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Customers' Perceptions of Ethical Issues in Corporate Governance of Islamic Banks in Bangladesh

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ABSTRACT

The study analyzes customer perceptions regarding the ethical standards of corporate governance of the Islamic banks in Bangladesh. The customers were found to have positive perceptions regarding the board of directors' competence, shariah board members' expertise and top management team's effectiveness to discharge Shariah laws. The clients very strongly agreed that their bank followed the Islamic principles. The customers responded positively regarding ethical disclosures of information by their banks. The study noted that the (Ed. note: should "the be changed to "each"?") bank had an effective and transparent mechanism to handle complaints, conflict management, and occurrences due to lack of due care. Interestingly the clients were found to rely more on newspapers, rather than each bank's website or e-mails for price-sensitive information. The customers were found to be positive regarding the regulatory body's position in regulating Islamic banks. The overall perception of the respondents regarding ethical corporate governance of the banks was found to be positive.

Keywords: ethical issues, corporate governance, compliance, information disclosure, Shariah rules, corporate and social reporting

I. Background

The Islamic banking renaissance in Bangladesh dates back to 1983, with the establishment of the first Islamic Bank in the country (Hassan, 2010). Since then, the Islamic banking sector has seen an impressive growth (Hassan et al. 2010). There are currently nine full-fledged Islamic banks operating in the country along with a number of conventional banks having Islamic windows. Islamic banks conduct their activities based upon Islamic law (Shariah1), which reflect the teachings of Islam. This religious framework encompasses four major principles: i) the prohibition of payment or receipt of interest (riba2); ii) the avoidance of involvement in speculative activities

(gharar3); iii) the prevention of investing in Islam-banned (haram4) products or services such as gambling and; iv) the payment of charity (zakah5).

The Islamic banks also operate under a socio-economic framework which is based on the principles of socio-economic development, social justice and social welfare that are achieved by mobilizing Shariah-compliant savings and investments. This framework encourages the profit-loss sharing principle which represents the core of Islamic finance. The profit-loss sharing principle promotes risk-sharing between lender and borrower, as well as ensuring equal distribution of wealth and the attainment of social justice. Trust finance (mudarah6) and equity participation (musharakah7) contracts represent the primary financial instruments that are based on the profit-loss sharing principle. Non-profit-loss sharing modes of Islamic finance also exist, which possess pre-determined and fixed rates of return, e.g., cost-plus financing

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(murabahah⁸), leasing (ijaarah⁹), leasing and purchasing (ijaarah was iqtinaa¹⁰), and forward sale (bay'salam¹¹).

The growth of Islamic financial institutions in Bangladesh, especially the Islamic banking sector, is currently witnessing a boom as a result of growing customer interest due to the unique religious value propositions of such institutions (Ahmad and Hassan 2007). Ethics is an integral component of Islamic banking and one of the major determinants of customer patronage. The corporate governance structure and Shariah compliance of Islamic banks also play important roles in positioning such institutions in the minds of the customers (Reaz and Arun 2006). Therefore, it is important to understand the awareness of customers regarding the ethical issues facing the corporate governance of Islamic banks.

The word "ethical" is typically used by Islamic banks as a label, but there is seldom any attempt to make the link between what is ethical and the specific methods of conducting financial transactions. Having a Shariah Supervisory Board which can endorse the bank's activities is seen as crucial to ensuring the institution's reputation. However, in their publicity materials, there is little attempt to explain the ethical merits of how the bank conducts its business (Ahmad and Hassan 2007). Although, Islamic banks primarily attract clients because of their religious beliefs, merely stating that a product is Shariah-compliant is insufficient to the clients. Islamic banks cannot expect to compete only on the basis of prices if these institutions wish to increase their number of customers. They have to convince potential customers of their inherent worth. They need to be more closely engaged with their clients and make them aware of the corporate governance structure through which the bank conducts its business.

Understanding the procedural and governance issues regarding ethics of Islamic banks requires a thorough understanding of Islamic economics and is outside the scope of this study. What is more important is the customers' perception of the ethical issues surrounding these banks, as those actions are directly reflected in their actions and choices of a bank? Hence, this paper attempts to find out the perception of customers of Islamic banks regarding the ethical issues in corporate governance of such banks. The findings will help the Islamic banks to take measures to improve the corporate governance practices and ethical standards by reducing the gaps, if any, that exist in their operations.

II. Objectives

The broad objective of the study is to find out the customers' perception of ethical issues in corporate governance of Islamic banks in Bangladesh. Specifically, this study looks into:

- a) knowledge of customers about the corporate governance structure and competence of Islamic banks
- b) perception of the customers about the level of compliance of Islamic banks with Shariah rules
- c) acquaintance of the customers regarding ethical disclosure of information by Islamic banks

III. Methodology

The study was conducted using both primary and secondary data and pertinent literature surveys. The primary data was collected through interviews and structured-questionnaire surveys of Islamic bank account holders. Secondary data has been collected from various research papers, books, and reports on Islamic banking and related publications. An extensive literature survey was undertaken to develop an insight into the nature and traditions of the Islamic banking sector in Bangladesh.

