

**CONSUMER RECEPTIVENESS OF ISLAMIC HOME
FINANCING: A STUDY OF FIRST-TIME HOUSE
BUYERS IN KOTA KINABALU AND LABUAN**

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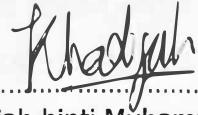


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DECLARATION

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ABSTRACT

Islamic home financing is one of the essential products of Islamic financing in the Islamic banking industry. However, consumer acceptance has often taken for granted whereby the significance view of consumers is neglected when Islamic banks are designing and offering the products. Furthermore, many efforts have been directed by Islamic banks to promote Islamic home financing products, however, the acceptance of the products is still lagged behind compared with their conventional peers. Owing to this trend, there is a need to examine the factors of influencing the intention of first-time house buyers to select Islamic home financing. Examining factors that can improve consumer receptiveness will offer support for the Islamic banks to boost the marketability of Islamic home mortgage products. First-time house buyers are selected due to the fact that they are part of customer base of Islamic banks. Furthermore, this particular group is a source of profit for the Islamic banks as they are mostly working adults aged from 25 to 35 years old, thus in highly potential to invest their money and commitment to the banks exclusively for Islamic home financing products. Operating the theory of planned behaviour (TPB) as a baseline theory, this study suggests a model to examine behavioural intention of selecting Islamic home mortgage. The role of perceived consumer *Taqwa* as a moderator is also examined. To explore the model, a mixture of qualitative and quantitative two-stage methodological approach are used. The first stage includes literature survey, interviews as well as expert feedbacks with three *Shariah* experts to induce measurement items. In the second stage, a survey methodology is used to examine 353 respondents who are bank customers of full-fledged Islamic banks in Labuan and Kota Kinabalu. The banks are chosen because of their nature of purely Islamic banks with variety of *Shariah* products offering. Moreover, high response rate is achieved as the location of the banks are strategic. The survey data are then analysed using Structural Equation Modelling technique namely Partial Least Squares (PLS). Based on the findings, it is suggested that (a) attitude and perceived behavioural control of theory of planned behaviour are significant to the intention to choose Islamic home financing products, (b) perceived *Maqasid*-based mortgage, perceived consumer *Taqwa* and price fairness of Islamic home financing are influential in determining Islamic home financing receptivity and (c) perceived consumer *Taqwa* is instrumental in moderating the relationship of consumers' attitude and their behavioural intention to select Islamic home financing products. Results are discussed in terms of implications for Islamic banks' managers to enhance the marketability and profitability of Islamic home financing and in terms of methodological and theoretical contributions. In short, this thesis contributes to the enhancement of items for TPB variables as well as generation of new measurement items for new factors reflecting Islamic home financing.

