumus, 2005).
Some research has been conducted on the impact of Islamic banks since their entrance into the Kenya finance market. According to Sitole (2011), small-scale traders in Nakuru, Kenya’s fourth largest town say that Islamic banks are cheaper sources of finance, have attractive banking products, such as Murabaha, Musharaka and Mudharaba. The traders maintain that while their contemporaries in conventional banks complain of high interest rates and bank charges, their loan repayment instalments are fixed with the cost of borrowing agreed with the customer in advance making them cheaper and more effective sources of finance.

2.2.3. Innovative Product Portfolio

The growth of Islamic financial industry cannot be achieved without having viable and attractive product to attract the players in the market. Islamic financial institutions have to be creative in coming up with the products which are Sharia compliant and at the same time attractive and competitive. According to Laldin (2011), Islamic financial institutions in Malaysia offer more than 40 Islamic financial products and services that may be offered by the banks using various Islamic concepts such as Mudharabah, Musyarakah, Murabahah, Bai’ BithamanAjil (Bai’ Muajjal), Ijarah, Qardhul Hasan, Istisna’ and IjarahThumma Al-Bai’. These help the banks meet and satisfy the needs of a wide range of customers.

The three main types of Shari’ah-compliant retail financing products use different contracts between the bank and customer with the contracts differing regarding ownership of the goods, nature of payments, and sharing of profit and loss. Instead of charging interest, the banks charge administrative and management fees that cover their costs and provide them a profit margin (Nawawi, 1999). According to Hunt (2007), all three contract types can be used for home financing, although the ijara and musharaka contract forms are the most commonly used.

According to Nawawi (1999), most Islamic banks also offer two unique profit-free financing types to individuals. Hajj financing which is provided for Muslims wishing to participate in the Hajj, the annual religious pilgrimage to Mecca (all followers of Islam who are physically able and can afford to do so are required to make the pilgrimage at least once during their lifetime) is typically unsecured and may require only evidence of the customer’s travel plans (Nawawi, 1999). The second unique product to Islamic
banking is qardalhasan (or qardhasan) a profit-free financing funded by the bank and based on the applicant's hardship or charitable need. According to Hunt (2007), Hajj and qardhasan financing reflect the ethical role of Islamic banks.

2.3. Strategies Used by Islamic Banks
The beginnings of the foundations of strategy thinking can be traced to Chandler (1962) who described strategy as the determination of the basic long-term goals and objectives of an enterprise, and the adoption of courses of action and allocation of resources necessary for carrying out these goals. Andrew (2003) added the ideas of distinct competence, company mission and business definition.

Ansoff (1965), states that strategy is the common thread, which is arrived at through the use of product-market scope. Mintzberg (1994) defines strategy as a pattern in a stream of decision and actions. He describes strategy using 5p’s: plan, pattern, ploy, position, and perspective. Johnson et al. (2005) defined strategy as the direction and scope of an organisation over the long-term which achieves advantages in a changing environment through its configuration of resources and competences with the aim of fulfilling stockholder expectations.

Porter (1980), in his book competitive strategy, reinterpreted the microeconomics of industrial organisation in a managerial context. His subsequent book, Competitive Advantage (1985) uses resource based view of the firm to build barriers and sustain monopolistic structures. Strategy is therefore a tool, which offers significant help for coping with the turbulence often faced by business firms.

Being a nascent idea, Islamic banking has the potential for attracting new customers and, consequently, enhancing a bank’s market share. This phenomenon may explain the increase in the branches of some Islamic banks, e.g. the Faisal Islamic Bank which has established many branches in one country and then moved to expand to other different countries (Garbois et al., 2012). On the negative side, however, this high potential for expansion would motivate new entrants to the industry, and, as a result provoke stiff competition.
2.3.1. Focusing on Competition and Increasing Efficiency

Efficiency measurement is one method of investigating a firm’s performance. According to the European Central Bank (2010), efficiency can be measured in three ways; maximisation of output, minimisation of cost, and maximisation of profits. Recent events have shown that the most common measure for a bank’s performance, i.e. Return on Equity (RoE), is only part of the story, as a good level of RoE may either reflect a good level of profitability or more limited equity capital making the measurement of efficiency crucial (European Central Bank, 2010).

In general, efficiency is divided into two components and a firm is regarded as technically efficient if it is able to obtain maximum outputs from given inputs or minimise inputs used in producing given outputs with the objective of producers here is to avoid waste (Kumbhakar and Lovell, 2003). According to Koopmans (1951), a producer is considered technically efficient if, and only if, it is impossible to produce more of any output without producing less of some other output or using more of some inputs. On the other hand, allocative efficiency relates to the optimal combination of inputs and outputs at a given price. According to Kumbhakar and Lovell (2003), the objective of producers might entail the following: to produce given outputs at minimum costs; to utilise given inputs so as to maximise revenue; and to allocate inputs and outputs so as to maximise profit.

Competition is increasing in the financial market in Kenya. According to Vayanos et al (2008), in many markets, Islamic banking has evolved from being a niche offering into being part of the mainstream financial services landscape and at the same time, the competitive landscape is being redrawn, with more Islamic financial services institutions in the marketplace than ever before. Competition is good because it ensures that the costs of production are minimised and at the same time it promotes efficiency (Nickell, 1996). Increased competition could force banks to operate more efficiently in order to survive. According to Nickell (1996), increased competition forces banks to produce products and provide services that are most demanded by the customers. Mokhtar et al (2008) conducted a study to empirically investigate the efficiency of fully fledged Islamic banks as well as Islamic windows and conventional banks in Malaysia. The findings showed that although the fully fledged Islamic banks were more efficient than the Islamic windows, they were still less efficient than the conventional banks (Mokhtar et al., 2008).
In this highly competitive environment, marketing strategies are the most important decisions that need to be carefully examined by Islamic banking institutions’ policy makers. A sound marketing strategy appears imperious as Islamic banking institutions not only operate in an environment where service quality and financial returns are perceived as the essential criteria from customers’s point of view. In Malaysia, due to globalisation, Islamic banks are now facing ever-increasing competition, particularly from the conventional banks which offer Islamic banking through their windows or subsidiaries (Mokhtar, Abdullah, and Alhabshi, 2008).

Islamic banks must also compete with conventional banks which are known to have more banking experience and expertise (Henry and Wilson, 2004). Religion, once thought to be the major factor that drove Muslims towards the Islamic mode of banking has now become irrelevant to Muslim customers (Cunningham, 2005). Coupled with an increasingly competitive environment both in the industry and the changes in customers’ perception, it is of paramount importance for Islamic banking institutions to assess the effectiveness of their marketing strategy (Al-Omar and Abdel-Haq, 2006).

2.3.2. Development of Islamic Capital Markets and Consumer Awareness

Kadir (2005), states that the creation of Islamic money market and capital market are another landmark development in the area of Islamic finance. A wide range of instruments have been developed to facilitate the effective management of liquidity and funding by the Islamic financial institutions (Kadir, 2005). This has facilitated the smooth flow of funds in the Islamic financial system. The encouraging development in the ICM has encouraged major Islamic banks to issue sukuk (Islamic bonds).

Consumer education and awareness about Islamic banking is critical to its success and future development. A consumer education program needs to be developed to enhance public awareness of the features of Islamic banking products and services (Aziz, 2005). The table below compares ICM products and services with conventional market products.
Islamic banking institutions offer products that address not only the needs of Muslims but anyone in the society including individuals and corporations. Among the customers of Islamic banking institutions include men, women, Muslims, non-Muslims, students, business people and companies (The Banker, 2008).

Non-Muslim investors have also begun to look for less risky alternatives since the onset of the global credit crisis over a year ago cast doubt on many Western risk management practices (Seidu, 2009).

### 2.3.3. Enactment of Islamic Banking Law

Ensuring adequate and comprehensive legal infrastructure. According to Mahmood (2005), the enactment of an Islamic banking law is an important part of this process. For conventional banks offering Islamic banking products, amendments to the existing banking legislation may be necessary to allow such banks to undertake trade-related activities and other multi-faceted functions. The investment policy of the Government may need to be reviewed to provide for the issue of Islamic investment instruments to facilitate the liquidity operations of such banking institutions (Musa, 2007). In addition, a legal fraternity that is competent in both Sharia and civil laws is very important including the tax legislation that accord neutrality in treatment between Islamic and conventional banking products (Mahmood, 2005).

Islamic banking institutions are growing fast not only in the Muslim world but also in countries that have Muslim minorities (The Banker, 2008). According to Benaissa, Jopart, and Tanrikulu (2007), buoyed by the potential and the growing of the assets of these Islamic institutions, regulations are being put in place which tries to balance religious
conformity with the economic reality that they offer. Many countries, both Islamic and non-Islamic, are putting ambitious infrastructure programs and regulations aimed at establishing Islamic banking institutions hence attracting part of the huge assets available in the sector. Countries are developing comprehensive changes in their banking laws and acts to fit the Islamic banking system in their existing banking environment (Hisham, Samaun, and Rohani, 2008). Even countries that once opposed the establishment of Islamic financial institutions on their soil are now enacting laws to allow such institutions to operate; these include Italy, France and Australia. Even the United States, which has long opposed amending laws or creating new ones especially for Islamic banking, announced in 2009 that it is considering using Islamic banking to fight the global crisis, according to the US Secretary of the Treasury Robert Kimmitt (Nasser, 2009).

In Italy, though a non-Muslim country, regulations and mechanisms are being put in place by the government to attract Islamic financial institutions to enter the Italian market. Bakkar (2008) notes that an effective legal infrastructure is important for the development of any type of industry in any country, especially in the Islamic finance sector which he considers to be enjoying a renaissance.

In France, the government requested the Paris financial markets authorities to produce a report analyzing the necessary measures in order to make this marketplace a competitive one worldwide in the provision of Islamic products and services in April 2008. A month later, the Senate hosted roundtable discussions with politicians, bankers and Shariah experts to discuss how to support Islamic finance and banking by raising awareness and changing the legal, banking and fiscal framework (Ramadier, 2008). Big GCC Islamic banks such as the Qatar Islamic Bank (QIB) and DIB open Islamic banks both in the Muslim and western countries to also facilitate investment opportunities for both individual and corporate investors who want to invest in a Shariah-compliant manner in these countries. In France, the first French Qatari Islamic bank is set to open in 2010 (Souilem et al. 2009).