There is a total of 56 scheduled banks (listed with the central bank) in Bangladesh. Of these institutions, nine are fully Islamic banks, 10 are offering Islamic banking as a parallel service, and the rest are conventional banks. The primary data had been gathered from the responses of the 80 clients of nine different full-fledged Islamic banks through a non-probabilistic convenience questionnaire sampling. This sample size (80) can be justified with a level of significance of 7.2%, precision of 10% and a proportion of 50%. The questionnaire was finalized through pre-testing of 15 survey respondents. Statistical Index analysis consisted of incorporating a student's t-test, factor analysis, correlation, regression, etc. These analyses were conducted to assess the different views of Islamic bankers regarding the ethical issues of Islamic banking in Bangladesh.

The study used face validity to identify the study

variables. From the literature review and expert opinions, we logically determined the items to measure as variable. A high Cronbach's Alpha ($0.904 \geq 0.70$) suggests that the variables had acceptable internal consistencies among them and were reliable.

IV. Literature Review

A. Corporate Governance in Islamic Banks

Effective corporate governance in Islamic banks, as well as the firms that use bank funds, is one of the most important pillars of the efficient functioning of such institutions. Unfortunately, however, corporate governance is considered to be generally weak in the corporations of most developing countries (Chapra and Ahmed, 2002). This is because all the institutions that play a crucial role in disciplining markets and ensuring efficiency and integrity are not well-developed in these countries. Information asymmetries are more severe, market participants less experienced, and regulations, even if they exist, do not get enforced effectively and impartially because of political corruption and the general weakness of judicial systems (Febianto, 2010). Disclosures are also not adequate, and accounting practices are not well developed. Consequently, these corporations suffer from inefficiencies and inequities that adversely affect all stakeholders (Arun and Turner, 2004).

In line with the growth of the Islamic finance sector in Bangladesh and worldwide and the complexity of duty and responsibility of the Islamic banks towards different stakeholders, it is strongly indicated that there must be a sound and proper corporate governance system (Ahmed and Khatun, 2013). The good corporate governance system enhances and strengthens the function of the Shariah board and its related institution for the purpose of Shariah compliance. Shariah governance is a unique kind of governance in financial architecture as it is concerned with the religious aspects of the overall activities of Islamic banks. The existing standard-setting agencies such as the Organization for Economic Cooperation and Development (OECD), the International Organization and Securities Commission (IOSCO) and the Basel Committee on Banking Supervision (BCBS) have issued numerous

guidelines on governance and risk management for financial institutions. Nevertheless, these standards and guidelines failed to address specific ethical issues of Islamic finance (Dusuki and Abdullah, 2007). However, it is not only sufficient to have a good corporate governance structure in place, but it is imperative to communicate the actual business functioning of the bank to all its stakeholders, including the customers (Hassan and Chachi, 2008).

B. Customers' Attitude towards Islamic Banks

Although few studies have assessed customer perceptions of the corporate governance of Islamic banks, a significant amount of literature on customers' attitudes towards Islamic banks, especially concerning selection criteria (or patronage) and customer satisfaction, is already in place. Various studies point out that religion (Islam) as the main reason for choosing Islamic banks. These institutions are grounded in the principles of the Qur'an and the Hadith. Surveying 206 bank customers in Jordan, Naser, et al. (1999) found that 70% of the respondents identified religion as the reason for choosing Islamic banking. Metawa and Almoosawi (1998) found Shariah-based principles as the single most important factor for choosing Islamic banks. In Gerrard and Cunningham's (1997) study, 25% of the respondents pointed religion as the first factor to choose an Islamic bank. A study by Khan, et al. (2007) on Islamic banks in Bangladesh found out that 'religious principles' is the key bank selection criterion of the Islamic bank customers, while customers' demography plays some role in determining which selection criteria matter more than others do.

Although corporate social responsibility (CSR) and ethical investment have been considered as premier factors important for choosing an Islamic bank, Ahmad and Haron (2002) affirmed that factors like the bank's name and image, confidentiality, friends and family influences and provision of quality services are equally important for customers when making decision on their choice of bank. However, studies in Malaysia (Dusuki and Abdullah, 2007), UAE (Kuehn and Bley, 2004), Kuwait (Othman and Owen, 2001) found non-religious factors like efficiency, cost-benefit, etc., in conjunction with religion as the influential factors behind choosing an Islamic bank. Interestingly, one of the earliest studies of the behavior

of Islamic bank customers by Erol and El-Bdour (1989) in Jordan concluded that factors such as a fast and efficient service, the bank's reputation and image, and confidentiality were the primary bank criteria for the choice of bank, whether Islamic or conventional. This implied that religious motivation in bank selection did not appear to be the only important factor.