ABSTRAK

PENERIMAAN PENGGUNA PEMBIAYAAN RUMAH ISLAMIK: SATU KAJIAN PEMBELI RUMAH KALI PERTAMA DI KOTA KINABALU DAN LABUAN

Pembiayaan rumah Islamik adalah salah satu produk penting pembiayaan Islamik dalam industri perbankan Islam. Walaubagaimanapun, penerimaan pengguna sering diambil ringan di mana pendapat mereka diabaikan semasa bank Islam merancang dan menawarkan produk tersebut. Tambahan lagi, pelbagai usaha telah dilakukan oleh bank-bank Islam untuk mempromosikan produk pembiayaan rumah Islamik, namun, penerimaan produk ini masih kurang jika dibandingkan dengan produk pinjaman rumah konvensional. Oleh sebab itu, terdapat keperluan untuk mengkaji faktor-faktor yang mempengaruhi niat pembeli rumah pertama kali untuk memilih pembiayaan rumah Islamik. Faktor penentu yang dapat meningkatkan penerimaan pengguna akan memberikan sokongan kepada bank-bank Islam dalam meningkatkan kebolehpasaran produk pembiayaan rumah Islamik. Pembeli rumah pertama kali dipilih kerana mereka adalah sebahagian daripada pelanggan asas bank Islam. Selain itu, golongan ini adalah sumber keuntungan bagi bank Islam kerana mereka ini terdiri daripada golongan bekerja yang berumur 25 hingga 35 tahun, dengan itu berpotensi untuk melabur wang dan komitmen kepada bank secara eksklusif untuk produk pembiayaan rumah Islamik. Dengan menggunakan Theory of Planned Behaviour (TPB) sebagai teori asas, kajian ini mencadangkan satu model untuk mengkaji niat untuk memilih pembiayaan rumah Islamik. Persepsi pengguna Taqwa sebagai moderator turut dikaji. Untuk mengkaji model ini, kombinasi pendekatan metodologi dua peringkat iaitu kualitatif dan kuantitatif digunakan. Peringkat pertama terdiri daripada tinjauan literatur, wawancara serta maklum balas pakar dengan tiga pakar Syariah bagi membina item pengukuran. Pada peringkat kedua, metodologi tinjauan digunakan untuk mengkaji 353 orang responden yang merupakan pelanggan bank Islam di Labuan dan Kota Kinabalu. Beberapa bank telah dipilih kerana ciri-cirinya sebagai bank Islam yang penuh di samping produk-produk Syariah yang ditawarkan. Selain itu, kadar tindak balas yang tinggi dicapai kerana lokasi bank-bank tersebut adalah strategik. Data tinjauan kemudian dianalisis dengan menggunakan teknik Pemodelan Persamaan Struktur iaitu Partial Least Squares (PLS). Berdasarkan penemuan ini, dicadangkan bahawa (a) faktor sikap dan perilaku tingkah laku pengguna dalam Theory of Planned Behaviour adalah signifikan dalam memilih produk pembiayaan rumah Islamik, (b) faktor persepsi gadai janji berasaskan Maqasid, persepsi pengguna Taqwa dan kesaksamaan harga pembiayaan rumah Islamik adalah berpengaruh dalam menentukan penerimaan pembiayaan rumah Islamik dan (c) Persepsi pengguna Taqwa berperanan dalam menyederhanakan hubungan antara sikap dan niat pengguna untuk memilih produk pembiayaan rumah Islamik. Hasil kajian dibincangkan dari segi implikasi untuk pengurus bank Islam bagi meningkatkan kebolehpasaran dan keuntungan pembiayaan rumah Islamik dan dari segi sumbangan metodologi dan teoritis. Pendek kata, tesis ini menyumbang kepada penambahbaikan untuk pemboleh ubah TPB serta penjana item pengukuran baru untuk faktor-faktor baru yang mencerminkan pembiayaan rumah Islamik.

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LIST OF ABBREVIATIONS

AIMAT	-	<i>Al-Ijarah Muntahia bi Tamleek</i>
ATT	-	Attitude
AVE	-	Average Variance Extracted
BBA	-	<i>Bay' Bithaman Ajil</i>
BFR	-	Base Financing Rate
BIMB	-	Bank Islam Malaysia Berhad
BLR	-	Base Lending Rate
BMMB	-	Bank Muamalat Malaysia Berhad
BNM	-	Bank Negara Malaysia
EFR	-	Effective Financing Rate
ELR	-	Effective Lending Rate
IA	-	Islamic Altruism
IHF	-	Islamic Home Financing
KFH	-	Kuwait Finance House
LPC	-	Late Payment Charge
MM	-	<i>Musharakah Mutanaqisah</i>
PBC	-	Perceived Behavioural Control
PCT	-	Perceived Consumer <i>Taqwa</i>
PDS	-	Product Disclosure Sheet
PF	-	Price Fairness
PLS	-	Partial Least Squares
PMB	-	Perceived <i>Maqasid</i> -based Mortgage
SEM	-	Structural Equation Modelling
SN	-	Subjective Norm
SPSS	-	Statistical Package for Social Science
TiCB	-	Theory of Islamic Consumer Behaviour
TPB	-	Theory of Planned Behaviour
TRA	-	Theory of Reasoned Action

LIST OF TERMINOLOGIES

<i>Al-Quran</i>	The Holy Book of Islam
<i>Bay' Bithaman Ajil</i>	Deferred payment
Darruriyat	Necessity
<i>Fatwa</i>	Legal opinion from <i>mufti</i> (a qualified jurist)
<i>Fiqh Muamalat</i>	Islamic jurisprudence in commercial transactions
<i>Gharar</i>	Uncertainty
<i>Ghubn</i>	Fraudulent practice
<i>Hadith</i>	Muhammad S.A.W's words, deeds and silent approval
<i>Hajiyyat</i>	Complementary
<i>Halal</i>	Permissible
<i>Haram</i>	Prohibited
<i>Hilah</i>	A trick in financial transactions to avoid Islamic law
<i>Ijarah Mawsufah fi Zimmah</i>	A forward lease contract
<i>Ijarah Muntahia bi Tamleek</i>	A contract of leasing ending with ownership
<i>Ijarah</i>	Lease
<i>Istisna'</i>	A manufacturing goods contract
<i>Maisir</i>	Gambling
<i>Maqasid al-Shariah</i>	Objectives of Islamic law
<i>Maslahah</i>	Public interest, opposite of <i>mafsadah</i> (harm)
<i>Murabahah</i>	A sale of goods with a disclosed cost and profit
<i>Musharakah Mutanaqisah</i>	A diminishing partnership contract
<i>Muslim</i>	A person who follows the religion of Islam
<i>Qardhul Hassan</i>	Benevolent loan
<i>Sadaqah</i>	Voluntary charity
<i>Tahsiniyat</i>	Embellishments
<i>Taqwa</i>	One's love and fear to Allah (SWT)
<i>Tawarruq</i>	A tripartite sale
<i>Urf'</i>	Common practice
<i>Zakat</i>	Obligatory charity