Elsewhere in the world, Central Banks have already put mechanisms and amendments in their Banking Acts to allow the operation of Islamic banks and Islamic banking windows in conventional banks (Bakkar, 2008). In England, the government has taken important measures to promote Islamic banking and finance. Following the same, the Bank of
England through the Financial Services Authority (FSA) authorised the Islamic Bank of Britain, the first wholly Islamic retail bank in a non-Muslim country (Ainley et al., 2007). England today has four Islamic banks (Watts, 2008).

Over the world, Central Banks have paved the way to allow more than 180 Islamic banks and other financial institutions to operate by issuing them licenses (Haque et al., 2009). In Malaysia for example, the Bank Negara Malaysia (BNM) which is the Central Bank had by 1983 put in place the Islamic Banking Act. Under the Islamic Banking Act, the BNM has licensed more than 8 Islamic banks to both local and foreign banks. In addition, the BNM has approved the opening of many Islamic banking windows and subsidiaries to conventional banks (Rosly, 2005).

2.4. Challenges Faced by Islamic Banks

2.4.1 Risk Management Strategies and Corporate Governance

Islamic banks face crucial challenge to improving their risk management strategies and corporate governance. Presently, Islamic banks are extremely exposed to all sorts of risks, such as those relating to interest rates, liquidity and non-payment (Garbois et al., 2012). According to Hobson (2006), sukuk issues entail risks involving interest rates, foreign exchange, credit and Sharia compliance while Islamic banks cannot use conventional risk management techniques and tools because they are based on interest, gambling and speculation, which are prohibited by Sharia.

Islamic banks are haunted by the chronic problem of excess liquidity. According to Islamic Finance News, 2006), they carry about 40% more liquidity than their conventional counterparts because there is a serious dearth of long-term Sharia-compliant investment tools and avenues. They commit 95% of their funds to short-term ijarah, murababah and musharakah instruments (Islamic Finance News, 2006). In the given context, good governance can greatly help to streamline the organisational structure of Islamic banks on a more efficient and democratic basis (Alvi, 2006). According to Garbois et al (2012), many Islamic banks are considerably smaller than their conventional competitors in their domestic markets. Moreover, even the biggest Islamic banks are typically small compared to international conventional competitors. There is no Islamic Citibank or Islamic Goldman Sachs—that is, no global pure-play Islamic banking leader with a broad or specialised business model (Garbois et al., 2012).
2.4.2 Human Capital

Islamic banking is a very fast industry that does not lack capital but expertise and uniformity (Laidi, 2009). As the sector continues to grow, it is becoming increasingly important for banks to ensure that their employees receive the training and resources to follow both Sharia principles and traditional compliance laws. Banks must act now to provide documentation and training for their employees. It is only with a knowledgeable, educated staff that Islamic financial institutions can survive and compete (Eagle, 2009). In their research, Haji et al (2009) present evidence that one of the main challenges of Islamic banking is the lack of expertise to perform the Shariah Review. Most of the time, auditors lack the Shariah background and the Shariah employees lack also the experience and training to perform effective and efficient Shariah-compliant operations.

There has been an acute shortage of human capital resources in the Islamic banking industry. Islamic banking personnel are largely drawn from conventional banking. They are neither properly trained nor devoted to learning and practicing Sharia-compliant banking. They are interested only in eliminating interest from Islamic banking operations without realising the true objective behind this exercise (Adulmalik, 2006). According to the executive director of the International Sharia Research Academy for Islamic finance, Mohamad AkramLaldin, 80% of Islamic financial products are merely Islamised versions of conventional ones (BBC, 2012). Incumbent banks and new market entrants are facing vastly different market conditions and need to develop new sources of differentiation beyond compliance with sharia to compete or remain successful in the future (Vayanos et al., 2008).

There is a serious shortage of competent Sharia experts in the Islamic banking industry. Only a small group of Sharia experts is serving on several Sharia boards of Islamic banks worldwide. Majid Dawood a London-based consultant on Sharia compliance pointed out that Sharia experts earn as much as US$88,500 per year per bank (Matthews, 2005). In some cases, they charge up to US$500,000 for advice on large capital market transactions (Tett, 2006). At present, there are simply not enough people with the requisite skills available in the marketplace. This situation exists at all levels in financial services institutions, but is particularly prevalent at the sharia board level. It takes many years of education and practical experience to become a sharia scholar. As a consequence, there
are few scholars available and many of them sit on multiple boards, raising the inevitable issue of conflict of interest (Booz et al., 2006).

In England where the Islamic finance is the most developed in Europe, it has been widely acknowledged that there is a shortage of qualified professionals in the Islamic finance sector. There is need for a clear scope for more education and training in the field (The Economist, 2008). In response to this, universities have designed degrees and professional training programs (Ainley et al., 2007). Iqbal et al (1998) pointed out the issues of under-qualified employees and their training. They noted that most of the managers in Islamic financial institutions were not very well trained in the use of Islamic modes of finance.

Most professional and training courses tend to be geared towards conventional banking rather than Islamic banking. In reality, there is a limited number of institutions and schools which offer training for Islamic institutions (Karbhari et al., 2004). So, after properly documenting all policies and procedures, there is need for Islamic financial institutions to educate their personnel to understand the principles of Shariah. However, training for employees on both general and Islamic banking principles does not have to be a costly or timely expenditure. ELearning is a cost effective way to educate employees on general banking principles, as well as on Islamic banking law (Eagle, 2009). Eagle added that by providing eLearning training to its employees, a financial institution will eliminate the need for costly and time-consuming in-house training. ELearning eliminates or greatly reduces the cost of travel, instructor time, materials and lost work days. ELearning provides a program that can be used for refresher training and new-hire training. Many larger conventional banks have a specialized function to educate employees and ensure on going adherence to Islamic principles (Hunt, 2007).

Training will not only help bank employees to become familiar with general banking principles, it will also teach them about the complex regulations that apply to Islamic products and services. Through these training programs, employees will gain the knowledge and tools needed to benefit the customer-banking relationship (Eagle, 2009).

### 2.4.3 Lack of Standardisation

A lack of standardisation represents another hurdle the sector is facing. For an industry that is supposed to be built on ethics, there are questions about the integrity of some of its
products. As a result, merely being Sharia compliant is not a major differentiator with standardisation and regulation presenting ongoing challenges for Islamic banks (Garbois et al., 2012). According to Hemed (2009), different interpretations of the acceptability of various products from a Sharia perspective makes standardisation difficult. For example, the same Islamic financial instrument can be rejected by one Sharia board and approved by another, as the Sharia rulings of these boards are based on their understanding of the underlying Sharia principles (Hemed, 2009).

Geographic differences also exist, and even within one country, different sharia boards may deliver different interpretations. Unless standardisation of the regulatory framework of Islamic banking is significantly improved, sharia arbitrage will continue to exist and grow. Sharia approval will be obtained by banks in a manner that best suits customers’ needs and the circumstances of individual products or transactions. The absence of universal standards, and the lack of transparency regarding the application of sharia, places a huge burden on the marketing of Islamic financial services (Benaissa et al, 2005).

2.4.4 Government Regulation on Islamic Banking

In Kenya, the Central Bank of Kenya and the government has the challenge of opening up the market and changing the Banking Act and Prudential Guidelines to reflect this new reality as has been done in South Africa, Europe, the United States, Canada, the Middle East, Far East and Australia (Hemed, 2009). Kenya has the potential of becoming like Bahrain, the centre of Islamic banking in the region. The involvement of the Islamic Development Bank, PTA Bank, IFC and Islamic banks and investors in the Middle East is important to turn this into a reality. The regional market is huge as both Muslims and non-Muslims welcome this form of banking that is transparent, and offer caring partnership and free from the uncertainty of interest rate fluctuations (Central Bank of Kenya, 2009).

In many non-Muslim countries, Islamic and conventional banks are not on a level playing field, as there are numerous legal and tax restrictions that make it difficult for Islamic banks to compete. For example, in many jurisdictions, Islamic real estate financing through the diminishing musharaka technique leads to a double taxation, with conveyance duty on the acquisition of the real estate (Khan and Bhatti, 2006). In addition to that, the challenge facing Islamic banks is not only to offer products that cover the same scope as
those of conventional banks, but also to ensure that their products are different from those of their Islamic peers. In this regard, having a well-honed product development capability is paramount (Dusuki and Abdullah, 2007).

2.5. Chapter Summary

This chapter has looked at literature in the field of Islamic banking, in terms of the growth of Islamic banks, the strategies it employs and the challenges it faces. Most of the literature illustrated that Islamic banking, being a niche market has a potential for growth. Islamic banking refers to Sharia-compliant tools and mechanisms to replace interest-based financial intermediation with the risk-sharing and interest-free paradigm. It primarily relies on equity modes to conduct its affairs. This ensures the most efficient, ethical and equitable use of economic resources of the polity.

From literature presented in the chapter, it has been noted that Islamic banks have been making good progress but at the same time also facing some teething problems and challenges. The problems and challenges of Islamic banks cannot be effectively dealt with unless the leadership of Islamic banking becomes truly committed and competent.

The following chapter describes the methods and procedures used to carry out the study by paying emphasis to research design, population and sample design, data collection methods, research procedures and data analysis methods.
CHAPTER THREE

3.0 RESEARCH METHODOLOGY

3.1 Introduction
This chapter provides the methodology used in the study. It identified, defined and provided justification for the research design used in the study. It also discusses the data collection instrument and population that were identified along with sampling frames, techniques and the size for the study and lastly the data analysis methods that were employed.