C. Corporate Governance and Shariah Compliance

The Organisation for Economic Co-operation and Development (OECD) defines corporate governance as "a set of relationships between a company's management, its board, its shareholders and other stakeholders which provide the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined". The philosophical foundation of corporate governance in Islam requires an additional layer of governance for the purpose of Shariah compliance. Therefore, a specific characteristic of the governance structure of Islamic banks is the Shariah Supervisory Board (SSB). It exists in addition to typical bank board governance structures, but its functions are mainly to certify (ex-ante) and to monitor (ex-post) all financial contracts, transactions, and further activities of a bank on behalf of shareholders and other stakeholders. The SSBs comprise of Shariah scholars or a committee of Fiqh al-Muamalat¹² (religious) scholars. The Shariah board plays the dual role of supervision and consultation.

As the nature and model of Islamic finance are different from the conventional counterparts, the need for a standard-setting agency, specifically for Islamic finance, was crucial. Hence, with the initiative of several Islamic Financial Institutions (IFIs) and regulatory authorities, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) and the Islamic Financial Services Board (IFSB) were established in 1992 and 2004 respectively. The AAOIFI has issued five governance standards while the IFSB has issued three Prudential Standards and one guiding principle on the governance in IFIs. The difference between the IFSB Prudential Standards and the AAOIFI Governance Standards is that the IFSB approach is more concerned towards regulators while AAOIFI, to individual IFIs.

D. Ethics in Islam

Ethics in Islam has a broad meaning, including character, behavior or code of conduct. In Islam, the word ethics is synonymous with the term *ad* (courtesy)¹³ and *khuluq* (good manners)¹⁴ (Siddiqui, 1997). These two terms denote good behavior or a standard of conduct to be observed in social interactions or the set of moral principles that distinguish right and wrong. Islamic model of corporate governance advocates a comprehensive approach by emphasizing the elements of ethics as propounded in the Holy Quran. Hence the Islamic ethical principles are a divine and religious construct.

Muslims regard Islam as a way of life and not merely a religion. Therefore, business ethics cannot be separated from ethics in the other aspects of a daily Muslim life. In the Islamic philosophy, it is claimed that ethics dominate economics and not vice versa (Anas and Ounira, 2009). Proper Islamic ethical conduct in business is based on leniency, which encompasses good manners, forgiveness, removal of hardship and compensation; service motive, where businesses provide needed services to the community; and consciousness of Allah that requires Muslim businessmen to be mindful of Allah in their conduct of business (Haniffa and Hudaib 2007).

V. Data Analysis and Findings

As noted the study has identified three parameters divided into a number of complex (7) and simple (46) variables to analyze the customer perception regarding the ethical standards of corporate governance of the Islamic banks in Bangladesh. Through a structured questionnaire using a five-point Likert-scale (1: Strongly agree & 5: Strongly disagree) client responses are observed regarding each of the 46 variables. Parameter-wise the detailed analysis is given below.

A. Corporate Governance Structure and Competence

The first parameter for this study, *corporate governance structure, and competence*, intended to find out the custom-

ers' knowledge of the composition and competence of board of directors and shariah supervisory board of the banks. In addition, the study also highlighted the top management team's role in maintaining Shariah compliance. This parameter consists of 3 complex variables that can be sub-divided into 15 simple variables (Table 1). Among these variables, only one has a high positive mean rating (1-2); 12 have a moderately positive mean rating (2-3), and the rest 2 have moderate negative mean ratings (3-4). All the indices except one were found to be significantly different from 3 (Indifferent) at 5% level of significance ($\alpha = 5\%$).

The study noted that the customers are not fully aware of the composition of the board of directors of the bank (3.23), but they responded a little positively regarding

the board of directors' honorarium (2.44), accountability (2.27) and competence (2.09). The customers are found aware of the presence of the shariah supervisory board of the bank (2.24), but they are not very sentient of its composition (3.34). The respondents noted that the shariah supervisory board members are expert in this area (2.46) and selected properly (2.27) and responsible enough for ensuring Shariah compliance of the bank (1.99). Customers found the Shariah supervisory board to be an independent body (2.56) and perceived them to be fair regarding their assessment (2.54) and accountability. They also think that the shariah board members of their bank do not sit on the shariah board of another bank (2.63). Customers noted that the top management takes part in decision-making in line with Shariah compliance

Table 1. Corporate Governance Structure and Competence

Parameter	Complex Variables	Simple Variables	Mean Index	Standard Deviation
Corporate Governance Structure (2.43)	Board of Directors (BOD) (2.51)	1) Clients awareness of the composition of the BOD of the bank	3.23*	1.42
		2) The honorarium of the BOD is in line with company policy	2.44	0.91
		3) The members of the BOD of the bank are accountable to all the stakeholders	2.27	0.95
		4) The members of the BOD of the bank are sufficiently qualified to run the bank	2.09	0.89
	Shariah Supervisory Board (SSB) (2.50)	1) Clients awareness of the composition of the SSB in the bank	3.34	1.34
		2) The members of the SSB of my bank do not sit on the SSB of another bank	2.63	0.83
		3) SSB is an independent body, not influenced by bank managers	2.56	1.12
		4) The SSB gives a truthful assessment and disclosure of the Shariah compliance of the bank	2.54	0.98
		5) The members of the SSB are experts in the field of Islamic finance	2.46	1.04
		6) The members of the SSB are selected on the proper criteria determined by Bangladesh Bank	2.27	0.90
		7) Clients awareness of the presence of an SSB in the bank	2.24	1.28
		8) The SSB is responsible for ensuring Shariah compliance of the bank	1.99	0.79
	Top Management (2.28)	1) The top management takes part in ethical decision making in line with Shariah compliance	2.41	0.74
		2) The top management has appropriate training in Shariah rules	2.28	0.82
		3) The top management ensures ethical behavior among employees of the bank	2.16	0.68

*Not significantly different from 3 (Indifferent) at $\alpha=5\%$. The rest are significantly different from 3 at $\alpha=5\%$.

