**Islamic Banking Products: Home Country Bias and Majority Out-group Consumption**

**ABSTRACT**

This study provides an overview of the incentives for Muslims and non-Muslims to adopt Islamic Banking (IB) products in non-Muslim developing country. Data is collected from a sample of 1,128 Mauritians. Religion is found to have a significant influence on the intention to adopt IB products. Our results support the prediction of the theory of reasoned action as an individual is more likely to adopt IB product if he/she understands the relevant concepts and terminologies (e.g., Sharia, Riba, Ijarah, Murabaha, Modaraba, Musharaka, Sukuk, and Takaful). The adoption of IB products for Muslim customers is significantly associated with bank selection criteria. Further, we provide evidence of a home country bias related to a set of financial products, as well as tactics successful in overcoming the costs of the liability of foreignness in incentivizing cultural “out-groups” to adopt IB products. Our study contributes to the literature on the motivation of Muslims and non-Muslims to adopt IB products, which is highly relevant for Islamic banks worldwide that seek to offer similar products and attract new customers. We provide implications for bank marketing managers facing the challenge of increasing adoption of new financial services and products in markets where customers may not be aware of the associated benefits due to cultural, religious, or ethnic barriers. Finally, our findings yield information for bank managers seeking to overcome the liability of foreignness and home country bias.

**KEYWORDS:** Islamic banking, Muslims, non-Muslims, home country bias, liability of foreignness, theory of reasoned action, Mauritius.

**JET**: M14, M31, O55, Z12.

**Introduction**

Islamic Banking (IB) has established itself as an alternative to conventional interest-based banking. A sharp rise in IB products has occurred globally over the last two decades, with alternatives to financial services provided by Conventional Banking (CB). Islamic banks operate in over 75 countries, mostly in Middle Eastern and Southeast Asian countries, with Malaysia and Bahrain being the biggest hubs (Bin Ghalaita 2015). The availability of IB products have increased as of late in non-Muslim countries as well (Nawi *et al.,* 2013). It is of interest to know whether and how, within a short period from the introduction into the existing of CB system, IB institutions can use financial services marketing strategies to convince non-Muslims to adopt Islamic banking products.

While Islamic Banking (IB) is not new in much of the world, Mauritius first launched IB products in 2009 and officially introduced of Islamic banks in 2011. The CEO of Century Banking Corporation Ltd (CBC) stated in 2009: “Corporate or institutions will now have access to funding alternatives, not only because our offerings will only be Sharia-compliant products, but also because wholesale banking is quite different in terms of banking products or services”. However, if awareness of the availability of IB products is limited, it could lead to lower rates of intermediation through Islamic banks (Ramdhony 2013). Hinduism is the most practiced religion in Mauritius, making it the sole African nation with a Hindu majority (Sen Nag 2018). Around half of the population is Hindu while Christians, Muslims, and Buddhists account for the rest. Most Hindus and Muslims in Mauritius are of Indian origin. Sino-Mauritians follow Buddhism or other traditional Chinese religions, while French and Creole Mauritians are mainly Christians. Mauritians have lived largely at peace albeit alongside minor religious and ethnic tensions.

The official introduction of Islamic banks in 2011 permits us to be the first to examine whether a Liability of Foreignness (LoF) exists related to religious faith within a country (Mauritius) from the inception of IB products. Motivated by the literature on the Theory of Reasoned Action (TRA) and the LoF, this study examines the factors that lead non-Muslims to adopt IB products by surveying Mauritians of all religions. Thus, we address the following question: *“What drives the perception and adaptation of new, but culturally distant, financial products?”.*

The current study contributes to three distinct bodies of literature. First, it assesses whether the concept of LoF applies to financial products. Second, it examines the role of financial service marketing in overcoming any barriers to “foreign” investment in financial products. Third, it contributes to the literature on the adoption of IB products. While other studies have investigated the perceptions of either Muslims or non-Muslims towards IB products, we conduct analyses for Muslims and non-Muslims separately to examine the factors that influence the perception and adoption of IB products for each group. Our findings provide evidence regarding the existence of a Home Country Bias (HCB) within a country related to a set of financial products, as well as tactics successful in overcoming the costs of the LoF in incentivizing cultural “*out-groups*” to adopt IB products.

