

RESEARCH ARTICLE

How Islamic is the Islamic Banking System? - A Study on Clients' Perception of Islamic Banks in Bangladesh

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ABSTRACT

This study aims at answering the question of how clients of different Islamic banks in Bangladesh perceive the Islamic identity of these banks. Besides, it tries to identify the other factors that influence clients' acceptance of Islamic banking. A structured questionnaire was designed to collect responses from 96 Muslim clientele who were randomly selected from various Islamic banks in Bangladesh. To investigate how the elements under consideration affect the acceptance of the Islamic banking system, factor analysis, regression analysis, correlation approach, and T-test were used. The findings of this study, like those in many other countries, support the assumption that the most significant association between clients' adoption of Islamic banking and their religious convictions, exists. The other variables affecting the perception of the clients are technological advancement and the reputation of the system, whereas knowledge and awareness, and promotion are found insignificant. As religious belief is the most significant factor in the banks' adoption, the banks should carefully handle their *shariah* councils, so as not to violate the Islamic principles in their banking practices.

ARTICLE HISTORY

Received: 15 December 2021

1st Revision: 22 June 2022

2nd Revision: 21 July 2022

3rd Revision: 12 August 2022

4th Revision: 18 August 2022

Accepted: 22 September 2022

Published: November 2022

KEYWORDS

Customers' Adoption, Clients' Perception, Factors Analysis, Islamic Banking, *Shariah* Compliance.

1. Introduction

The Islamic banking system is a standard banking activity that adheres to Islamic *Shariah* rules. The acceptance of a fixed rate of interest on money

(known as usury, or *riba* in Arabic) is forbidden under Islamic *Shariah*. Investment in businesses of goods or services that are not permitted as far as Islamic *Shariah* is concerned (e.g. pork or alcohol), is also not allowed for the Muslims. It has been during the late 20th century that the Muslim countries around the globe adopted the Islamic banking system devoid of any interest.

Islamic banks became popular in Bangladesh during the 1980's with the establishment of Islami Bank Bangladesh Limited in 1983. Since then a few other banks were established under the Islamic principles. As of June 2021, Bangladesh had ten full-fledged Islamic banks that were operating according to Islamic *Shariah* principles, also known as the Profit-Loss Sharing (PLS) model. These banks provide a direct contribution to Bangladesh's economic development. It is worth noting that Islamic banks control around 27.26 percent of total banking deposits and 27.55 percent of total banking investments in the country.¹ This indicates how significant are the roles of Islamic banks in making their contribution to uplifting Bangladesh from an underdeveloped country to a developing one.

A lot of people in Bangladesh claim that Islamic banks are just a “twisted way” of interest-based banking. However, as a Muslim-majority country, people are also very sensitive to their religion. This is also evident from the deposit and investment data of the Islamic Banks vis-a-vis the conventional banks. Therefore, being ignorant of the Islamic principles on which Islamic banks are being operated is a major problem for the Islamic banking industry in Bangladesh, similar to many other Muslim countries around the globe. It also implies that the people know very little about Islamic financing methods such as *musharakh*, *mudharabah*, *HPSM*, and the like.

There exists a strong competition in the banking sector in Bangladesh. As of 2021, there is a total of 61 commercial banks operating in the country. Of these, 10 are *shariah*-based banks, and 51 are conventional commercial banks. Therefore, there is a nail-biting competition among them for funds. More often than not, some commercial banks are found to face liquidity

¹Islamic Banking Cell, Research Department, Bangladesh Bank (The Central Bank of Bangladesh), *Developments of Islamic Banking in Bangladesh*, available https://www.bb.org.bd/pub/quarterly/islamic_banking/apr-jun2021.pdf, access date, March 17, 2022.

crises and need the government to bail them out. (Rahman and Banna, 2015). To avoid a crisis of this magnitude, Islamic banks must meet the needs of their clients and provide them with high-quality services.