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CHAPTER 1

INTRODUCTION

1.1 Background of the Study

According to the Islamic Finance Development Report and Indicator, the global Islamic finance assets are expected to grow by nearly 72 per cent to USD3.78 trillion in 2022 from USD2.2 trillion as at the end of 2016. In terms of industry growth, Malaysia maintains a leading position worldwide followed by other Muslim countries such as Bahrain, the United Arab Emirates (UAE), Pakistan, Kuwait, Saudi Arabia, Jordan, Oman, and Brunei. Evidently, Malaysia's Islamic banking sector had raised USD204.4 billion by the end of 2017, ranked third globally after Iran and Saudi Arabia.

The emergence and rapid growth of Islamic banking and finance today is a clear manifestation of Islam as a religion and a way of life. The Islamic financial system unites Islamic values with the traditional financial system, with a priority to meet the various needs of modern-day Muslims. This alternative to traditional finance is indeed an attractive plan for both Muslims and non-Muslims owing to the unique features that it offers.

It is clear that Islamic banking and products are uniquely different from its conventional peers because of two main reasons. First, Islamic banks have to thrive under strict religious guidelines or the *Shariah* principles to ensure interest is prohibited in all forms of transactions and business activities. Transactions and business activities should be conducted on the basis of fairness and legal (*halal*) profits. Second, Islamic banking products are developed by applying the concept of *ijtihad* with the presence of *Shariah* advisors as the experts in Islamic financial institutions.

The current study emphasises one of the Islamic banking products, known as Islamic home financing. It is a type of financing offered by Islamic banks that uses a house as collateral whereby the consumers have to pay a sum of money every month to the bank (Amin *et al.*, 2009). It is one of the important sources of profit for the

bank along with other financing facilities such as automobile financing, credit cards, and others. For example, Bank Islam Malaysia Berhad (BIMB) reported that Islamic home mortgages contributed higher than 50 per cent to the total financing profit of Islamic banks (Amin *et al.*, 2017).

Besides that, the facility follows the objective of *Shariah* or generally known as *Maqasid al-Shariah* (Amin *et al.*, 2013). Many *Shariah* scholars have approved that the objective of *Shariah* is to act for the benefit of society and to protect them from harm (Aris *et al.*, 2013). It promotes human well-being by protecting and upgrading faith, human self, intellect, lineage, and wealth. It is for this purpose that the *Shariah* guides the Islamic home financing facility to involve only in *halal* activities (productive and permissible).

In the academic literature, many research endeavours have been devoted over the years to examine consumer receptiveness of Islamic home financing. Consumer receptiveness, or consumer behaviour, is a study of how entities or specific groups of individuals are likely to choose, purchase or consume of products and services. A study of consumer behaviour is conducted partly to meet consumers' satisfaction (Solomon, 2014). The current study also suggests that the definition of consumer behaviour is beyond that; it stresses the importance of balanced consumption rooted by God-fearing or God-consciousness (*Taqwa*) and altruistic behaviour. As organisations or marketers obtain much information about their consumers, they can use it to enhance their product offering and marketing strategy.

In relation to home financing, Koklic & Vida (2006) indicate that mortgage suppliers should examine their clients' knowledge and experiences on mortgages. The reason is that consumers have a high tendency to worry and feel concerned about their mortgages, as these are risky investments that affect one's long-term financial commitment. Therefore, the current study has taken a keen interest in this research topic. Among others, the rationale behind this are three-fold. First, there is a concern pertaining to the poor market share of Islamic home financing than its competitors in the mortgage market. Second, various research studies have proven that consumers are the key stakeholders for the banks and become a source of income as well as competitive advantage for Islamic banks (Amin *et al.*, 2017). Third, empirical evidence on the intention of first-time house buyers to choose Islamic home financing is still lacking, although many studies have been conducted in this area.