3.2 Research Design
The research design used in this study was descriptive. A descriptive study is a study with clearly stated investigative questions. The research objective in a descriptive study is to describe the phenomena or characteristics associated with a subject population i.e. the who, what when, where and how of a topic, estimates of the proportions of a population that have certain characteristics, discovery of associations among different variables and discovery and measurement of cause and effect relationships among variables (Cooper and Schindler, 2003). A descriptive study was justified as it attempted to describe the characteristics associated with the subject population and based on the findings of the study; discovery of associations among different variables arose thus enabling the researcher to draw conclusions.

Descriptive studies/research in contrast to exploratory studies is more formalised and typically structured with clearly stated hypothesis or investigative questions (Cooper and Schindler, 2003). The goal of this study was to answer the research questions posed and not to develop hypothesis or questions for future research tasks. Formal studies such as descriptive studies also try and discover associations among variables. This is sometimes labelled correlational study, a subset of descriptive studies (Saunders et al., 2000).

This study used cross-sectional research because some types of information once collected cannot be collected a second time from the same person without the risk of biases. While longitudinal research is important and can be used in this study, the constraints of budget and time imposed the need for cross-sectional analysis.
The dependent variable for this study was the emergence of Islamic banks in Kenya (focusing on Gulf African Bank) while the independent variables were; factors influencing growth of Islamic banks, the strategies and the challenges being faced by Islamic banks.

This design was adopted as the suitable research design because it facilitated the collection of original data necessary to realise the research objectives. The design was also appropriate in collecting useful data that could be quantified and reported as a representation of the real situation or characteristic in a study. In the same order, Pervez and Kjell (2002) commented that the key features of a descriptive research are structure, precise rules and procedures. Further, Cooper and Schindler (2008) defined a descriptive study as versatile and popular in business research.

3.3 Population and Sampling Design

3.3.1 Population

The population is the entire group of individuals, events, or objects having a common observable characteristic. For GAB, the population represents the total number of customers in all its branches countrywide which is estimated at 100,000 (Business Daily Africa, 2013). According to Tull and Hawkins (2008), a population is the group the researcher wants to generalise or learn about whereas Cooper and Schindler (2008) define a population as the total of the elements upon which inferences can be made.

A population is therefore the total collection of all elements about which one wishes to make some inferences (Cooper and Schindler, 2003). The target population in this study were customers of GAB. In addition the study also relied on secondary data from the conventional banks that are operating in Kenya. GAB has a customer base of 100,000 nationally (Business Daily Africa, 2013). The Westlands branch in Nairobi from which the respondents who took part in this study were drawn had more than 8,000 customers.

3.3.2 Sample Design and Sample Size

The basic idea of sampling is to select some elements of the population that will help the researcher to draw conclusions about the same entire population. Sampling presents benefits. It has the advantages of lower research costs, greater accuracy on the obtained results, greater speed of the data collection and the availability of the required population
elements (Cooper and Schindler, 2008).

3.3.2.1 Sampling Frame
A sample frame is the list of elements from which the sample is actually drawn. Ideally it is a complete and correct list of population members only (Cooper and Schindler, 2003). The sampling frame used in this study was a list of existing customers of GAB. The list of the existing customers was provided by the branch manager of GAB, Westlands Branch.

3.3.2.2 Sampling Technique
Probability sampling is based on the concept of random selection – a controlled procedure that assures that each population element is given a known chance of selection (Cooper and Schindler, 2003). There are various ways of probability sampling, these include; stratified sampling, systematic sampling, simple random sampling, cluster or multistage sampling and probability proportional to size sampling.

Simple random sampling was used for this research so as to increase the sample’s statistical efficiency and to provide adequate data for analysing the various subpopulations. A sample is a smaller but hopefully representative collection of units from a population used to determine truths about that population (Field, 2005). Simple random sampling is applicable when population is homogeneous and readily available.

3.3.2.3 Sample Size
While the population is the larger set of observations, the smaller set is referred to as the sample. How large a sample size should be is a function of the variation in the population perimeters under study and the estimating precision needed by the researcher (Cooper and Schindler, 2008). A sample size of 100 existing customers was selected out of a population of 8,000. The sample elements consisted of 100 existing customers within the Westlands branch Nairobi. They were selected at random depending on their willingness to participate in the research study.

Inappropriate, inadequate, or excessive sample sizes can influence the quality and accuracy of research (Bartlett et al. 2001). The goal of survey research is to collect data that is representative of a population. According to Holton and Burnett (1997), one of the real advantages of quantitative methods is their ability to use smaller groups of people to
make inferences about larger groups that would be prohibitively expensive to study. The study sample size of 100 represents just 1.25% of the population of the Westlands branch customers. However, the researcher felt this sample size to be sufficient as categorical variables such as gender, level of education, income and age of the respondents was taken into consideration meaning that the sample size despite its small was deemed representative of the bank’s customers both countrywide and in the Westlands branch.

3.4 Data Collection Methods
The data was collected using a survey method. A survey is a means of questioning a respondent via a collection for questions and instruments for both the respondent and the interviewer (Cooper and Schindler, 2003). The instruments used in survey can be either in the form of questionnaires or interviews. Questionnaires are generally less costly, less time consuming, and considerably less demanding with respect to such matters such as selection, training, and supervision of personnel. Being more uniform and standardised than interviews, questionnaires are also less susceptible to biases due to deviations from instructions and method of administration (Cooper and Schindler, 2005). Finally, confidentiality and anonymity can be more effectively insured through the use of questionnaires.

Questionnaires can therefore be used for descriptive or explanatory research. Descriptive research, such as the one being undertaken using attitude and opinion questionnaires and questionnaires of organisational practices, will enable one to identify and describe the variability in different phenomena (Saunders et al., 2000).

The questionnaire was thus the main instrument used to collect data for this study. The questionnaire developed contained both structured and unstructured questions. The questionnaire consisted of two sections: section one was focusing on the respondent’s demographics; their gender, age, employment status, education level, religion and income levels. Section two of the questionnaire is designed to rate some statements pertaining to Islamic banking systems. The section was developed using the key variables identified as factors influencing customers in the selection of Islamic banks. Unlike section one where the questions required direct answers, the questions in section two relied on a Likert scale. The use of Lickert scales presents a simple way of gauging specific opinions and also enables the measurement of broader attitudes and values (Johns, 2010).
3.5 Research Procedures

Pilot test is conducted to detect weakness in design and instrumentation and to provide proxy data or selection of a probability sample (Cooper and Schindler, 2003). A pilot test of the questionnaire was done whereby five existing customers of GAB chosen at random responded to the questionnaire. The Branch Manager handed out the questionnaire to customers from the Westlands branch of GAB. The reason of doing this was to obtain feedback on any weaknesses and errors on the questionnaires. The questionnaires were then reviewed based on the comments and suggestions of those who responded to the pilot test.

After the pilot test, the instruments were fine-tuned and redesigned on the basis of the feedback that the researcher received. In terms of validity, both content and criterion-related forms of validity were undertaken. On the other hand, stable reliability was considered before actual research was undertaken. The final version of the questionnaire included in the appendix of this report was later administered to the respondents selected in the sample size excluding the respondents who participated earlier in the pilot test.

The questionnaires were given to the Branch Manager who handed them out to customers over a period of 10 days beginning on the 14th of August 2013. The researcher and the Branch Manager had consulted to ensure that the questionnaires were given to a wide cross-section of customers in order to gather responses that were as representative of the banks body of customers as possible. A total of 68 respondents responded to the questionnaire. The filled questionnaires were returned to the branch from where they were collected by the researcher.

3.6 Data Analysis Methods

An in-depth quantitative analysis of the content of the responses will be carried out. The structured data was analysed using Statistical Package for Social Scientists (SPSS) computer software package. Thereafter, the data was cleaned to ensure completeness of the information obtained. The collected data was statistically analysed using Microsoft Excel program and the Statistical Program for Social Scientists (SPSS) and presented in tables and figures to give a clear picture of the findings at glance. These aided in making comparisons based on the factors that influence the growth of Islamic Banks in Kenya.
3.7 Chapter Summary

This chapter has detailed the proposed research method, giving a description of the research design, population and sampling design, data collection method, research procedures. The population and sample size was also discussed. Justification was provided for the sample size that was used in the end. This was pertinent as it is imperative that the research reflects the views of the bank’s customer base. The chapter also indicated how the data was analysed using Excel and SPSS and presented on the form of charts and tables. The next chapter presents the study results and findings based on the research questions.
CHAPTER FOUR

4.0 RESULTS AND FINDINGS

4.1 Introduction

This chapter presents the results of the research that was conducted on the emergence of Islamic banks in Kenya. The data was gathered using the questionnaire that was administered among GAB customers.

The study targeted 100 customers out of whom 68 responded to the questionnaire, thereby having a response rate of 68%.

Table 4.1: Questionnaire Response Rate

<table>
<thead>
<tr>
<th>Response Rate</th>
<th>Distribution</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Frequency</td>
<td>Percentage</td>
</tr>
<tr>
<td>Questionnaires Returned</td>
<td>68</td>
<td>68%</td>
</tr>
<tr>
<td>Questionnaires Not Returned</td>
<td>32</td>
<td>32%</td>
</tr>
</tbody>
</table>

4.2 Demographic Information

Demographics are characteristics of a population that are used in research exercise such as the one included in this dissertation (Pennsylvania State University, 2006). The demographic information was included in the questionnaire in order to ensure that valid and useful results were obtained and to ensure that the respondents were fairly representative of stakeholders that is GAB’s customer base. The demographic information on the questionnaires spanned the gender and age of customers, their occupation, their academic qualifications and their religion and income levels.

4.2.1 Gender and Age of Customers

The first question on the questionnaire addressed the age and gender of the respondents. It was considered important to investigate the gender and age of the customers surveyed. This was done to ensure that the sample were representative of the variation in gender and age of customers of GAB both within the Westlands branch and countrywide.

The 68 respondents included 21 women (31%) and 47 men (69%). 5 of the respondents representing 7% of the group were over 50 years of age. 16 respondents (24%) were aged
between 40-49 years, 28 respondents (41%) were aged between 30-39 years, 17 respondents (25%) were aged between 20-29 years while 2 respondents (3%) were less than 20 years old.