To remain competitive, both Islamic and traditional banks must offer Muslim and non-Muslim clients the option of selecting suitable banking products and services based on their needs and preferences. This competition is not only among the various products and services offered by conventional banks, but also among Islamic banks. As far as the fierce competition among the banks in Bangladesh is concerned, the Islamic banks should adhere to such criteria as, better performance than their competitors, quick inter and intra-bank fund transfer facilities, and varieties of quality products to attract all types of clients (Adnan, 2012).

It is believed that Islamic banking is very important for all Muslims because they are obliged to follow the Islamic *Shariah* (Islamic rules and regulations). However, many studies have been conducted on the effectiveness and profitability of Islamic banking products. But unfortunately, so far as we know, no serious study has been conducted yet covering the understanding of clients' perception of Islamic banking in Bangladesh. This is the research gap needing special attention. In this backdrop, the purpose of this study is to explore clients' perceptions of Islamic banking in Bangladesh. It is expected that the findings of the study will help the stakeholders increase the Islamic banks' ability to obtain sustainable competitive advantage and future growth potential.

For the purpose of the study, the paper is organized into eight sections. The first and the second sections describe the introduction of the study and the literature review respectively. The third section covers the objectives of the study followed by the hypotheses in section four. Section five includes a brief explanation on the methodology of the study. This is followed by the findings and analysis in section six. Section seven arrives at a conclusion followed by recommendations and further scope of the study in section eight.

2. Literature Review

2.1 Knowledge and Awareness

The majority of people around the world are unaware of the distinction between Islamic banks and other commercial banks. Islamic banks provide banking products and services based on Islamic *Shariah* principles. To influence customers, Islamic banks should provide the clients with the correct understanding of Islamic financial products and services, as well as educate them on the differences between similar products offered by conventional banks. It should also make them aware of how they can help their customers. According to a Tunisian study, customers' awareness of the differences between Islamic and conventional banks is an important factor influencing their decision to use Islamic banking services (Abdelghani, 2015). According to Bashir (2014), Dariyoush (2014), and Khokhar (2014), customer awareness level plays an important role in customers' service utilization decisions in the banking sector. Clients of Islamic banking are unaware of the difference between the expected and actual returns on their investments, as any fixed rate of return is found to be contradicting Islamic banking principles. Client's perceptions of the similarity or dissimilarity between the two types of banking systems are influenced by the lack of information available to them about Islamic banking products, which is the result of a poor understanding of the Islamic banking concept.

Most Muslims understand the fundamental concepts of Islamic finance, but they are unfamiliar with specific Islamic financial products such as *Mudharabah*, *Musharakah*, *Murabaha*, *Ijara*, and so on (Kashif, 2010). People who are more aware of Islamic banking products are more likely to use them (Nain, 2014). In India, Ramdhony (2013) discovered that more than half of the respondents surveyed had heard of Islamic Banking. Muslims are more aware of Islamic Banking terminologies than non-Muslims, but both groups have a low level of awareness. Respondents were frequently found to be eager to purchase Islamic banking products, but only if credit facilities were available. This is against Islamic *Shariah* law and indicates a lack of understanding of Islamic finance principles (Rammal, 2007). People are unable to distinguish between Islamic and conventional banking systems due to a lack of awareness and knowledge, but they are content with Islamic banking because they trust the *Shariah* Boards that run them (Sohail, 2014).

2.2 Religion

Religious beliefs imply a strong influence on people's perceptions and attitudes in different phases of life. Islam has its guideline, known as Islamic *Shariah* Principles in the banking system. Available literature in the related field discovered that the majority of customers chose the Islamic banking system primarily for religious reasons, as keeping deposits in a traditional bank violates Islamic principles (Kashif, 2010, Rahman, 2015, Nasir, 2013).

When customers choose Islamic banks over conventional banks, religious motivations were discovered to be the second most important factor (Muhammad, 2012). Religion was the primary driver of the rise of interest-free banking, as traditional banks were unable to provide a financially inclusive environment for the global Muslim community (Nain, 2014).