It is argued that more studies should discover further practical and useful insights of first-time house buyers' perspectives about Islamic home financing. This is because this segment mainly consists of Gen Y or the millennials, thus, serves as an indicator for the demand and supply of Islamic home financing. Moreover, this segment is believed to be a source of profit for the Islamic banks as they mostly consist of working people aged from 25 to 35 years old. These people have high potential to invest their money, time, and commitment to the banks exclusively for Islamic home financing products. Following these reasons, first-time house buyers are selected as the main subject of this study. According to the U.S. Department of Housing and Urban Development, a first-time house buyer is an individual who has never owned a house before (HUD, 2012).

As a fundamental approach, this study uses an underlying theory, the theory of planned behaviour (TPB), by Ajzen (1991). This theory consists of a set of psychological factors, namely attitude, subjective norms, and perceived behavioural control. To contribute to the body of literature, this study modifies the theory by adding a number of consumer factors that reflect consumer behaviour from the Islamic perspective and Islamic home financing itself, namely perceived *Maqasid*-based mortgage, perceived consumer *Taqwa*, and price fairness of Islamic home financing. The proposed factors are built from extensive literature review and prompt interview sessions with the experts in Islamic Finance.

1.2 Overview of Islamic Home Financing in Malaysia

Islamic home financing has shown tremendous growth throughout the years. From the existing sixteen Islamic banks under Bank Negara Malaysia (BNM), it has been recorded that the amount of Islamic home financing transactions increased from RM29.8 billion in 2010 to RM131.1 billion as at the end of 2017, representing 27.1 per cent of Islamic banks' total financing. This positive trend specifies that Islamic home financing has gained a positive response from the public. However, this trend does not confirm the definite control of Islamic banks on mortgage as a whole, given the Islamic home financing's market share is lesser compared to the conventional home loans in Malaysia. As at the end of 2017, Islamic home financing represented only 21.2 per cent of the total market share and the rest was retained by its conventional peers with 78.8 per cent (BNM, 2018).

In terms of the pricing structure of Islamic home mortgages, the base rate has been implemented by BNM as a new pricing framework effective from 2 January 2015. This pricing framework affects both Islamic banks' and conventional banks' financing products including mortgages. This Base Rate (BR) exists as a substitute to the former Base Financing Rate (BFR) and Base Lending Rate (BLR), which were initiated since 1983. This new rate is determined by banks according to their statutory reserve requirements (SRR) and benchmark cost of fund. Other constituents such as operating costs, liquidity risk premium, profit margin and debtors' credit risk are included in the spread or profit rate above the base rate.

Hence, in computing the effective lending rate (ELR) or effective financing rate (EFR), two components are considered, namely the base rate and spread. Such structure results in greater transparency of the banks, which improves the decision making by consumers in choosing financing products. It also brings higher flexibility among commercial banks to determine their benchmark rates (BNM, 2014). For example, Bank Islam Malaysia Berhad and Maybank Islamic offered EFR of 4.70% and 4.60%, respectively, as at June 2019 (BNM, 2019). This indicates that the banks are being competitive among each other to meet the rising consumer demand for financing facilities.

In the aspect of *Shariah* principles or contracts under Islamic home financing, the products under such principles often vary from one bank to another in terms of their name, related fee or charges, financing margin, *takaful* coverage, and benefits offered. A reason for the products' variation is that the Islamic banks attempt to differentiate their products from those of their conventional peers. Apart from that, Aris *et al.* (2012) had explained clearly that the *Shariah* committee in each of the banks often have a different point of view of the contracts involved in an effort to ensure compliance with *Shariah* as outlined by BNM. The committee usually involves a group of three qualified persons approved by BNM, and they are known to possess high integrity and expertise in *Shariah*.