(2.41), has appropriate training in Shariah rules (2.28) and also ensure ethical behavior of the bank employees (2.16).

B. Compliance with Shariah Rules

The second parameter of the study *banks compliance and regulation of Shariah rules* tried to find out customer perception regarding the bank's compliance and regulation of Shariah rules. In addition, the parameter also sought customer's perception about the role of regulatory bodies, like Bangladesh Bank, Government of Bangladesh, IFSB (Islamic Financial Services Board), and AAOIFI (Accounting and Auditing Organization for Islamic Financial Institutions). To analyze this parameter, the study has identified two complex variables and a total of 14 simple variables (Table 2). Among these variables, eight have a high positive mean rating (1-2); 4 have a moderate positive mean rating (2-3) and the rest 2

have moderate negative mean ratings (3-4). All the indices are found significantly different from 3 (Indifferent) at 5% level of significance ($\alpha = 5\%$).

The study found the respondents familiar with the Shariah rules (2.20). The clients very strongly agreed that their bank follows all the Islamic principles in their operations (1.66). Specifically, they very strongly approved that their respective banks do not pay (1.54) or receive (1.63) any interest, do not get involved in speculative activities (1.84), do not invest in haram services (1.60) or product (1.73), make obligatory payment of zakah (1.71) and give interest-free loans (2.44). Regarding the influence of regulatory bodies on the compliance of Shariah rules the customers are found positive to the role of Bangladesh Bank (2.11) and Government of Bangladesh (2.30) in regulating Islamic banks. But customers' perceived knowledge about the functions of other regulatory authorities of Islamic financing, like Islamic Financial Services Board (IFSB) (3.59) and Accounting and Auditing Organization for Islamic Financial

Table 2. Compliance with Shariah Rules

Parameter	Complex Variables	Simple Variables	Mean Index	Standard Deviation
Compliance and regulation to Shariah Rules (2.41)	Compliance with Shariah laws by the banks (1.81)	1) Bank gives interest-free loans	2.44	1.395
		2) I am familiar with the Shariah rules	2.20	1.072
		3) Bank is not involved in any speculative activities	1.84	.863
		4) On acceptance of business risk financing bank entitles a customer the return	1.81	1.020
		5) Bank does not invest in any venture producing haram products	1.73	.954
		6) Bank pays the obligatory payment of income and wealth (zakaah)	1.71	.944
		7) Bank follows all the major principles of Islamic banking	1.66	.913
		8) Bank does not receive interest	1.63	1.123
		9) Bank does not invest in any haram services	1.60	.894
		10) Bank does not pay interest	1.54	1.072
	Influence of regulatory bodies on the compliance of Shariah Rules (3.00)	1) I know the functions of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)	3.99	1.225
		2) I know the functions of the Islamic Financial Services Board (IFSB)	3.59	1.338
		3) Government plays an important role in regulation of Islamic banks in Bangladesh	2.30	.877
		4) Bangladesh Bank plays a major role in regulating the Islamic banks in Bangladesh	2.11	.751

N.B.: The indices are significantly different from 3 at $\alpha=5\%$.

Institutions (AAOIFI) (3.99) are found very limited.

C. Disclosure of Information

The third parameter of the research, disclosure of information, intended to find out the customers' knowledge and awareness of the information that should be disclosed by the bank. The study also intended to find out (i) if the customers know whether their bank takes adequate measures to notify the customers about the disclosed information and (ii) the means by which the customers get to know about the disclosures. This parameter consists of 2 complex variables which are further divided into 17 simple variables. Among these only 1 variable, social responsibility has a high positive mean rating (1.61), 12

variables have a moderately positive mean rating (2-3) and the rest 4 simple variables have a moderately low negative mean rating (3-4). All the indices are found significantly different from 3 (Indifferent) at 5% level of significance ($\alpha = 5\%$).