The gender and age of the respondents are presented in the graph below. There are less women respondents could be because of the fact that women have lesser rights to wealth and property. The figure correlates to the estimation of the World Bank (2011) that only 39% of Kenyan women above the age of 15 have got access to bank accounts. With the variations recorded in the age and gender from the respondents, the sample used can be said to be representative of GABs customers within the branch and countrywide.

![Figure 4.1: Gender and Age of Respondents](image)

### 4.2.2 Occupation of Respondents

The occupation of the respondents was investigated in order to ensure that they were representative of GAB’s customer base with self-employed, private sector employed and government sector employed people being proportionally represented.

The respondents included 3 students (4%) of the sample and are classified under other occupations in the results presented below. The majority of the GAB customers surveyed were self-employed. Self-employed respondents numbered 50% of those surveyed. Private sector employed respondents totalled 29% while 11% were government sector employed. Retired people represented 4% of the respondents.
The respondents with their employment backgrounds are representative of GAB’s customers as well as the Kenyan population. According to the Kenya National Bureau of Statistics (2012), 10% of the Kenyan population are government sector employed while 67% are employed in the private sector. This figure for private sector employed individuals may include self-employed people. Accurate figures for those who are self-employed or retired was not available. The respondents are disaggregated by occupation in the graph below.

![Occupation of Customers](image)

**Figure 4.2: Respondents disaggregated by Occupation**

### 4.2.3 Academic Qualifications

The academic qualifications of the respondents were also investigated in the questionnaire. This was seen as important as it would help provide some background information on the respondents and would help explain some of the responses that they have provided to the questions that were put to them.

A total of 24 respondents (35% of the sample) were holders of Bachelor’s degrees. A further 17 people (25%) had diplomas or post-secondary certificates while 12 people (18%) had masters degrees or above. Only 5 respondents representing 7% of the total number of GAB customers surveyed had educational qualifications less than high school.
The educational level of the respondents taking into consideration the number of holders of Bachelor’s degrees, Masters degrees and above and diploma or post-secondary certificate is higher than the Kenyan average. This could be put down to the fact that bank accounts in Kenya are mostly held by people who belong to the middle classes. Indeed Chase Bank, one of the banks that offers Islamic bankingservices in Kenya targets the middle class and growing SME sector (Global Alliance for Women, 2013). Despite the higher than average academic qualifications, the sample can still be said to represent GAB customers.

![Academic Qualification of Customers](image)

**Figure 4.3: Academic Qualifications of Respondents**

### 4.2.4 Religion and Income Levels

The last of the demographic questions addressed by the questionnaire. The purpose of the question was to ensure that the views of people from different income brackets were captured and to investigate if GAB services were accessed by non-Muslims.

Of the 68 respondents, only 2 were non-Muslim. The highest income bracket captured is those who earn more than Kshs 130,000 per month where 29% of the respondents fall. The lowest income bracket was less than Kshs 10,000 and 6% of the respondents reported to earn this amount. A further 25% of the respondents earn between Kshs 10,000 and Kshs 40,000 per month, 14% earn between Kshs 40,000 and Kshs 70,000 per month.
The incomes shown in the pie-chart are well above Kenyan’s average monthly incomes. 29% of the respondents had a monthly income above Kshs 130,000. This figure could be attributed to the self-employed respondents who represented 50% of the sample. To this may be added the fact that 53% of the respondents held Bachelor’s degrees or Masters degrees and above.

In terms of religion, although only 2 out of the 68 respondents were non-Muslim, it shows that there is a level of awareness that the bank’s services are not only targeted at Muslims. This is confirmed by the GAB publicity material. According to Gulf African Bank (2012), Islamic finance is available to anyone who may wish to use interest free banking with anyone of any religious background being welcome to apply for products from Islamic banks.

![Pie Chart: Customers' Incomes](image)

**Figure 4.4: Respondents' Income Levels**

### 4.3 Factors Influencing the Growth of Islamic Banks in Kenya

This section is designed to address the first research question concerning the factors influencing the growth of Islamic banks in Kenya. While the factors investigated apply specifically to GAB since it commenced operations in Kenya in 2008, they can also be extrapolated to explain the expansion of the Islamic banking sector in Kenya.
4.3.1 Account Types

The respondents were surveyed on the type of accounts that they operate with GAB. The results are shown in the table below. The respondents either had one account or two accounts with the bank.

The respondents were surveyed on the type of accounts that they operate with GAB. This subsection of the questionnaire was targeted at investigating the behavioural information provided by the respondents. The results are shown in the table below. Their responses can be used to help explain the significant growth of GAB since it made its entry into the highly competitive Kenyan financial market.

According to the results, respondents either had one account or two accounts with GAB. 41 customers representing more than 60% of the sample held single accounts. Out of this number, the Hajj account was the most popular. A total of 10 customers (15% of the total number of respondents) held a Hajj account. A further 9 (13% of the total respondents) had a current account. The savings account and the time deposit account both had 8 customers each representing 12% of the respondents. Out of the respondents with two accounts, the most popular combination was the current and Hajj accounts which had 8 customers representing 12% of the sample of respondents. Current and savings accounts were held by 10% of the respondents.

The most common response to the question addressing the reason respondents had more than one account were that it enabled customers to hold accounts with different types of services and products.

Current accounts, saving accounts, time deposit accounts emerged as the most common accounts held by the respondents. This was true of respondents who had single accounts as well as those with two accounts. These types of accounts are also available in conventional banks suggesting that respondents opened them with GAB due to the fact that the bank offers Shariah compliant services which represent an attractive proposition for those seeking to operate accounts with institutions that offer new sources of differentiation to mainstream services. The Hajj and Anisaa accounts are only offered by fully fledged Islamic banks and banks that offer Islamic windows explaining respondents opened these two types of accounts with GAB. These Hajj and Anisaa accounts can be said to add to the bank’s product portfolio.
The question and the answers offered by the respondents addressed consumer behavior. According to Peter and Olsen (2005) consumer behavior is the process, thoughts, feelings and actions related to a consumption process and is the dynamic interaction of the individual in the environment by which the human being conducts exchange aspect of their lives. It is therefore important for banks such as GAB that are seeking to both expand and retain their customer base to take this into account to enable them to offer services that are responsive to their customers’ needs.

### Table 4.2: Types of Accounts Held by Respondents

<table>
<thead>
<tr>
<th>Type of Account(s)</th>
<th>Frequency</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current Account</td>
<td>9</td>
<td>13</td>
</tr>
<tr>
<td>Savings Account</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Time Deposit Account</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Hajj Account</td>
<td>10</td>
<td>15</td>
</tr>
<tr>
<td>Anisaa Account</td>
<td>6</td>
<td>9</td>
</tr>
<tr>
<td>Current and Savings Accounts</td>
<td>7</td>
<td>10</td>
</tr>
<tr>
<td>Current and Time Deposit Accounts</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>Current and Hajj Accounts</td>
<td>8</td>
<td>12</td>
</tr>
<tr>
<td>Savings and Hajj Accounts</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Current and Anisaa Accounts</td>
<td>5</td>
<td>7</td>
</tr>
<tr>
<td>Savings and Anisaa Accounts</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>68</strong></td>
<td><strong>100</strong></td>
</tr>
</tbody>
</table>

4.3.2 Rating of GAB Services and Customer Awareness of Services

The question on respondents’ rating of the services and customer awareness of services was also used to investigate the factors that have contributed to the growth of Islamic banks in Kenya. The subsection is targeted at obtaining attitudinal information from the respondents. Attitudinal information describes how a person thinks or feels about something like a service offered (Radi and Erol, 1989).

A total of 36 out of 68 representing 53% of the respondents rated the services they receive from the bank as excellent. 32% of the respondents felt the services were good while
another 15% rated the services as OK. None of the 68 respondents rated the services as poor or very poor two further options which were also included in the questionnaire. Additionally, all of the respondents were aware of the products that GAB has to offer its customers. 40 customers representing 60% of the respondents said that they strongly agreed that they were aware of the bank’s services. The remaining 40% agreed that they were aware of the services.

Customer satisfaction is one of the factors that are critical for banks that are seeking to retain their existing customers and to attract new ones. The fact that 53% of the respondents ranked the services they receive as excellent and that a further 32% felt that GAB services were good augur well for the bank. While the numbers of customers who rank the services as excellent can be improved further, the results obtained here should provide a platform for GAB and other fully fledged Islamic banks to retain their current customers and even attract customers who are disgruntled with the services offered by conventional banks. All of the respondents were described themselves as either strongly aware or aware of the bank’s services. While this is to be expected due to the differentiation between the services offered by GAB and those offered by conventional banks it also illustrates that the bank has marketed itself well among its customers.

The respondent’s replies to the question on the quality of GAB services are shown in the graph below.

The results illustrated below show that the respondents were aware of the GAB brand and were also satisfied with the services offered by the bank. According to Upshaw (1995), a brand is a source of promise to customers promising relevant differentiated benefits or a unique value proposition making it critical that the promise or proposition be delivered consistently at each point of customer contact, time after time. According to the results obtained, GAB appears to be fulfilling these satisfactorily.
4.3.3 Main Reasons for Opening an Islamic Bank Account

This represented another question aimed at investigating the factors that influence the growth of Islamic banks in Kenya. Investigating the main reasons that customers had for opening an Islamic bank account can explain directly the growth that has been experienced in the country’s Islamic banking sector.

For the respondents, religious considerations represented the main reason for opening an account with GAB by 26 people (38% of the sample). Better product portfolio was the reason offered by 22 respondents representing 32% of the total sample. Better customer service was the reason 10 customers 15% of those surveyed had opened an account with GAB. The remaining 4 respondents or 6% of the customers stated that their main reason for opening an account with an Islamic bank was other considerations. For all the respondents in the latter category, the reason given was the absence of interest rates.