According to one study in Pakistan, the majority of people prefer the Islamic banking system because it is interest-free, as interest is *Haram*, or forbidden in Islam. When it comes to choosing Islamic banks, the religious motive is the second most compelling factor (Subhani, 2012). Religion, awareness of Islamic banking products and services, advertising, networking, and awareness of Islamic financial teachings were discovered to have a significant impact on customers' perception of Islamic banking (Akhtar, 2016). Some studies, such as Khokhar (2014) and Ergun (2011), investigated the factors used by customers when choosing Islamic banking and discovered that religion was an important criterion for Muslims to choose Islamic banks over conventional banks, while high returns were the most important factor for non-Muslims.

2.3 Technological Advancement

According to some researchers, one of the most important factors influencing the adoption of Islamic banking is technology. A banking network is a type of banking service provided by a country's banking system via a secure website, apps, and social media for bill payment, account balance viewing, statement of account, fund transfer, and so on. In a study by Nain (2014), the first four important criteria are awareness of Islamic financial teachings, the reputation of the banking system, technological networking, and religion.

2.4 Promotion

Advertising is the most essential method through which awareness about anything is created for the intended clients. Banks spend a lot of money on advertising to attract their clients by creating awareness about such aspects as service quality, their products' features and benefits, the way of usage characteristics, lifetime, and other attributes of the offered services. In some studies, product and service awareness and advertising were found to have no significant impact on the perception and adoption of Islamic banking (Nain, 2014).

Bank customers have been poorly informed about Islamic banks' products and services. According to survey results from a large number of respondents, they were not well-versed in the Islamic banking system and its products. Only a few people understand the Islamic banking system completely. Marketing efforts need to be increased to attract more customers to the Islamic banking system (Sohail, 2014).

2.5 Reputation

Customers' perceptions are heavily influenced by an organization's reputation. The reputation of a firm is established when it serves the needs of clients according to their desires. The reputation of a bank is a significant aspect that influences clients' perceptions (Razal, 2012). When a consumer is satisfied, he or she has a good influence on others and is likely to advocate for his or her bank. As a result, it creates a positive perception of the bank and aids in the adoption of it. According to a survey, reputation is the second most essential criterion for Islamic banking adoption (Nain, 2014).

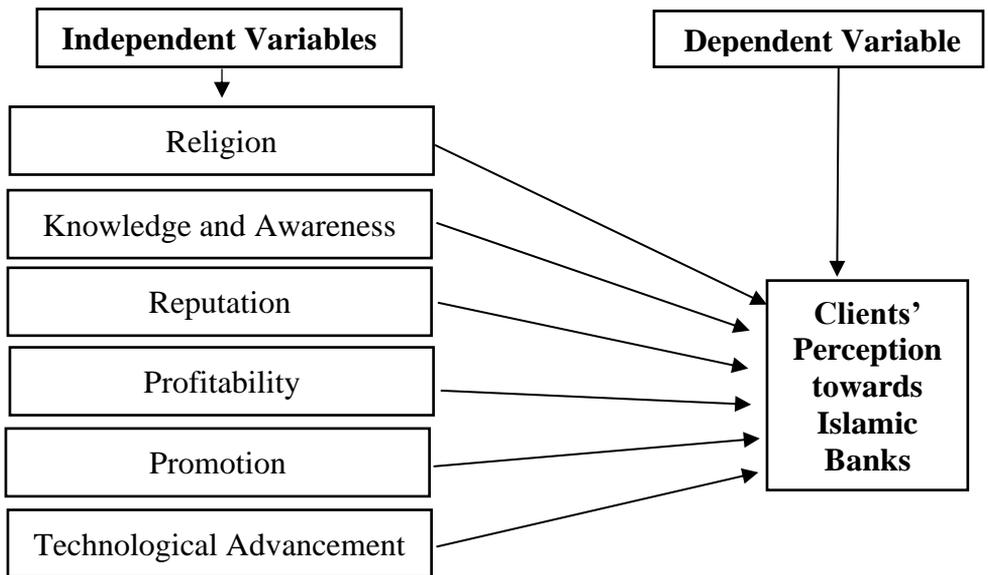
2.6 Profitability

Regardless of the type of bank, whether Islamic or conventional, the rate of return is one of the most important aspects to be considered when selecting one. The greater the profitability, the more likely people are to adopt based on economic considerations. This decision-making process is applied by both institutional and private clients to some extent. Though Islamic banks do not provide predefined or fixed profits, it is clear that they share above-average profits, particularly in Bangladesh's banking sector. As a result, when clients take a loan or make investment decisions, they find a better potential return with the *Shariah* compliance banks. A significant proportion of respondents stated that they would prefer to