The study has several implications for both practitioners and academics. We contribute to the literature on Islamic banking, specifically on the motivation of Muslims and non-Muslims to adopt IB products, which is highly relevant for Islamic banks worldwide that seek to offer similar products and attract new customers. The results of this study have implications for bank managers aiming to market new financial service products in markets where customers do not recognize their benefits due to cultural, religious, or ethnic barriers. In other words, our findings yield information for bank managers seeking to overcome the LoF and HCB, except in this case, the bias is not towards the home country per se, but rather towards one’s prevailing faith.

The rest of the paper is organized as follows. Section 2 looks at the relevant literature review. Section 3 provides theory and hypothesis development. Section 4 presents our research method and outlines the rationale of sample selection. Section 5 points out major results and findings of data analysis. Section 6 discusses the study’s findings. Section 7 provides a conclusion of this study.

**Literature review**

A significant body of literature exists indicating that investors sometimes hold suboptimal portfolios because they overweigh assets issued by entities domiciled in their home countries (Stulz 1981; French and Porterba 1991; Uppal 1992; Ferreira and Miguel 2011; Cooper *et al.,* 2013; Ibrahim 2015). The phenomenon has been observed in many countries, including the US (Campbell and Kraeussl 2007; Kho *et al.,* 2009), Germany (Oehler *et al.,* 2008), and Sweden (Karlsson and Norden 2007). This bias even extends to a propensity of investors to seek assets of companies issued locally, because, despite the potential for reduction of systematic risk from product market and geographic diversification, awareness is higher for local companies than for nonlocal companies. The local environment provides familiarity, comfort, and low risk, even if this prior contradicts actual risk-adjusted returns data (Coval and Moskowitz 1999; Lau *et al.,* 2010). Kilka and Weber (2000) and Strong and Xu (2003) argue that investors exhibit excessive optimism regarding domestic securities’ performance. The HCB is also documented in the marketing and management literature regarding non-financial goods, such as a documented product market “out-group bias” where consumers avoid goods produced in foreign countries (Balabanis and Diamantopolous 2004). Therefore, given that the majority of Mauritians are non-Muslims (a majority out-group from the perspective of the newly introduced IB system), one might expect that they would be biased against adopting IB products. One path to adoption of IB products by IBs is that greater investment knowledge is associated with lower HCB (Graham *et al.*, 2009).

Previous research indicates that there are costs referred to as a LoF associated with entry into foreign markets (Tesar and Werner 1995; Buckley and Casson 2003). Generally, the LoF paradigm seeks to explain that firms find it difficult to internationalise because local market participants assign a risk premium to foreign entities (Hennart 1982). Further, the literature indicates that there are regulatory, normative, and cognitive aspects of institutions which affect the perceived LoF, including (Massa and Simonov 2006; Scott 2008). Regulatory aspects of the LOF are state or regime sanctioned regulations (Cao *et al.,* 2011). Normative aspects of the LoF relate to the establishment of goals deemed legitimate within a society and norms for achieving these goals (Scott 2008). The cognitive dimension pertains to people’s mental schema, values, and beliefs in the society (DiMaggio and Powell 1983).

Language barriers may generate an additional cultural barrier (Grinblatt and Keloharju 2001) to the adoption of IB products by non-Muslims as the terms to describe most Islamic financial products are in Arabic. Language differences may exist given that Muslims tend to be more familiar with Arabic terms due to study of the Holy Qur'an, whereas non-Muslims would typically not study Arabic (Abdullah *et al.*, 2012). A simple example is that in CB, the term “car loan” is easily understood by English speakers (which predominate in Mauritius). The corresponding IB product is called “*Murabaha*”, which is far less easily recognizable to those with no familiarity of Arabic (El-Gamal 2006). A Hindu Mauritian seeking what they call a “car loan” may not be aware that such products exist at the local IB unless the term “*Murabaha*” (more accurately, financing) is clearly translated into terms he or she can understand.

To the extent that a product or service arises from a system that is characterised by distance in terms of these factors, it will be difficult to convince out-groups “foreign” to the system (here, religious rather than national) to adopt the product or service. To overcome the costs associated with the LoF, firms exploit their specific advantages, including branding and differentiated products, location cost savings, or superior managerial expertise and organisational skills (Solnik and Zuo 2012). Hence, to obtain out-group (e.g., non-Muslim) clients, Islamic banks must recognize and overcome LoF costs using education, clear marketing materials, branding, product development strategies, employing non-Muslims to assist with out-group marketing efforts, and so forth (Zaheer 1995).