The most prevalent reason offered for opening an account with an Islamic bank was therefore religious considerations closely followed by the product portfolio. These two reasons were proffered by 70% of the respondents. Customer service touched upon in the previous subsection addressing respondents’ rating of GAB services and customer

Figure 4.5: Quality of GAB Services
awareness was also important for 15% of the respondents. The most popular reason for opening an account with GAB obtained from the results of this research activity confirms the notion that Islamic accounts are popular for people who prefer their trading activities to be interest-free for religious reasons. The product portfolio’s importance is due to the fact that the bank offers accounts that such as the Hajj account and the Anisaa account are not available at conventional banks that do not operate Islamic banking windows. Combined, the two reasons i.e. religious considerations and a better, more responsive product portfolio are consistent with the basic principles of Islamic banking.

The results obtained in response to the main reasons for opening an account with GAB are captured in the graph below. The information obtained in this subsection can further explain the growth of Islamic banking in Kenya. The banks are popular with people from the religion who want access to Shariah compliant services that are not available in the conventional banking system. Utilised in marketing campaigns ad awareness raising drives, the findings can be used by the banks to expand their customer base as well as in determining how to retain existing customers.

![Figure 4.6: Main Motivations for opening an Islamic Bank Account](image)

**4.3.4 Other Accounts Held**

This subsection comprised another investigation of respondents’ behavioural information. 20 out of the 68 respondents stated that they hold parallel accounts with other non-Islamic banking institutions. This represents just less than 30% of the total number of
respondents. The most common reason given to explain this was the better network already put in place by these non-Islamic banks which tend to have more branches around the country making it easier for clients to access funds and services. These results show that Islamic banking institutions such as GAB may still be vulnerable to competition from conventional banks.

4.3.5 Reasons for Transacting with GAB

This subsection may be taken to represent a direct supplement to that which addressed the main reason customers opened an account with an Islamic bank. The respondents were asked to rate on a scale from 1 to 5 the factors that make them transact their business with GAB. On the scale in ascending order, 1 represents strongly disagree, 2 represents disagree, 3 represents neither agree nor disagree, 4 represents agree while 5 represents strongly agree.

The findings show that 50 respondents representing 74% of the sample strongly disagreed that profitability was the reason that they transact with GAB. 38 people representing 49% of the respondents strongly agreed that confidentiality was the reason that they transacted with the bank. Loan availability and bank reputation was the reason for transacting with GAB for 36 (53%) of the respondents and 30 (44%) of the respondents respectively. The results are illustrated in full in the graph shown below.

With the exception of profitability, there was not much variation in the responses obtained and illustrated in the graph. The responses to the research question concerning the factors that are influencing the growth of Islamic banks in Kenya show that for the customers of GAB bank, the most important of these include the account types i.e. a better product portfolio, the quality of services offered by the bank as well as religious considerations including the availability of Sharia banking, the availability of interest-free loans and confidentiality.
4.4 Strategies Adopted by Islamic Banks to Penetrate into the Kenyan Market

This section is designed to address the next research question concerning the strategies that have been adopted by Islamic banks to penetrate into the Kenyan market.

4.4.1 Bank Growth

The question in this subsection of the questionnaire looks at the areas in which the respondents felt that GAB had grown i.e. bank’s growth areas. The question was intended to gather attitudinal information from customers that can inform knowledge on these strategies. Respondents were therefore asked the main areas in which they felt the bank had grown. These include customer base, profitability and revenue.

According to the respondents, 34% either strongly agreed or agree that the bank was growing in terms of customer base. Comparative figures for profitability, revenue and product portfolio were found to be 39%, 63% and 60% respectively. Ranking these according to the answers provided by the respondents in terms of whether they strongly agree or agree on the areas in which GAB has grown, revenue ranks first followed by product portfolio, profitability and customer base in that order.
The table also contains other responses to the question on growth area including respondents who were neutral, disagreed or strongly disagreed.

The mean and covariance for the data represented in the table was also calculated. On a scale of 1 to 5 where one was strongly disagree and 5 was strongly agree, the mean was calculated at 3.59 for respondents who felt that the bank had grown in terms of customer base. The mean for profitability, revenue and product portfolio were calculated at 3.28, 3.87 and 3.66 respectively. The co-variances for the four areas were all calculated at positive values showing that the variables are positively related.

The growth of the bank in certain areas including customer base and product portfolio can be easily noticed by customers. These manifest themselves in lengthier queues caused by the bank having no customers and in the range of products that are available to the customers. Profitability and revenue however would represent information that would not be accessible for customers unless they saw the bank’s financial statements. This would mean that these two questions would have been better answered by the management of GAB.

Table 4.3: Respondents’ Perception of Bank Growth

<table>
<thead>
<tr>
<th></th>
<th>Strongly Agree</th>
<th>Agree</th>
<th>Neutral</th>
<th>Disagree</th>
<th>Strongly Disagree</th>
</tr>
</thead>
<tbody>
<tr>
<td>Customer Base</td>
<td>15; (22%)</td>
<td>22; (32%)</td>
<td>22; (32%)</td>
<td>6; (9%)</td>
<td>3; (4%)</td>
</tr>
<tr>
<td>Profitability</td>
<td>12; (18%)</td>
<td>14; (21%)</td>
<td>20; (29%)</td>
<td>15; (22%)</td>
<td>7; (10%)</td>
</tr>
<tr>
<td>Revenue</td>
<td>18; (26%)</td>
<td>25; (37%)</td>
<td>17; (25%)</td>
<td>10; (15%)</td>
<td>2; (3%)</td>
</tr>
<tr>
<td>Product Portfolio</td>
<td>23; (34%)</td>
<td>18; (26%)</td>
<td>12; (18%)</td>
<td>11; (16%)</td>
<td>4; (6%)</td>
</tr>
</tbody>
</table>

4.4.2 Current GAB Strategies

This subsection investigated the strategies that GAB is currently using to penetrate the Kenyan finance market. The strategies investigated were whether the bank was using civic education and advocacy with regards to the laws that currently govern Kenya’s banking sector.
A total of 27 respondents, about 30% of the total sample either disagree or strongly disagreed that GAB was using civic education targeted at existing and potential customers to penetrate the Kenyan market. A further 22 people or 32% of the respondents either agreed or strongly agreed that the bank was using civic education as a means to penetrate the market while 33 people representing 49% of the respondents disagreed and strongly disagreed that the bank was advocating for the change of Kenyan banking policies and laws. Of the remaining respondents, 17 representing 25% of the sample either agreed or strongly agreed that the bank was using advocacy as a strategy to penetrate the Kenyan market. A significant number of respondents gave “neutral” as their answer implying that they neither agreed nor disagreed that the bank was currently using the two strategies. A total of 21 people or 31% of the respondents were neutral on whether the bank uses civic education to penetrate the market. Slightly less than that number, 18 people or 26% of the respondents were neutral on whether GAB was using advocacy as a tool to penetrate the Kenyan financial market.

The answers provided by the respondents depend largely on whether or not they are aware of any strategies that are being utilised by the bank to increase its market share.

The responses on the strategies are presented in full in the graph below. Using the figures represented in the graph, the mean calculated for the strategies used by the bank using a scale of 1 to 5 was 2.87 for civic education and 2.70 for advocacy. Positive covariances were calculated for the two categories.

![Figure 4.8: Market Penetration Strategies used by GAB](image)
4.4.3 Future GAB Market Penetration Strategies

This subsection expands on the issues addressed in the previous section addressing the current strategies used by GAB to penetrate the market in Kenya. The GAB customers sampled were asked what strategies they felt GAB should adapt in future including better training of staff, civic education and awareness raising on Islamic banking, advocacy with the government for changes in the banking policies and laws and increasing the presence of the bank through the opening of more outlets than are currently available.

A total of 34 respondents representing 50% of the sample felt that civic education and awareness raising on Islamic banking was very important for GAB to increase its share of the Kenyan financial market. A further 26 people (38%) felt this would be important meaning that 88% of the respondents ranked this strategy as either important or very important. Advocacy, increasing the number of outlets and better training of bank staff were ranked as important and very important by 86%, 71% and 90% of the respondents respectively.

The results show that the strategy ranked highest by the respondents was better training of staff followed by civic education, advocacy and increasing the number of outlets in that order.

The responses they provided to the question are presented in full in the graph below. The mean calculated for better training of staff, number of outlets, advocacy and civic education were 2.32, 2.01, 2.32 and 2.38 respectively. A positive value for covariance was calculated for all the categories.

To summarise the results obtained under this section, the respondents felt that the bank was growing especially in terms of revenue and product portfolio. In response to the research question on the strategies being used by Islamic banks to penetrate into the Kenyan market, the customers felt that the current strategies being used were civic education and advocacy although the responses tended to reflect the fact that bank customers may not always be aware of the actual strategies being used by institutions like banks. The question on future strategies that Islamic banks may use received more with advocacy, civic education, better training of staff and increasing the number of bank outlets all being given importance.
4.5 The Challenges Faced by Islamic Banks in Kenya

This section investigated the challenges that are faced by Islamic banks in Kenya. This was investigated using questionnaires administered among the 68 respondents.

4.5.1 Quality of Staff

This subsection gathered the attitudinal information from respondents addressing the quality of staff at the bank’s branches where they have conducted transactions.

A total of 45% of the respondents either agreed or strongly agreed that GAB staff are not fully conversant with the concept of Islamic banking. This is set against 41% of respondents with the opposite view. In response to the second part of the question, 50% of GAB customers felt that there is a shortage of qualified professionals in the Islamic finance sector.

The high numbers of respondents who feel that GAB staff are not fully conversant with Islamic banking and that there is a shortage of professionals in the sector should be a cause of concern for Islamic banks like GAB. This is especially true if the banks want to...
provide services that are genuinely differentiated from those that are offered by conventional banks and banks that only offer Islamic banking windows.

Table 4.4: Quality of Staff in the Islamic Banking Sector

<table>
<thead>
<tr>
<th></th>
<th>Strongly Disagree</th>
<th>Disagree</th>
<th>Neutral</th>
<th>Agree</th>
<th>Strongly Agree</th>
</tr>
</thead>
<tbody>
<tr>
<td>GAB staff are not fully conversant with Islamic Banking</td>
<td>12; (18%)</td>
<td>17; (25%)</td>
<td>9; (13%)</td>
<td>16; (24%)</td>
<td>14; (21%)</td>
</tr>
<tr>
<td>There is a shortage of professionals in the sector</td>
<td>10; (15%)</td>
<td>11; (16%)</td>
<td>13; (19%)</td>
<td>15; (22%)</td>
<td>19; (28%)</td>
</tr>
</tbody>
</table>

4.5.2 Access to GAB Accounts

The respondents were asked about their opinion on non-Muslims being able to hold accounts with GAB. The question was addressed at the bank’s customers but it can potentially shed light on a potential challenge that could be faced by Islamic banks that try to attract interested non-Muslim customers.