invest their savings in Islamic banks if they had offered a better return than that of traditional banks (Mohammad, 2012). According to the findings of a few other articles, substantial profit and inexpensive service charges are two of the most essential aspects as perceived by Pakistani clients (Muhammad, 2012; Subhani, 2012).

Based on the above literature review and discussion, the researchers of the present study have proposed a conceptual framework that attempts to illustrate how clients' perception is influenced by various independent variables.

Figure 1: Proposed conceptual framework in accordance with the research questions and objectives.



Source: Developed by the researchers

3. Objectives

The primary aim of this paper is to investigate the question of how clients of different Islamic banks in Bangladesh perceive the Islamic identity of these banks. In order to do so, the researchers attempted to find out the factors that influence the clients' adoption of the banks. In addition to this, they tried to identify different factors that influence clients' perceptions of the Islamic banking system in Bangladesh.

4. Hypotheses

In order to achieve the stated objectives, the following hypotheses have been proposed for this study:

H₀₁: There is a positive relationship between knowledge and awareness and the perception of Islamic banks by the clients.

H₀₂: There is a significant positive relationship between religious beliefs and clients' perceptions of Islamic banks.

H₀₃: There is a strong positive correlation between technological advancement and clients' perception of Islamic banks.

H₀₄: There is a positive relationship between clients' perception of Islamic banks and promotion.

H₀₅: There is a positive relationship between reputation and clients' perception of Islamic banks.

H₀₆: There is a positive relationship between profitability and clients' perception of Islamic banks.

5. Methodology

To investigate the factors influencing clients' perception and acceptance of Islamic banking, the descriptive research (quantitative) approach was used to assess the variables' effects. However, in order to make the study more meaningful, both primary and secondary sources of data have been used and analyzed. The field survey was carried out to collect primary data for conducting the study. Secondary data was collected from various books, journals, articles, and web-based publications.

The target population of this study is the clients who have accounts with any Islamic bank in Bangladesh. The non-probability judgmental technique was used to select the sample of 96 respondents from the various branches of Islamic banks in Dhaka, Bangladesh. A semi-structured questionnaire was developed to collect primary data on various independent variables, i.e. Religion, Knowledge and Awareness, Reputation, Profitability, Promotion, and Technological Advancement as identified by the researchers after reviewing the different literature. All the variables were measured by using a 7-point Likert Scale. Using the Statistical Package for Social Sciences (SPSS-Version 17.0), the data was

analyzed and the relationship between the dependent and the independent variables as proposed in the conceptual framework was investigated.

6. Analysis and Findings

6.1 Reliability Test

The Cronbach Alpha coefficient was used to assess the internal consistency of the collected data. Except for the profitability factor, the coefficients were over 0.8, which is acceptable for this study. Cronbach Alpha for the profitability factor is 0.647, with two items below 0.7. As a result, these items were removed from the list of factors and did not appear in the regression analysis. Consequently, six criteria were chosen for further investigation.

Table 1: Cronbach alpha for all variables taken in the study.

Factors	Cronbach Alpha	No. of items
Knowledge & Awareness	.840	5
Religiosity	.835	6
Technology	.879	5
Profitability	.647	2
Promotion	.818	4
Reputation	.889	5

Source: SPSS analysis of the collected primary data by the researchers

6.2 Convergent Validity

Table 2 below indicates the correlation matrix between different pairs of the components. The correlation value for all the pairs is below 0.8 which indicates no multi-co-linearity problem among factors and the factors are convergent and valid.