There are meaningful differences in the execution of an IB versus CB system which have been examined in a number of contexts, including IB from Muslim majority countries such as Jordan, Pakistan, and Malaysia (Erol and El-Bdour 1989; Haque *et al.,* 2009; Marimuthu *et al.,* 2010; Abdullah *et al.*, 2012; Tara *et al.,* 2014; Kamiyama and Kashiwagi 2019) and Muslim minority countries where IB has long been established such as Australia, Singapore, and UK (Gerrad and Cunningham 1997; Rammal and Zurbruegg 2007; Akbar *et al.,* 2012).

IB is the provision of banking activities conform to the principles of Islamic laws, generally known as the Sharia, emphasizing justice and partnership (Garett, 2010). These sources come from the Holy Qur'an, Hadith, Sunna, Ijma (consensus), Qiyas (deductive analogy process), and Ijtihad (law). Central to the essential principles of IB operations, which differs from CB, is the prohibition of Riba (interest) because it encourages the concentration of wealth in the hands of a few individuals (Akbar *et al.,* 2012; Kamiyama and Kashiwagi 2019). IB increases risk sharing even further, but Riba violates risk-sharing, collaboration, and justice principles by not allowing all parties to partake in losses when using debt instruments, as bondholders or creditors get a committed payment regardless of the financial condition of the entity (Abdullah *et al.,* 2012). According to Marimuthu et al. (2010), Islam forbids profit from financial activity unless the beneficiary is also exposed to the risk of loss. Ryu *et al.* (2012) identifies major differences between the operations of both CB and IB because Sharia laws do not allow interest-based transactions, but rather profit-loss sharing transactions for equity creation.

El-Gamal (2006) states that the main permissible financing methods (see Appendix 1)are usually classified into two main categories. The first is profit and loss sharing, in which the bank is a party to the transaction and splits profits with the other parties. The main Islamic finance methods under this category include Musharaka (partnership), Mudharabah (trust financing), Sukuk (Islamic bonds), and Takaful (insurance). The second category is based on markup (not profit and loss sharing), where the bank charges a profit margin on the transactions including Murabaha (cost plus) and Ijarah/leasing. Some of these instruments have analogous products in CB, but there are clearly regulatory and normative differences between IB and CB regarding the ethics of practices associated with CB. Accordingly, ethical, and moral issues are involved in IB beyond just 'interest-free' transactions, underscoring normative and cognitive aspects of distance or foreignness (Johnes et al., 2014; Kamiyama and Kashiwagi 2019).

***Appendix 1 near here***

Abedifar *et al*. (2013) investigate possible perceived risks associated with IB across twenty-four countries and find that credit risk is lower for IB systems in Muslim majority countries. Their findings indicate that (counter to general perception), Islamic banks do not charge customers additional fees for Sharia-compliant products and that loans offered by Islamic banks are not as interest-rate sensitive as those offered by conventional banks. Faye *et al.* (2013)’s results indicate that the efficiency of Islamic banks in Africa has been higher than conventional banks, suggesting that IB could be advantageous for African customers, while Beck *et al.* (2013) argue that Islamic banks have not been found cost-effective as CBs. However, Islamic banks have proved effective in terms of higher intermediation, capitalization, and asset quality. The improved performance of Islamic banks in crisis situations, according to Beck et al. (2013), is related to higher asset quality and capitalization rates than CBs. Chazi *et al.* (2018) examine the relative operating performance and risk-taking behavior of IB and CB in the Gulf Cooperation Council region during the global financial crisis (2007-2009) and the role played by their corporate governance structures. They document outperformance of IBs versus CBs in terms of return. They also indicate that IBs exhibited more conservative risk-taking behavior than CBs. These findings indicate that IB products would not typically be rejected by either Muslims or non-Muslims on the grounds that they are “inferior” to CB products and services.

Osahon (2011) documents that a perception of IBs may lack expertise across a wide spectrum of business activities. Hanif(2011) argues that IB can address most business needs and create trust in the depositors. While Islamic banks at present tend to have a smaller range of financing and investment products than CBs, the evolution of financial markets and products, as well as competition with CB products, may enhance IB offerings. Many non-banking services and financial institutions have also emerged in Islamic finance when the financial sector diversified into capital markets in the MENA countries (Cheteni 2014).