Table 1.1: Islamic Home Financing Product Offerings as at June 2019

No.	Islamic bank	Product name	Shariah contract
1.	Affin Islamic Bank	Home Financing-i Home Financing-i	MM <i>Tawarruq</i>
2.	Al-Rajhi Bank	Structured Home Financing-i	<i>Tawarruq</i>
3.	Alliance Islamic Bank	i-Wish Home Financing-i	BBA
4.	Ambank Islamic Bank	MTQ Home Financing-i My First Home Scheme-i	<i>Tawarruq</i> <i>Tawarruq</i>
5.	MBSB Bank Berhad	Standard Home Financing-i Ultimate Home Financing-i My First Home Scheme-i	<i>Tawarruq</i> <i>Tawarruq</i> <i>Tawarruq</i>
6.	Bank Islam	<i>Baiti</i> Home Financing <i>Wahdah</i> Home Refinancing	<i>Tawarruq</i> <i>Tawarruq</i>
7.	Bank Muamalat	Home Financing-i SmartMortgage	<i>Tawarruq</i> <i>Tawarruq</i>
8.	CIMB Islamic Bank	Flexi Home Financing-i Variable Home Financing-i Term Financing-i (Residential Vacant Land) HomeFlexi Smart-i Variable Home Financing (PR1MA Homes) Vacant Land Flexi Smart-i (Residential Vacant Land) My First Home Scheme	<i>Tawarruq</i> <i>Tawarruq</i> <i>Tawarruq</i> <i>Shariah-compliant</i> <i>Shariah-compliant</i> <i>Shariah-compliant</i> <i>Shariah-compliant</i>
9.	HSBC Amanah	HomeSmart-i	MM or <i>Istisna'</i>
10.	Hong Leong Islamic	CM Flexi Property Financing-i	<i>Tawarruq</i>
11.	Kuwait Finance House	Asset Acquisition Financing-i (Completed house) Asset Acquisition Financing-i (House under construction)	<i>Ijarah Muntahia Bi Al-Tamlik</i> <i>Ijarah Mawsufah Fi Al-Zimmah</i>
12.	Maybank Islamic	Commodity <i>Murabahah</i> Financing-i	<i>Tawarruq</i>
13.	OCBC Al-Amin Bank	Manarat Home-i	<i>Ijarah Muntahia Bi Al-Tamlik</i>
14.	Public Islamic Bank	ABBA House Financing-i Home Equity Financing-i	BBA MM or <i>Ijarah Mawsufah Al-Zimmah</i>
15.	RHB Islamic Bank	Commodity <i>Murabahah</i> Term Financing-I for Home Commodity <i>Murabahah</i> Term Financing-i for Home(Full Flexi) Commodity <i>Murabahah</i> Enabler Home Financing-i Commodity <i>Murabahah</i> My First Home Financing-i Equity Home Financing-i Equity My First Home Financing-i	<i>Tawarruq</i> <i>Tawarruq</i> <i>Tawarruq</i> <i>Tawarruq</i> MM MM
16.	Standard Chartered Saadiq	Saadiq My Home-i Saadiq My HomeOne-i	MM MM

Source: A compilation from various websites of Islamic banks (2019)

Table 1.1 above depicts the current Islamic home financing products offered by Islamic banks in Malaysia. The list of products may not be in exhaustive detail and not complete to some extent. As shown in Table 1.1, Islamic home financing products are based on several *Shariah* contracts, namely *tawarruq*, (MM), *ijarah mawsuffah al-zimmah*, *ijarah muntahia bittamlik*, (BBA), and *istisna'*. Currently, the dominant *Shariah* contracts used by Islamic banks is *tawarruq*. The possible reason could be that *tawarruq* is attractive to the customers as it features commodity as the underlying asset for offering financing facility. More explanations on the *Shariah* contracts are provided in the following section.

i. *Tawarruq* home financing

Tawarruq is commonly known as commodity *murabahah* or reverse *murabahah*. This contract was officially implemented in the financial market by *Shariah* Advisory Council (SAC) of BNM during their 51st meeting on 28 July 2005. The issue of the contract's validity arises as many scholars have diverse views whether *tawarruq* is permissible or not. As for the current resolution, *tawarruq* is permissible according to its application and *fatwas* from various Islamic countries but subject to certain conditions (BNM, 2010).

Bank Islam Malaysia Berhad (BIMB) clearly explains the modus operandi of *tawarruq* for their home financing product (BIMB, 2018). First, the Islamic bank customer executes the Sale and Purchase Agreement (SPA) with the housing developer and becomes the owner of the house. Second, the customer requests for financing from the Islamic bank under *tawarruq* home financing to finance the remaining payment, say, 90% of the selling price of the house. The house will be charged to the bank to secure the repayment by the customer. Third, the customer appoints the Islamic bank as an unrestricted agent (*wakil*) to buy a *Shariah*-compliant commodity such as crude palm oil (CPO). Fourth, the bank sells the commodity to the customer. Fifth, the customer agrees to buy the commodity on deferred payment basis and appoints the bank as his agent again to sell the commodity on his behalf to any third party for immediate cash equal to the financing amount. The sale proceeds shall be disbursed to the customer to settle the payment of his house price to the developer. The customer will then pay the bank at the bank's selling price on a deferred payment basis. The selling price includes the financing amount plus profit margin disclosed by the bank to the customer (*murabahah*). This *murabahah*