The study noted that the customers responded positively regarding ethical disclosure of information of the bank (2.57). They agreed that their banks make them aware of the credit risk (2.19), recognizes all expected profit or losses when reasonably measurable (2.26), discloses the amount it is obligated to deposit as compensating balances (2.48), do not manipulate price (2.03), never mislead clients by withholding information (2.01), never deliberately issues misleading information (2.85), and make full disclosure before signing a document (2.08). The study noted that the bank has an effective procedure

Table 3. Disclosure of Information

Parameter	Complex Variables	Simple Variables	Mean Index	Standard Deviation
Ethical Disclosure of Information (2.57)	Corporate and Social reporting (2.40)	The bank sometimes mistakenly issues information that is potentially misleading to the stakeholders	3.51	1.31
		The bank makes undisclosed profit at the expense of its clients	3.21	0.92
		The bank never deliberately issues information that is potentially misleading to the stakeholders	2.85	1.58
		The bank discloses the amount it is obligated to deposit with others as compensating balances	2.48	0.83
		The bank is transparent about conflicts while making clear what mechanisms are in place to manage them properly	2.36	0.98
		The bank has appropriate safeguard against occurrences due to lack of due care	2.32	0.79
		The bank recognizes all expected profit or losses when reasonably measurable	2.26	0.82
		The bank has an effective procedure to handle complaints	2.24	0.92
		The bank provides General disclosure about credit risk in its financial statements	2.19	0.86
		The bank informs clients about its obligation to make full disclosure of facts relevant to the proposed transaction before signing any documents	2.08	0.73
		The bank never manipulates price	2.03	0.73
		The bank never misleads clients by withholding material information	2.01	0.80
		The bank conducts its business in a socially responsible manner	1.61	0.81
	Measures to notify clients about the disclosed information (2.74)	I check the bank's website for price-sensitive information	3.10	1.50
		I check mails/e-mails for price-sensitive information of the bank	3.01	1.51
		I check newspaper for price-sensitive information of the bank	2.54	1.54
		The bank sends invitation to its share-holders to annual general meetings	2.33	1.50

N. B.: The indices are significantly different from 3 at $\alpha=5\%$.

Table 4. Frequency of Responses regarding Ethical Standards

Scores	Frequency	Percent
Strongly Agree (1)	17	21.5
Agree (2)	51	64.6
Neither agree nor disagree (3)	8	10.1
Disagree (4)	3	3.8
Strongly Disagree (5)	-	-
Total	79	100.0

Table 5. Total Variance Explained by the Factors

Factors	Eigen value	Variance (%)	Cumulative Variance (%)
1. Compliance with shariah rules	9.991	21.719	21.719
2. Corporate governance structure and competence	5.523	12.006	33.725
3. Shariah Supervisory Board Structure & Competence	3.727	8.103	41.828
4. Regulatory bodies of the banks	3.160	6.869	48.697
5. Disclosed information to clients	2.623	5.703	54.400
6. Effective complaints handling	2.070	4.500	58.900
7. Non-issuance of misleading information	2.024	4.400	63.301
8. Recognition of expected profit or loss	1.748	3.800	67.101
9. Government regulation	1.470	3.196	70.297
10. Safeguard against casual occurrences	1.192	2.591	72.888
11. Obligation to full disclosure	1.115	2.424	75.312
12. Shariah Supervisory Board	1.100	2.392	77.704
13. Corporate Reporting & bank regulation	1.016	2.208	79.912

to handle complaints (2.24), has a transparent mechanism of conflict management (2.36), and has an appropriate safeguard against undue occurrences (2.32). The clients did not believe that their bank mistakenly issues misleading information (3.51), nor made an undisclosed profit at the expense of its clients (3.21). Respondents agreed that the bank sent them an invitation to annual general meetings (2.33). But interestingly the clients are found to rely more on newspaper (2.54), rather than bank’s website (3.10) or e-mails (3.01) for price-sensitive information of their bank.

D. Overall Perception towards Ethical Standards in Corporate Governance

The overall perception of the respondents regarding ethical corporate governance of the banks is found positive. The study found that 86.1% of the respondents think

positively about banks ethical corporate governance. Mean index for overall perception towards ethical standard in corporate governance is found to be 1.96 (Std. dev.=0.82). It means that customers overall perception towards ethical standard in corporate governance of Islamic banks is positive.

E. Factor Analysis¹³

A factor analysis using orthogonal rotation¹⁴ is conducted to reduce the 46 variables into a few numbers of factors. The analysis reduced the 46 survey variables into 13 factors with Eigenvalue greater than one (Table 5). The factor analysis of 46 variables with 80 sample¹⁵ is found adequate (KMO test result = 0.543 \geq 0.5) and valid (Bartlett’s test of sphericity significance level = 0.000). As can be seen from the table, these 13 factors explain 79.91% of the variability. Also, it can be noted

Table 6. Variables of Factor 1

Sl No.	Variable Name	Factor Loading
1	Bank does not pay interest	.893
2	Bank does not receive interest	.879
3	Bank does not invest in any venture producing haram products	.776
4	Bank does not invest in any haram services	.690
5	Bank is not involved in any speculative activities	.613
6	Bank gives interest-free loans	.598
7	Bank follows all the major principles of Islamic banking	.507
8	Bank pays the obligatory payment of income and wealth (zakaah)	.494

Table 7. Variables of Factor 2

Sl No.	Variable Name	Factor Loading
1	The members of the BOD of the bank are sufficiently qualified to run the bank	.856
2	The members of the BOD of the bank are accountable to all the stakeholders	.694
3	The honorarium of the BOD is in line with company policy	.673
4	The members of the SSB are selected on the proper criteria determined by Bangladesh Bank	.580
5	The top management ensures ethical behavior among employees of the bank	.513

that the first two factors (Compliance of Shariah rules and Corporate Governance Structure and Competence) appear to be the most important as they explain 21.72% and 12.00% of the variability respectively. Some of the other notable factors include Shariah Supervisory Board ($s_2=8.10\%$), compliance assurance ($s_2=5.706\%$) and learning from mistakes ($s_2=4.944\%$). The communalities¹⁶ of the variables that constituted the factors are found very strong, which indicates strong relationships among the variables (Appendix 2).