Table 2: Component Correlation Matrix

Component	KA	RG	TEC	PFT	P	RPT
KA	1.000					
RG	.231	1.000				
TEC	.250	.395	1.000			
PFT	.308	.357	.242	1.000		
P	.382	.429	.267	.206	1.000	
RPT	.124	.052	.027	.122	.054	1.000

Where, KA- Knowledge and Awareness, RG- Religion, TEC- Technology, PFT- Profit, P- Promotion, and RPT- Reputation

Source: SPSS analysis of the collected primary data by the researchers

6.3 Demographic Analysis

According to the demographic analysis, the number of male respondents was a bit higher at roughly 78%; and 36% were between the ages of 25 and 35. A large number of respondents (44.8%) held a postgraduate degree, and 35.4% were businessmen by profession. Interestingly, a significant portion of the respondents (44.8%) had a monthly income of less than Tk. 10,000 only.

6.4 Factor Analysis

Factor analysis helps to reduce items to a smaller number of factors. A variety of methods can be used to conduct factor analysis. In this investigation, the Principal Component Factoring method was used. The Kaiser-Meyer-Olkin test determines sample adequacy, suggesting that values greater than 0.5 are considered quite good. This study's KMO is .748, which is acceptable, and the sample are suitable for further testing. While Bartlett's test determines the correlations between variables are large enough for the factor analysis to be useful (Field, 2005). In this case (Table 4.7), the Bartlett's test is highly significant ($p < 0.001$) and sufficient for further investigation.

6.5 Principal Component Analysis (PCA)

The principal component analysis of all 27 constructs produced six factors based on Kaiser's criterion of retaining eigenvalues greater than 1.0 (Field, 2005). Eigenvalues demonstrate the similarity of all data and components by reflecting the value of their attributes. The average explanatory power of these factors is represented by the cumulative Extraction Sums of Squared Loading. The components used in this study have an explanatory power of 68.47 percent, which is satisfactory because it exceeds the rule of thumb of 50 percent.

6.6 Factor Loading

Loaded indicators were conducted via factor analysis as the primary element of the exploratory factor analysis after standard components were extracted and rotated to equalize them. The number of loaded entries in the pattern matrix is shown in Appendix 1. Each component's data was sorted by size. The numbers 1 to 6 in the columns represent six different elements or components that were grouped based on sample statistics. The goal with Promax was on fitting each indicator to a single component (factor). As a result, other integers in the matrix that is smaller than 0.5 are suppressed by our SPSS criteria.

Loaded numbers were sorted by size according to the pattern matrix in Appendix 1. Therefore, they are not in order of questions in the questionnaire. Component 1 items are loaded for technology. Component 2 items are completely loaded with the items relevant to the reputation variable. Component 3 items are loaded for religious variables, component 4 items are loaded for education and awareness variables, component 5 items are for promotion variables, and lastly, component 6 for all the items are linked to profitability.

We can deduce from the loaded factors that the model used for this study based on the 6 independent variables for the adoption of Islamic banks' dimensions is appropriate to accept because practically all of the items are loaded in their component with substantial coefficient values. As a result, we can utilize the factor loading results as regression scores to determine the impact of the Islamic banking system's perception as a dependent variable on the regression test.

6.7 Regression Analysis

This section of the study employs linear regression to investigate the predictive abilities of the established constructs on the dependent variable and determine whether or not the hypotheses can be confirmed. Table 3 shows the R, R², and adjusted R² coefficient determinants. After entering all 27 independent variable items, R equals 0.847, indicating a strong relationship between the independent variables and the dependent variable elements. R² is equal to 0.718. This means that the items of these independent variables account for roughly 72% of the changes in the dependent variable's item. The point is that the R² analysis omitted a degree of freedom. As a result, we get adjusted R² = 0.613 (which involves df), indicating that the model for this study is a good fit.

Table 3: Regression Model Summary b

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.847 ^a	.718	.613	.568

a. Predictors: (Constant), KA(1-5), RG(1-6), TEC(1-5), P(1-4), RPT(1-5).

b. Dependent Variable: I like Islamic bank because it is beneficial to me.