The overwhelming majority of the customers, 55 out of 68 about 81% felt that non-Muslims should be allowed to have accounts with GAB. This is good news for banks such as GAB meaning that they would not stand to lose their Muslim customers if non-Muslim customers joined the bank.

The results are presented in the graph below. Only 6 respondents representing 9% of the sample felt that non-Muslims should not open accounts at fully fledged Islamic banks. The remaining 7 people or 10% of the respondents did not know whether or not non-Muslims should be allowed to operate accounts with Islamic banks.
4.5.3 Challenges Faced by GAB Customers

This represented the final question addressing the challenges that are faced by Islamic banks. While addressed at respondents who are customers of the bank, it can also be useful in highlighting the challenges that are faced by the Islamic banks.

The most common challenge cited by GAB customers was to do with the number of branches that the bank has. Other significant challenges include the service and product range, branch opening hours and the competence of GAB staff.

The results are shown in full in the graph below. The limited number of branches is a significant challenge as customers may feel that for convenience, they may have to open an account at a bank that is viewed by GAB as a competitor. It is therefore up to the bank to open more branches or seek other solutions that will benefit their customers. According to Gulf African Bank (20212), customers can do their banking through all branches of National Bank and Cooperative Bank countrywide for only cash and cheque deposits.

The responses received in this section investigating the challenges faced by Islamic banks in Kenya focused mostly on the fact that staff are not fully conversant with the concept of Islamic banking and a lack of qualified professionals in the Islamic finance sector. The respondents also saw the number of branches, opening hours and service and product range as significant challenges. The respondents felt that Islamic banking should be open to people from all religious backgrounds meaning that Islamic banks that want to expand
their customer base to include more non-Muslims would not face resistance from its customers.

![Bar chart showing challenges faced in operating GAB accounts](image)

**Figure 5.1: Challenges faced in Operating GAB Accounts**

### 4.6 Chapter Summary

The chapter presented the feedback obtained from the respondents who consisted of GAB customers. The findings presented in the form of graphs, pie-charts and tables are largely consistent with existing literature on the research questions. The next chapter will discuss and these findings. Conclusions and recommendations will also be made based on the results that have been presented in chapter 4.
CHAPTER FIVE

5.0 DISCUSSION, CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction
This chapter discusses the results obtained from the questionnaire that was administered among GAB customers. The results are put into context with the objective of the assignment which is to investigate the factors that are influencing the growth of Islamic banks in Kenya. This chapter consists of four sections, namely, summary, discussion, conclusions, and recommendations following that order. The first section summarises the important elements of the study including the objectives of the study, the methodology used, and the findings. The second section discusses the major findings of the study with respect to the specific objectives. The third section uses findings and results obtained in chapter four to discuss conclusions based on the specific objectives. The fourth section provides recommendations for improvement based on the specific objectives and gives recommendations for further studies.

5.2 Summary
The purpose of this study was to determine the factors that have influenced the growth of Islamic banks. The study was guided by three research questions which also represented the specific objectives. These include:

i. What are the factors influencing growth of Islamic banks in Kenya?
ii. What are the strategies adopted by Islamic banks to penetrate into the Kenyan market?
iii. What are the challenges faced by Islamic banks in Kenya?

To achieve the above, the research was conducted in the form of a descriptive study. This design was adopted as the suitable research design because it identifies patterns or trends in a situation. The target population were existing customers of GAB. The study commenced by gathering the respondents’ demographic information. This was done because demographics as characteristics of a population can be used to enable the research activity to access who to survey and how to break down the overall survey response data into meaningful groups of respondents (Wyse, 2012). Doing this enabled the researcher to proceed with the exercise with the knowledge that the people among
whom the questionnaire was administered represented a wide enough wide cross-section of the bank’s customers to lend validity to the responses they provided meaning this could be extrapolated and safely assumed to represent the views of GAB’s customer base. This was successfully achieved and the data gathered in subsequent sections and subsections of the questionnaire appear to be truly representative of the opinions of GAB customers.

A simple random sampling technique was used to identify the 100 sample size elements. Questionnaires were used to collect the primary data from. The questionnaire was given to 100 customers drawn from the bank’s Westlands branch in Nairobi. The collected data was first coded statistically and then analyzed using the Statistical Package for Social Scientists (SPSS). SPSS and Microsoft Excel enabled the researcher to compute descriptive statistics such as percentages, frequencies, and ranges. Finally, the presentation of the results was done by use of graphs, charts, tables, cross-tabulations and pie charts for clarity and ease of understanding of the findings.

The study found that religious considerations represented one of the main reasons the respondents offered for opening an account with an Islamic bank with non-Muslims underrepresented among the respondents who responded to the questionnaire. The majority of the customers surveyed are self-employed. This is in agreement with research conducted at the time Islamic banking was being introduced in Kenya. The thinking at the time was that there were potential lucrative markets for Islamic banking within the business community in Nairobi, Mombasa and other towns with sizeable Muslim communities.

Better product portfolio was another reason offered by the respondents for opening an account with GAB. The most popular account held by the former group is the Hajj account. The Anisaa account was very popular within women at whom it is exclusively targeted. The majority of the respondents rated the services they receive from the bank highly. The study thus confirms the opinions in the literature review that states that the growth of Islamic banking is based on Islamic values, customer satisfaction and an innovative product portfolio. According to the respondents, in addition to product innovation, the main strategies used by GAB to penetrate the Kenyan market are advocacy and civic education. The study also covered strategies that GAB ought to use including better training of staff, increase in the number of outlets, advocacy and civic
education. All of these potential strategies were ranked as either important or very important by the majority of the respondents.

The challenges that are faced by Islamic banks operating in Kenya is highlighted by the fact that a substantial number of respondents felt that GAB staff were not fully conversant with the concept of Islamic banking making this one of the most significant challenge that the bank faces. The number of branches and opening hours were also mentioned by the respondents as the main challenges that they face. The bank seems to be aware of the inconvenience brought about by the low number of branches and have moved to engage larger banks such as the National Bank and the Cooperative bank in partnerships where GAB customers can use these banks’ facilities to undertake some transactions. Another arrangement put in place to counter this particular challenge has seen customers able to withdraw money using Pesa Point ATM services.

The attraction for customers is based on the fact that Islamic banking is based on profit-risk sharing principles, reducing the burden from the borrowers. Opportunities exist for Islamic banks and their customers. A large majority of GAB customers were Muslims proving that Islamic banking is still largely attracting customers on religion basis instead of its own features. Increasing competition and diversity of service development in banking and financial services sector pressures the Islamic banks to become increasingly responsive to market considerations in terms of segmentation, management and market strategies, internal and external infrastructure, their use of information technology and their ability to innovate and differentiate.

In addition to addressing the research questions, the empirical findings of this study can be used to determine how customers perceive GAB with regards to its brand image and identity, how satisfied they are with the goods and services they receive from the bank and which factors influence consumers. The findings can therefore be used by the bank to see whether it has put in place strategies and structures to improve and attract new customers and retain those who already operate GAB accounts.

The study has come up with recommendations for improving the performance of Islamic banks in Kenya. These include the implementation of clear growth strategies by the banks, the establishment of a national Sharia Board that will lead to the standardisation of
goods and services and the launching of corporate responsibility activities by Islamic banks in the country to improve their visibility among potential customers. The study further recommends that future research activities in the sector focus on the quality of the service offered to customers by Islamic banks and banks that offer Islamic banking windows.

5.3 Discussion
This section gives a discussion based on the research specific research objectives. The research findings are also compared with the literature review in Chapter 2.

5.3.1 Factors Influencing the Growth of Islamic Banks in Kenya
Islamic banks have made a remarkably successful entrance into the Kenyan financial market. According to the Standard Newspaper (2011), it only took GAB exactly 2 years to break even while First Community Bank only took 3 years to break even. As at December 31, 2011, the two Islamic finance banks collectively commanded 0.9 per cent of the banking sector net loans and advances of $115 million and deposits of $171 million (Standard Newspaper, 2011). The attraction for customers is based on the fact that Islamic banking is based on profit-risk sharing principles, reducing the burden from the borrowers. The regional market is also huge as both Muslims and non-Muslims welcome this form of banking that is transparent, and offer caring partnership and free from the uncertainty of interest rate fluctuations.

The academic qualifications of the respondents appear to be higher than the Kenyan average. More than half, 52% of the respondents had Bachelor’s degrees or above. According to the results of the Kenya Population Census conducted in 2009, only 5% of Kenyans had university degrees (Kenya National Bureau of Statistics, 2009). About 31% of the respondents had monthly incomes of Kshs 40,000 and less. The rest had higher monthly incomes. This may indicate that the bank’s services are not yet being extended to lower income, less educated members of society who also need access to Islamic banking services despite the fact that people from these backgrounds also suffer from the high interest rates and volatile fluctuation of interest rates by conventional banks.

According to the study, religious considerations represented one of the main reasons the respondents offered for opening an account with an Islamic bank. Only 2 out of the 68
GAB customers surveyed were non-Muslim. This represents just fewer than 3% of the sample. While it is expected that Muslims would constitute the majority of the bank’s customers, non-Muslims appear to be underrepresented given the fact that Muslims constitute only 11% of Kenya’s population. According to Janmohamed et al (2011), the goals of Islamic banks within the marketing sector are to gain the interest of Muslims and non-Muslims within conventional banking, create competitive products and services and expand the share of existing customers.