The following sections describe and analyze these factors in detail.

Factor 1: Compliance with Shariah Rules

The first factor explaining 21.27% of the variability consists of eight variables (Table 6). The high factor loading¹⁷ explains the strong correlation of the variables with the factor. As noted most of the variables are linked with the compliance of shariah laws by the banks.

Factor 2: Corporate Governance Structure and Competence

The second factor explains 12% of the variability and consists of 5 variables (Table 7). The high factor loadings in this case also explain the strong correlation of the

variables with the factor. As noted most of the variables here are linked mostly with the parameter corporate governance structure, which includes the board of directors, the shariah board, and the top management.

Factor 3: Shariah Supervisory Board Structure and Competence

The third factor explains 8.1% of the variability consists of 5 variables (Table 8). The high factor loadings in this case also explain the strong correlation of the variables with the factor. As noted most the variables here are linked mostly with the features of shariah supervisory board.

Factor 4: Regulatory bodies of the banks

The fourth factor explains 6.87% of the variability and consists of 5 variables (Table 9). The high factor loadings in this case also explain the strong correlation of the variables with the factor. As noted, most of the variables here are linked mostly with the customer awareness about the regulatory bodies of the banks.

Factor 5: Disclosed information to clients

The fifth factor explains 5.7% of the variability and consists of four variables (Table 10). The high factor

Table 8. Variables of Factor 3

Sl No.	Variable Name	Factor Loading
1	The SSB is an independent body, not influenced by bank managers	.857
2	The SSB gives a truthful assessment and disclosure of the Shariah compliance of the bank	.769
3	The SSB is responsible for ensuring Shariah compliance of the bank	.588
4	The top management takes part in ethical decision making in line with Shariah compliance	.521
5	The SSB members are experts in the field of Islamic finance	.458

Table 9. Variables of Factor 4

Sl No.	Variable Name	Factor Loading
1	I know the functions of Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI)	.846
2	I know the functions of Islamic Financial Services Board (IFSB)	.740
3	Shariah board members do not sit on Shariah board of other banks	.527
4	Clients' awareness of the composition of the BOD of the bank	.476
5	Clients' familiarization of the Shariah rules	.460

Table 10. Variables of Factor 5

Sl No.	Variable Name	Factor Loading
1	I check the bank's website for price-sensitive information	.901
2	I check mails/e-mails for price-sensitive information of the bank	.897
3	I check newspaper for price-sensitive information of the bank	.754
4	The bank sends me the invitation to annual general meetings	.516

Table 11. Variables of Factor 6-8

Sl No.	Variable Name	Factor Loading
Factor 6 (Effective complaints handling)		
1	The bank has an effective procedure to handle complaints	.786
2	The bank never misleads clients by withholding material information	.729
3	The bank is transparent about conflicts while making clear what mechanisms are in place to manage them properly	.652
Factor 7 (Non-issuance of misleading information)		
1	The bank never deliberately issues information that is potentially misleading to the stakeholders	.849
2	The bank sometimes mistakenly issues information that is potentially misleading to the stakeholders	.732
Factor 8 (Recognition of expected profit or loss)		
1	The bank recognizes all expected profit or losses when reasonably measurable	0.705
2	The bank discloses the amount it is obligated to deposit with others as compensating balances	0.652

loadings in this case also explain the strong correlation of the variables with the factor. As noted, most of the variables here are linked mostly with the tools banks use to disseminate information to their clients.

Factor 6-8: Corporate and social reporting

The factor 6-8 mainly grouped the corporate social reporting variables explaining 4.5%, 4.4% and 3.8% of the variability respectively. The factors consist of 3, 2, and 2 variables respectively (Table 11). The high factor

Table 12. Variables of Factor 9

SI No.	Variable Name	Factor Loading
1	Bangladesh Bank plays a major role in regulating the Islamic banks in Bangladesh	0.863
2	Government plays an important role in regulation of Islamic banks in Bangladesh	0.850

Table 13. Variables of Factor 10-11

SI No.	Variable Name	Factor Loading
Factor 10 (Safeguard against casual occurrences)		
1	My bank has appropriate safeguard against occurrences due to lack of due care	0.844
2	The bank never manipulates price	0.630
3	My bank conducts its business in a socially responsible manner	0.386
Factor 11 (Obligation to full disclosure)		
1	The bank informs clients about its obligation to make full disclosure of material facts relevant to the proposed transaction before signing any documents	0.824
2	The bank provides general disclosure about credit risk in its financial statements	0.709

Table 14. Variables of Factor 12

SI No.	Variable Name	Factor Loading
1	I am aware of the presence of a Shariah Supervisory Board in my bank	0.646
2	The top management has appropriate training in Shariah rules	0.634
3	I am aware of the composition of the Shariah Supervisory Board of my bank	0.573

loadings in each of the cases also explain the strong correlation of the variables with the factors. As noted, most of the variables here are linked with the banks corporate social reporting to their clients.