Source: SPSS analysis of the collected primary data by the researchers

6.8 ANOVA for Regression

As per table 4, the ANOVA test for the independent variable's questions has a significant correlation with the independent variable's question. As can be seen, with a P-value of 0.000, it is possible to conclude that the F is significant at 0.01. This indicates that at least one of the independent variable questions accurately predicts the dependent variable question.

Table 4: ANOVA for Coefficient Values in Regression

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	54.934	25	2.197	6.821	.000 ^a
	Residual	21.582	67	.322		
	Total	76.516	92			

a. Predictors: (Constant), KA(1-5), RG(1-6), TEC(1-5), P(1-4), RPT(1-5).

b. Dependent Variable: I like Islamic bank because it is beneficial to me.

Source: SPSS analysis of the collected primary data by the researchers

According to Table 4, four items that are RG-2 (try to follow Islamic injunctions), RG-3 (try to avoid minor and major sin), RG-6 (feel sorrow and dissatisfaction), and TEC-1 (Islamic banks provide better online banking services) is significant at the 1% level of significance and $t > 1.65$, whereas the other five items are not. KA-2 (aware of the distinction between Islamic and conventional banking), RG-4 (aware of the fundamental and necessary knowledge of my religion), RG-5 (belief in all basic ideological dimensions of Islam), TEC-4 (use technology for every activity more than that of conventional banks) and P-1 (provide more advertisement than that of other conventional banks) are significant at 5% level and $t > 1.65$. Another two items that are KA-1 (aware of Islamic bank products and services) and KA-5 (know about benefits of using Islamic banking) are significant at a 10% level and $t > 1.65$.

Table 5 shows the ANOVA test for independent factors with a significant relationship to independent variables. The F is significant at 0.01 with a P-value of 0.000. This means that at least one independent variable can predict the dependent variable.

Table 5: ANOVA for Coefficient Values in Regression^b

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	27.969	5	5.594	10.347	.000 ^a
	Residual	48.656	90	.541		
	Total	76.625	95			

a. Predictors: (Constant), M_RPT, M_TEC, M_RG, M_KA, M_PRO

b. Dependent Variable: I like Islamic bank because it is beneficial to me.

Source: SPSS analysis of the collected primary data by the researchers

6.9 Testing of Hypotheses

According to Table 6, religion is significant at a 1% level of significance ($t > 1.65$), whereas banks' reputation is significant at a 5% level of significance ($t > 1.65$) and technology is significant at a 5% level of significance ($t > 1.65$). Beta weights are used to determine the magnitude of an independent variable's influence on the dependent variable, whereas Beta weights are used to predict changes.

Table 6: Test of Hypotheses

Hyp	Relationship	Beta	Std. Error	t-value	Decision
H ₀₁	Knowledge and Awareness → Perception	-.003	.127	-.028	Not supported
H ₀₂	Religion → Perception	.289	.147	3.011*	Supported
H ₀₃	Technology → Perception	.173	.126	1.743***	Supported
H ₀₄	Promotion → Perception	.147	.113	1.422	Not supported
H ₀₅	Reputation → Perception	.225	.133	2.135**	Supported

*indicates 1% level of significance, ** indicates 5% level of significance, *** indicates 10% level of significance.

Source: SPSS analysis of the collected primary data by the researchers

The findings of the study revealed that hypotheses H₀₁ and H₀₄ were not significant, which differed from previous studies. On the other hand, hypotheses H₀₂, H₀₃, and H₀₅ were accepted and were similar to the existing literature. The hypothesis (H₀₁) asserts that there is a positive relationship between client knowledge and awareness and their perception of Islamic banks. This outcome is not significant, indicating that Islamic banks' acceptance is not determined by knowledge and awareness.