The majority of the customers surveyed are self-employed. This appears to be in line with contemporary thinking within the Islamic banking sector. The entry into the market of both GAB and the First Community Bank ushering in the first 100% Sharia-compliant financial institutions with an array of products was met with a lot of expectation from both Muslims and non-Muslims for this alternative form of banking that was expected to bring in a new form of partnership and interest free banking. According to Nzibo (2005), research conducted at the advent of Islamic banking in Kenya indicated that potential lucrative markets for Islamic banking will be the business community in Nairobi, Mombasa and other towns with sizeable Muslim communities. In general, Islamic finance is ideal for traders and manufacturers (Janmohamed et al., 2011).

Better product portfolio was another reason offered by the respondents for opening an account with GAB. About 60% of the respondents hold one account with GAB while 40% hold two accounts with the bank. The most popular account held by the former group is the Hajj account while for the latter group, a combination of the Hajj account and a current account was the most popular. The Hajj account helps customers realise their lifetime dream of fulfilling one of the fundamental pillars of Islam by growing their Hajj savings through halal earnings (Gulf African Bank, 2012). 52% of the female respondents were holders of the Anisaa account which is exclusively targeted at women. According to Naser and Moutinho (1997), Islamic banks have to fight stiff competition and as such building a competitive edge can only help them, which can be done by effective positioning strategies. It is clear that the Hajj and Anisaa accounts have enabled GAB to offer unique products to banking customers.

Of the 68 respondents, 36 representing 53% of the respondents rated the services they receive from the bank as excellent reflecting high levels of customer satisfaction. 32% of the respondents felt the services were good while another 15% rated the services as OK.
None of the 68 respondents rated the services as poor or very poor. The study thus confirms the opinions in the literature review that states that the growth of Islamic banking is based on Islamic values, customer satisfaction and an innovative product portfolio.

5.3.2 Strategies Adopted by Islamic Banks to Penetrate into the Kenyan Market
Due to the nature of the services provided by the sector, Islamic banking has the potential for attracting new customers and, consequently, enhancing a bank’s market share. A significant number of the respondents felt that the bank had grown in terms of customer base, profitability, revenue and product portfolio. This is supported by evidence from the local finance industry. According to Business Daily Africa (2013), fully fledged Islamic banks such as GAB and First Community Bank outpaced their rivals in conventional banking by posting triple-digit rise in profits helped by lending to peers, households and companies. The same report states that GAB posted a 154% growth in net profit to Kshs 242.2 million in the fiscal period ending December 2012.

Responses on reasons for transacting with GAB were largely similar with those that were given in response to the question on the reasons for opening an account at the bank. Compliance to sharia laws was rated highly as was loan availability, confidentiality and bank reputation. This finding is in line with other previous studies on the subject. According to Rashid and Hassan (2009), non-Islamic factors such as efficiency, banking services and confidence were also accorded great importance by customers of Islamic banks.

Religious considerations and the product portfolio provided by the bank proved the two most compelling reasons for customers opening an account with GAB. Dusuki and Abdullah (2007) have argued that Islamic banks must not only rely solely on religious factors as a strategy to secure customers’ allegiances but they should also emphasise providing quality and efficient services. Other studies have drawn the same conclusions on customers’ bank selection criteria. Rashid and Hassan (2009) also found that compliance to Sharia laws was one of the influential factors, whereas the other factors are convenience, cost-benefit, corporal efficiency, core banking services and facilities and confidence. Available literature on Islamic banking included in the literature review state that Islamic banks like GAB can adopt strategies that include focusing on competition
and increasing efficiency, the development of Islamic capital markets and consumer awareness and the enactment of Islamic banking law.

Kenyan banks have developed numerous strategies to gain a competitive edge in the banking industry including optimisation of customer value in a demanding marketplace (Musa, 2007). The innovative products that Islamic banks like GAB have introduced into the Kenyan financial market has emerged as a response to the increasingly competitive environment while also addressing emerging customer needs. The study showed that Islamic banking has already increased the availability of more products and services in the Kenyan banking sector. According to the respondents, in addition to product innovation, the main strategies used by GAB to penetrate the Kenyan market are advocacy and civic education. Civic education which would include raising national awareness on Islamic banking and increasing political and financial commitment through advocacy and sensitisation of policy makers at all levels including the Kenyan government and collaborating with government and other stakeholders in reviewing existing banking laws that might hamper the growth of Islamic banking. Civic education can thus be used to achieve the goal of gaining the interest of Muslims and non-Muslims within conventional banking, creating competitive products and services and expanding the share of existing customers (Janmohamed et al., 2011).

Islamic banks that take the time now to consider strategic choices and address operational fundamentals will be in a stronger position to capture untapped market opportunities and master the changing dynamics of the industry (Garbois et al., 2012). The study covered strategies that GAB ought to use including better training of staff, increase in the number of outlets, advocacy and civic education. All of these potential strategies were ranked as either important or very important by the majority of the respondents.

5.3.3 The Challenges Faced by Islamic Banks in Kenya
The literature review identified risk management and corporate governance, the lack of human capital, lack of standardisation and government regulation on Islamic banking as some of the challenges faced by the Islamic banking sector. 30% of the respondents held parallel accounts with other banks. This is because despite the advantages of Sharia-compliant services, Islamic banks have to fight stiff competition and as such building a competitive edge can only help them, which can be done by effective positioning.
strategies along with redesigning service (Zineldin, 1996). According to Kahf (2004), some Islamic banks in majority Muslim countries may pay little attention to the quality of services they offer to their clients especially if such banks enjoy a position where they can exercise some monopolistic power in the market. In Kenya, banks like GAB are in a situation where they no longer act alone in the Islamic financial services market. Many conventional banks in Kenya like Barclays Bank, KCB and Chase Bank, and National Bank of Kenya offer Islamic window services making the market more and more competitive.

A total of 53% of the respondents rated the services they receive from GAB as excellent while 22% thought the services were good. These results show that the bank is performing well in terms of the quality of services that it offers its customers. Services are instantly provided and hence every customer feels the result instantly meaning that it is very important that the bank leaves its customers with a good impression (Zeithaml and Bitner, 1996). According to Othman and Owen (2003), the nature of products which are basically intangible in services including a tangible action, so customer satisfaction in services is not only influenced by objective measures of performance but also influenced by intangible aspects during the service performance.

Only 30% of the respondents either agreed or strongly agreed that GAB staff were not fully conversant with the concept of Islamic banking. 34% agreed or strongly agreed that there was a shortage of professionals in the Islamic banking sector. According to Tahir (2003), lack of qualified manpower is one of the biggest hurdles in the advancement of Islamic banking and while pioneers in Islamic banking developed their financial instruments and painstakingly trained their staff, there is no training institute to meet the manpower needs of existing and future Islamic banks. This is also in line with the findings of Garbois et al (2012) who state that salespeople often are poorly prepared and have little understanding of the products they are selling. According to Garbois et al (2012), this is even more pronounced in Islamic banking, where customers may require additional explanations of Sharia-compliant product structures.

According to Tahir (2003), while the Islamic financial model is feasible, it faces problem of general acceptability, mainly due to unfamiliarity with the various Islamic modes of financing. Civic education can be achieved by raising awareness of consumers about Islamic banking and persuading the consumers with products and communications.
Nzibo (2010) argues for civic education to convince the Muslim community that these are truly fully fledged Islamic banks with reputable Sharia advisory boards of international standards.

Number of branches and opening hours were also mentioned by the respondents as the main challenges that they face. In addition to its headquarters, GAB has 6 other branches and operates 4 ATMs in Nairobi. This is in addition to being connected to the Kenswitch and Pesa point ATM networks throughout the country (Gulf African Bank, 2012). The bank’s opening hours are generally similar to those of conventional banks also operating in the country. The bank will have to address these challenges faced by their clientele in order to ensure customer satisfaction. Naser et al (1999) state that because Islamic banks face competition from other Islamic banks and non-Islamic banks offering more or less similar products and services, it is the customer satisfaction that can influence the performance of an Islamic bank and determines whether its competitiveness and success are vulnerable.

5.4 Conclusions
The purpose of this study is to determine the factors influencing growth of Islamic banks, the strategies adopted by Islamic banks and the challenges faced by Islamic banks. The following are the major conclusions based on the findings and discussions.

5.4.1 The Market for Islamic Banking
Islamic banking can be a key driver of economic development if well understood. Precepts of Islamic banking could assist in the alleviation of poverty by giving the poor access to microfinance facilities based on the concepts of risk sharing and free-interest. Opportunities therefore exist for Islamic banks, their customers as well as the nation which would benefit from the promotion of entrepreneurship in a country where unemployment is rife especially among young people.

Islamic banking is a very young but growing concept. From the findings and discussion on the features of Islamic banking, it can be concluded that Islamic banking is really taking form in Kenya. The study has established that Islamic banking has been growing in recent years though the sector remains marginal. It is however, expected that the sector will continue to grow. Islamic banking institutions will receive more recognition as
financial institutions that fill the financial gaps standing in the way of real economic transactions at the grassroots level.

5.4.2 Strategies Adopted by Islamic Banks in Kenya
This study found that a large majority of GAB customers were Muslims. This may prove that Islamic banking is still largely attracting customers on religion basis instead of its own features and simultaneously, it is being offered majorly to Muslims only. This can be effectively countered by expanding understanding and awareness among the public of Islamic finance and lobbying in order to ensure strong regulatory frameworks and suitable jurisprudence. Islamic banking is in the process of establishing its identity in Kenya showing that it is here to stay, grow and develop into a competitive alternative to interest-based financial architecture.

5.4.3 Challenges Faced by Islamic Banks in Kenya
However, there are several challenges that must be overcome by GAB other Islamic banking institutions. Increasing competition and diversity of service development in banking and financial services sector pressures the Islamic banks to become increasingly responsive to market considerations in terms of segmentation, management and market strategies, internal and external infrastructure, their use of information technology and their ability to innovate and differentiate. The emerging popularity of Islamic banks has led mainstream finance institutions in Kenya to begin operating their own Islamic banking windows in response to rising demand from customers. For fully fledged Islamic banks to thrive, they will need to put in place effective market positioning to identify influential factors affecting customer satisfaction is of paramount importance for Islamic banks.