Factor 9: Government regulation

The ninth factor explains 3.2% of the variability consists of 2 variables (Table 12). The high factor loadings in this case also explain the strong correlation of the variables with the factor. As noted both the variables here are linked with the customer awareness about the public regulatory bodies.

Factor 10-11: Corporate and social reporting

The factors 10-11 again grouped the corporate social reporting variables explaining 2.59% and 2.42% of the variability respectively. The factors consist of 3 and 2 variables respectively (Table 13). The high factor loadings in most of the cases also explain the strong correlation of the variables with the factors. As noted, most of the variables here are linked with the banks corporate social reporting to their clients.

Factor 12: Shariah Supervisory Board

The twelfth factor explains 2.39% of the variability and consists of 3 variables (Table 14). The high factor loadings in this case also explain the strong correlation of the variables with the factor. As noted, most of the variables here are linked mostly with the customer awareness about the shariah body of the bank.

Factor 13: Corporate Reporting & bank regulation

The thirteenth factor explains 2.21% of the variability consists of 2 variables (Table 15). The high factor loadings in this case also explain the strong correlation of the variables with the factor. As noted, most of the variables here are linked with the customer awareness, corporate reporting & bank regulation.

Table 15. Variables of Factor 13

Sl No.	Variable Name	Factor Loading
1	My bank makes undisclosed profit at the expense of its clients	-0.769
2	My bank had entitled me to return only when I accepted the business risk of my financing	0.561

Table 16. Factor-wise distribution of simple variables in different parameter/complex variable

Parameters →	Corporate governance structure			Compliance with shariah rules		Ethical disclosure of information	
	Board of Directors (BOD)	Shariah Supervisory Board (SSB)	Top Management	Compliance by the banks	Influence of regulatory bodies	Corporate and Social reporting	Measures to notify clients
Complex Variables →							
Factors ↓							
Factor 1	-	-	-	8	-	-	-
Factor 2	3	1	1	-	-	-	-
Factor 3	-	4	1	-	-	-	-
Factor 4	1	1	-	1	2	-	-
Factor 5	-	-	-	-	-	-	4
Factor 6	-	-	-	-	-	3	-
Factor 7	-	-	-	-	-	2	-
Factor 8	-	-	-	-	-	2	-
Factor 9	-	-	-	-	2	-	-
Factor 10						3	
Factor 11						2	
Factor 12		2	1				
Factor 13				1		1	
Σ =	4	8	3	10	4	13	4

F. Factor-wise Distribution of Variables in Different Parameter/Complex Variable

The factor-wise distribution of 46 simple variables in different parameter/complex variable is shown in Table 16. As noted factors 1 and 9 covers mostly the variables under parameter “compliance of shariah rules”; whereas the variables under parameter “corporate governance structure” are grouped in factors 2, 3, and 12. Factors 5, 6-8, 10-11 mostly cover variables under the parameter “ethical disclosure of information”. Only factor 4 and 13 variables are a mixture of variables from two different parameters.

Further analysis shows that factor 1 contains most of the variables (8 of 10) of the complex variable “bank compliance of shariah rules”, factor 2 contains most of the variables (3 of 4) of the complex variable “BOD structure”, factor 3 contains most of the variables (4 of

8) of the complex variable “SSB structure” and factor 5 contains all the variables (4 of 4) of the complex variable “measures to notify clients”. Factors 6-8, and 10-11 only cover variables of complex variable “corporate and social reporting”. Hence it can be concluded that the factor-wise distribution of 46 simple variables is well-grouped in different parameter/complex variable.

VI. Correlation between Overall Ethical Standards and Different Demographic Features

The study tried to find out correlation between responses regarding the overall ethical standards and different demographic features (Appendix 3). It is noted that there is no significant correlation of the overall ethical standards

with age ($r = -0.073$ and $\alpha = 0.526$), gender ($r = -0.125$ and $\alpha = 0.272$), average monthly income ($r = -0.246$ and $\alpha = 0.067$), level of education ($r = -0.169$ and $\alpha = 0.145$), formal Islamic education ($r = 0.205$ and $\alpha = 0.074$), length of relationship with Islamic bank ($r = -0.215$ and $\alpha = 0.065$) of respondent at a significance level of 5%.

VII. Summary, Conclusion, and Recommendation

The study tried to analyze the customer perception regarding the ethical standards of corporate governance of the Islamic banks in Bangladesh. The first parameter for this study, *corporate governance structure, and competence*, intended to find out the customers' knowledge of the composition and competence of board of directors and shariah supervisory board (SSB) of the bank. In addition, the study also intended to find out top management role to maintain Shariah compliance.