The hypothesis (H₀₂) proposed that there is a positive relationship between clients' religion and their perception of Islamic banking. The significant result of the study ($\beta=0.289$, $p<0.01$) indicates that religion is a predictor of Islamic banks' acceptance. This supports the prevalent idea that Islamic banks are functioning well in Bangladesh because people are well aware of the prohibition of interest and Islamic religious teachings (*Shariah*).

The hypothesis (H₀₃) suggested that there is a positive correlation between technology and Islamic banks' perception. This study's finding is significant ($\beta=0.173$, $p<0.010$), indicating that technology is a predictor of Islamic bank acceptance. As a result, Islamic banks in Bangladesh are able to keep up with technological advancements in the general banking sector. The hypothesis (H₀₄) proposed a positive relationship between bank promotion and Islamic bank acceptance. The finding of this study indicates that promotion is insignificant as a predictor of Islamic banks' acceptance. The hypothesis (H₀₅) proposed a positive relationship between bank reputation and Islamic bank acceptance. This result is significant ($\beta=0.225$, $p<0.05$), indicating that reputation is a predictor of Islamic banks' perception and adoption.

7. Conclusion

The aim of the study was to identify the factors that influence clients' perceptions and, as a result, the adoption of Islamic banking in Bangladesh. Religion is identified as the most important factor, but the research findings indicate that Islamic banks should adapt to rapid technological development by incorporating current, cutting-edge technology into their operations, and redesigning their slow manual decision-making structure.

However, Islamic banking is becoming more and more popular among the Muslims due to Islamic laws and principles, and it is primarily religion that influences clients' perceptions and subsequently leads to the adoption of Islamic banking in the context of Bangladesh.

8. Recommendation and Scope for Further Studies

Because the findings of this study show that the three significant factors influencing clients' perception of Islamic banks are religion, technological advancement, and the bank's reputation, Islamic banks must strictly adhere to the guidance provided by their *shariah* council. Furthermore, they must keep up with the technologically advanced services vis-a-vis those provided by conventional banks. They must also take proper notice of their reputation in the mindset of the Muslim clients. The findings also suggest that the responsibility lies with the regulatory body, i.e. the Bangladesh Bank, to ensure that the concerned banks strictly follow the *sharia*-based banking principles for ensuring their acceptability to Muslim clients.

This research is important not only for the people of this country but also for the global banking industry. It provides an answer to the question of how far people perceive the Islamic banking system to be Islamic. Furthermore, it serves as a foundation for understanding the critical factors that influence clients' perceptions of Islamic banking in Bangladesh.

This research invites further investigation into the causes of why the Islamic banking system is gaining popularity even in the Western world by considering larger sample size and by taking additional variables into consideration in order to dig deeper into the causes of the adoption and popularity of the Islamic banking system around the globe.

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Appendix 1

Rotated Component Matrix and Loaded Factors

Pattern Matrix ^a						
ITEMS	Component					
	Technology	CSR	Religion	Knowledge and Awareness	Promotion	Profitability
KA-1				.727		
KA-2				.722		
KA-3				.746		
KA-4				.668		
KA-5				.798		
RG-1			.567			
RG-2			.836			
RG-3			.849			
RG-4			.782			
RG-5			.621			
RG-6			.654			
TEC-1	.677					
TEC-2	.812					
TEC-3	.816					
TEC-4	.914					
TEC-5	.827					
PFIT-1						.575
PFIT-2						.748
P-1					.773	
P-2					.840	
P-3					.759	
P-4					.648	
RPT-1		.777				
RPT-2		.857				
RPT-3		.787				
RPT-4		.831				
RPT-5		.883				

a. Rotation converged in 7 iterations.

Source: SPSS analysis of the collected primary data by the researchers

Declaration of Interests

We, the authors of this research manuscript, declare that we have no financial interest. We have provided written consent to publish the paper in this journal.

To cite this article: Rahman, M, L; Masukujjaman, M. and Islam, A. (2022). How Islamic is the Islamic Banking System? - A Study on Clients' Perception of Islamic Banks in Bangladesh. *Journal of Business and Development Studies*, vol: 01, issue: 01, page: 31:51, ISUCRDP, Dhaka