However, the study showed that there were concerns about the familiarity of bank staff with the concept of Islamic banking. The pace of development of Islamic banking can be expedited through public education campaigns, the inclusion of Islamic banking concepts in school curriculum, making Islamic financing course a part of business administration programs and offering full-fledged degree programs in Islamic financing. These will enable Islamic bank employees who deal directly with clients to offer professional services quickly and efficiently gaining the client’s confidence.
In addition to the training of personal qualified in Islamic finance, Sharia compliant banks will need to conduct promotion and marketing activities. The promotion and marketing goals and plans should address matters such as product and service price, distribution, communication and the development of new products. In the Kenyan market, GAB and other Islamic banks need to develop credibility and spread awareness of products, educate the staff and keep up dated with the customers’ demands and put in place a strong infrastructure for operating smoothly.

5.5 Recommendations
This section provides recommendations that the researcher feels are key for Islamic banks in Kenya to continue to grow and become permanent features of the financial market. The recommendations are made based on the findings from the research and the conclusions of the study.

5.5.1 Recommendations for Improvement
5.5.1.1 What are the Factors’ Influencing The Growth of Islamic Banks In Kenya?
It emerged during this study that despite the growth experienced in the Islamic banking sector, there is little concerted effort by GAB and other Islamic banks in Kenya to implement what would constitute a clear growth strategy. The banks appear to be growing mostly through the exclusive patronage of Kenya’s 4.3 million strong Muslim population. A focused strategy would provide a way of developing and expanding Islamic banks as well as competition with other Islamic banks and conventional banks that offer Islamic banking windows. Kenya being a majority non-Muslim nation, the majority of the population believes that service quality and financial returns are the main aspects when looking at the customer’s point of view. However, the nature of Islamic banking with the absence of punitive interest rates represents a new form of partnership. Growth strategies that also target non-Muslims would likely be successful especially after the recent global financial crises which convinced many bank customers that current conventional banking systems promote speculation resulting in greed and phony markets.

5.5.1.2 What are the Strategies Adopted by Islamic Banks to Penetrate into the Kenyan Market?
With a strong base emanating from Kenya’s Muslim population as well as the potential to expand into other countries in the region, the outlook currently looks bright for Islamic
banks. However, not all Muslims are convinced that banks like GAB are truly fully fledged Islamic banks with reputable Shari’ah advisory boards of international standards. This represents a considerable barrier to the continued growth of these institutions. The researcher recommends that Islamic financial instruments should be properly and fully developed accommodating all relevant factors, principals of Islamic banks should set economic and Shari’ah parameters for providing bank financing and that the prospects of Shari’ah compliance should be enhanced through introduction of penalties for the bank staff and Shari’ah-rating of the bank.

5.5.1.3 What are the Challenges Faced by Islamic Banks in Kenya?
In addition to the strategies for expansion, Islamic banks should embrace corporate social responsibility by providing social services that are noticeable by the segment of the society from which the bank derives its clientele and staff. The social services provided should be noticeable in order to entrench the name and presence of the bank in the minds of existing and potential customers. Increasing visibility will have the effect of increasing awareness of the existence of the bank among both Muslim and non-Muslim sections of the Kenyan population. Corporate social responsibility is a useful marketing tool which will help raise awareness on Islamic banking instruments and concepts.

Collectively, Kenya’s banks contribute more than Kshs 1.2 billion every year through their social investment programmes (corporate social responsibility) (Kenya Bankers Association, 2013).

5.5.2 Recommendations for Further Studies
The most basic requirement is the need for an Islamic bank to work perfectly on the demand of, or response to its customers’ needs and wants. This study briefly investigated the quality of service offered by GAB to its customers but along with customer satisfaction, this only constituted a small part of the questionnaire that was administered among respondents. A future research activity in the area of Islamic banking could have as its focus the quality of services that are available to customers in this newly thriving sector of the banking industry. This could encompass both fully fledged Islamic banks as well as banks that offer Islamic banking windows enabling a subsequent comparison and discussion of their relative merits.
REFERENCES


Ireland, S., & Williams, P. (2012). *Research Methodology using Interviews*. Salford University, Salford


65


APPENDIX A: QUESTIONAIRE

Dear Respondent,

Attached is a questionnaire that will be used to collect data on the emergence of Islamic banks in Kenya. You were identified as one of the key customers of Gulf African Bank. You are therefore kindly requested to provide the required information in the questionnaire. The instructions on how to fill the questionnaire are provided below. Any information and opinions obtained in connection to this study are important and will remain confidential to be used only for this research. No individual responses will be reported.

Results from this study will be of importance to the banking industry in determining the emergence of Islamic banks and the challenges faced by them.

Should you require a summary of the results, please do not hesitate to contact the researcher on the address below.

Once again thank you for your cooperation and time.

Mohammed RizwanKasmani
Email: rizwankasmani@gmail.com

Instructions on how to fill the Questionnaire
This questionnaire contains two parts: Section One and Section Two.
Section One is designed to obtain some general information. Kindly tick the box next to the option that best applies to you.
Section Two is designed to rate some statements pertaining to Islamic banking system. In some cases, you will be required to provide your opinion by filling in the blank spaces.
Section One: Demographics

1. What is your gender? Please tick (✓) in ONE of the check boxes provided below.

   Female □       Male □

2. What age bracket do you fall under? (Please tick (✓) in ONE of the boxes provided below).

   a). Less than 20 years □
   b). Between 20 years and 29 years □
   c). Between 30 years and 39 years □
   d). Between 40 years and 49 years □
   e). 50 years and above □

3. What is your occupation? (Please tick (✓) in ONE of the boxes provided below).

   Self employed □
   Private sector employed □
   Government Sector employed □
   Retired □
   Other. Please specify……………………………………………………………………

4. Which is the highest academic qualification you have received? (Please tick (✓) in ONE of the boxes provided below).

   a) Less than High School □
   b). High School certificate □
   c). Diploma or Post-Secondary Certificate □
   d). Bachelor’s Degree □
   e). Masters and above □

5. What is your religion? Please tick (✓) in ONE of the check boxes provided below.

   Muslim □       Non-Muslim □

6. What is your Income level? Please tick (✓) in ONE of the check boxes provided below.
Section Two

1. Account you operate: {Please tick (✓) ALL boxes that apply}.
   a). Current account
   b). Savings account
   c). Time Deposit account
   d). Hajj account
   e). Anisaa account

3. If you ticked in more than one box in 2, please state the reason why you operate more than one account ..................................................................................................................................................
   ..................................................................................................................................................

4. How would you rate the services that GAB has to offer

   Excellent[ ]  Good[ ]  OK[ ]  Poor[ ]  Very Poor[ ]

6. You are aware of all the products that GAB has to offer to its customers

   Strongly Agree[ ]  Agree[ ]  Neutral[ ]  Disagree[ ]  Strongly Disagree[ ]

8. What was the main reason you considered when opening an account with an Islamic bank? (Please tick (✓) in ONE of the boxes provided below).

   a). Religious reasons
   b). High profit returns
   c). Better product portfolio
   d). Better customer service
d). Other, please specify........................................................................................................
...........................................................................................................................................
...........................................................................................................................................

9. Do you operate a parallel account with a conventional bank (non Islamic banks) as well

Yes ☐  No ☐  Don’t Know ☐

10. If Yes to question 9, please state the reason why so? .......................................................
...........................................................................................................................................
...........................................................................................................................................

11. You transact with GAB because of the following reasons:

(Please indicate extent on a scale of 1 to 5 on ALL the boxes below with a tick (✓))
where;
(1 = Strongly Disagree; 2 = Disagree; 3 = Neither Agree/Disagree; 4 = Agree; 5 = Strongly Agree)

<table>
<thead>
<tr>
<th>Factors</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>a). Based on religious values (Sharia)</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
<tr>
<td>b). Profitability</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
<tr>
<td>c). Feasible location</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
<tr>
<td>d). Service charges</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
<tr>
<td>e). Effectiveness in transaction</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
<tr>
<td>f). Bank reputation</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
<tr>
<td>g). Provision of investment opportunities (product portfolio)</td>
<td>☐ 1    ☐ 2    ☐ 3    ☐ 4    ☐ 5</td>
</tr>
</tbody>
</table>
12. GAB has grown in the following areas
   a) Customer base
      Strongly Agree □ Agree □ Neutral □ Disagree □ Strongly Disagree □
   b) Profitability
      Strongly Agree □ Agree □ Neutral □ Disagree □ Strongly Disagree □
   c) Revenue
      Strongly Agree □ Agree □ Neutral □ Disagree □ Strongly Disagree □
   d) Increase in Product Portfolio
      Strongly Agree □ Agree □ Neutral □ Disagree □ Strongly Disagree □

13. The staff at GAB are not fully conversant with the concept of Islamic banking
    Strongly Disagree □ Disagree □ Neutral □ Agree □ Strongly Agree □

14. There is a shortage of qualified professionals in the Islamic finance sector
    Strongly Disagree □ Disagree □ Neutral □ Agree □ Strongly Agree □

15. Using a scale of 1 to 5 where 1 is strongly disagree and 5 is strongly agree, the strategies used by GAB to penetrate into the Kenyan market are:
    a) Carrying out civic education for its existing and potential customers
       Strongly Agree □ Agree □ Neutral □ Disagree □ Strongly Disagree □
    b) Advocating in the change of Kenyan banking policies/laws
16. Using a scale of 1 to 3 where 3 is very important, 2 is important and 1 is not important, rank the importance of each of the following strategies that could be used by GAB to penetrate into the Kenyan market in future

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Very Important</th>
<th>Important</th>
<th>Not Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Civic Education</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Advocacy</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Increase Number of Outlets</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>Better training of staff</td>
<td>3</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

17. Do you feel that non-Muslims should be allowed to hold GAB accounts?

- [ ] Yes
- [ ] No
- [ ] Don’t Know

18. What challenges do you face in operating your GAB account? Tick all that apply

- Number of Branches
- Opening Hours
- Service and Product Range
- Competence of staff

--------You’ve reached the end of the questionnaire. Thank you for participating!--------