The study noted that the customers are not fully aware of the composition of the board of directors of the bank, but they responded a little positively regarding the board of directors' competence, accountability, and honorarium. The customers were found to be aware of the presence of the shariah supervisory board of the bank, but they are not very sentient of its composition. The respondents noted that the shariah supervisory board members are expert in this area and selected properly and are responsible enough for ensuring Shariah compliance of the bank. Customers found the shariah supervisory board to be an independent body and perceived them to be fair regarding their assessment and accountability. They also think that the shariah board members of their bank do not sit on the shariah board of another bank. Customers noted that the top management team had an appropriate training in Shariah rules, take part in decision-making in line with Shariah compliance and also ensure ethical behavior of the bank employees.

The second parameter for this study is the bank's compliance and regulation of Shariah rules. The study found the response familiar with the Shariah rules. The bank clients very strongly agreed that their bank follows all the Islamic principles in their operations. Specifically,

they very strongly approved that their bank does not pay or receive any interest, do not involve in speculative activities, do not invest in haram services or product, make obligatory payment of zakah and give interest-free loans. Regarding the influence of regulatory bodies on the compliance of Shariah rules the customers are found positive to the role of Bangladesh Bank and Government of Bangladesh in regulating Islamic banks. But customers' perceived knowledge about the functions of other regulatory authorities of Islamic financing, like Islamic Financial Services Board (IFSB) and Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) are found very limited.

The third parameter of the research, disclosure of information, intended to find out the customers' knowledge and awareness of the information that should be disclosed by the bank. The study noted that the customers responded positively regarding ethical disclosure of information of the bank. They agreed that their banks make them aware of the credit risk, recognizes all expected profit or losses when reasonably measurable, discloses the amount it is obligated to deposit as compensating balances, do not manipulate price, never mislead clients by withholding information, never deliberately issues misleading information, and make full disclosure before signing a document. The study noted that the bank has an effective procedure to handle complaints, has a transparent mechanism of conflict management, and has an appropriate safeguard against undue occurrences. The clients do not believe that their bank mistakenly issues misleading information, nor makes an undisclosed profit at the expense of its clients. Respondents agreed that the bank sends them the invitation to annual general meetings. But interestingly the clients are found to rely more on newspaper, rather than bank's website or e-mails for price-sensitive information of their bank.

The overall perception of the respondents regarding ethical corporate governance of the banks is found positive. The study found that majority of the respondents think positively about bank's ethical corporate governance. It means that customers' overall perception towards ethical standard in corporate governance of the Islamic banks is positive.

Notes

1. Shariah: The basic principle in the Shariah (Islamic Canon Law) is that exploitative contracts based on interest or usury and speculation should be unenforceable. These laws are derived from three sources: The Quran, the Hadith, and the Sunnah.
2. Riba: Literally, an increase or addition. Technically it denotes in a loan transaction any increase or advantage obtained by the lender as a condition of the loan. Synonymous to rate of interest in the conventional banking mechanism.
3. Gharar: Speculative Activities
4. Haraam: That which is forbidden
5. Zakah: Charity
6. Mudaraba: The term refers to a form of business contract in which one party brings capital and the other personal effort. The proportionate share of profit is determined by mutual agreement. But the loss, if any, is borne only by the owner of the capital, in which case the entrepreneur gets nothing for his labor.
7. Musharaka: A partnership between two parties, both of whom provide capital towards the financing of a project.
8. Murabaha: It is a contract of sale in which the seller declares his cost and the profit.
9. Ijarah: This is a contract involving hiring or leasing through which the services of a person or legal entity or organization is rented out or leased
10. Ijaarah wa iqtinaa: leasing and purchasing
11. Bay'salam: forward sale
12. Fiqh al-Muamalat: Basic Shariah Principles
13. Factor is a linear combination of the original variables. Factors also represent the underlying dimensions (constructs) that summarize or account for the original set of observed variables. Factor Analysis is a type of analysis used to discern the underlying dimensions or regularity in the phenomenon. Its general purpose is to summarize the information contained in a large number of variables into a smaller number of factors. It is an interdependence technique in which all variables are simultaneously considered.
14. Orthogonal refers to the mathematical independence of factor axes to each other (i.e., at right angles, or 90 degrees). Factor rotation is the process of

manipulating or adjusting the factor axes to achieve a simpler and pragmatically more meaningful factor solution.

15. Ideally, the sample size should be at least 230 (subject to a variable ratio greater than 5). But due to accessibility and convenience, we have to limit our response size to 80 which is less than preferred one. The factor analysis of 46 variables with 80 sample is found adequate (KMO test result = $0.543 \geq 0.5$) and valid (Bartlett's test of sphericity indicates a significance level of 0.000).
16. Communality refers to a measure of the percentage of a variable's variation that is explained by the factors. It is the amount of variance an original variable share with all other variables included in the analysis. A relatively higher commonality indicates that a variable has much in common with the other variables taken as a group.
17. 'Factor Loading' is a measure of the importance of the variable in measuring each factor. It is used for interpreting and labeling a factor. It is the correlation between the original variables and the factors, and the key to understanding the nature of a particular factor.

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