In sum, for Muslims, IB products are familiar, “local”, and not culturally distant. These products reflect the belief sets common to those raised in the faith and thereby informed about Islam. From the perspective of non-Muslims, IB products suffer from the Liability of Foreignness, as indicated by research documenting a lack of understanding of IB principles and products among non-Muslims (Cheteni 2014), as well as distant linguistic terms related to IB terminologies. The regulatory regime inherent to IB also differs from CB (Kamiyama and Kashiwagi 2019). The normative dimension is distant for non-Muslims because the means to achieve the goals accepted within the IB system differs from that of CB. There is a cognitive distance between IB and CB for non-Muslims, namely, the primary belief set differs, including religious practices that inform financial products.

In Mauritius in particular, research indicates that economic growth has been hindered by poor management of cultural diversity by the state, religious leaders, socio-cultural groups, and the private sector (Mukonoweshuro 1991; Schiff, 1998; Ramdhony 2013). Mauritians do share certain common cultural commodities and values (e.g., an affinity for jeans and Kentucky Fried Chicken), which facilitates some level of social interaction among members of distinct religious/cultural groups and promote limited social conflict (Esman 1997). However, members of religious faiths and cultural communities (Tamil, Muslim, Creole, and Chinese) tend to closely associate for business relationships and political interests (Oommen 1997; Ramdhony 2013). Therefore, it is likely that perceived normative and cognitive distance between IB and CB systems exist in Mauritius, as it does elsewhere in the world.

**Theory and hypothesis development**

***Theory of Reasoned Action (TRA)***

One of the most commonly used classes of models in studies of consumer behavior is the TRA (Fishbein and Ajzen 1975). The TRA is based on learning theory, and it assumes that a person's behavior toward a certain activity is approximated by their intention, or conscious plan, to perform that activity (Eagly and Chaiken 1993). The TRA originated from the field of Social Psychology and has been widely utilized to explain people’s actions. It indicates that an individual's intention to engage in a particular behavior predicts their future conduct. Intention is predicted by two factors: the individual's attitude toward the behavior's outcome and the subjective norm, which is the opinion of the person’s social environment (Fishbein and Ajzen 1975; Ajzen and Fishbein 1980). Consumer choices – such as to seek a service like financing the purchase of a car from an IB or a CB - are subsequent applications of the TRA (Ajzen *et al.,* 2009). The TRA relies on the concept that consumers (on average) make informed, rational decisions rather than irrational decisions based on unconscious factors or overwhelming, uninformed, spontaneous urges (Fishbein and Ajzen 1980).

Under the TRA model, a consumer’s intent to explore IB versus CB is based on the relative perceived advantages, compatibility, complexity, and facilitating conditions related to IB (Echchabi and Olaniyi 2012). This implies that non-Muslim consumers can be oriented towards IB, if, for instance, adequate awareness of IB alternatives to CB is raised, knowledge of IB products is generated, and initial transactions between IBs and potential customers are simple and relatively costless from consumers’ perspective. While IB products may be “foreign” to non-Muslim customers, if they are made aware of the benefits or risk mitigation possibilities of IB products, the TRA predicts that consumers will act in an informed, rational manner, potentially choosing IB versus CB products based on their respective merits. Tan and Lee (2014) argue that financial services marketing facilitates trust, which in turn lowers dimensions of information asymmetry and agency conflict related to financial intermediaries and their customers. As a result, there is an important role for financial services marketing to promote IB products in markets where they are newly introduced. In the TRA model, IBs can generate greater levels of customer interest in IB products and loyalty through the communication of information regarding products, promoting risk matching of products and customer preferences, and encouraging regular feedback from customers.

***Hypothesis development***

*Religious status and adoption of IB products*

HCB and LoF suggest that a bias likely exists in the minds of non-Muslims towards IB products because IB is distant from CB due to regulatory, normative, and cognitive dimensions. Studies identifying the impact of religion on banking selection criteria show different findings, as it is among the most important criteria, especially among Muslims. Kasmo *et al*. (2015) find that IB is popular among the young generation in Malaysia; sixty-three percent of those surveyed indicate that they prefer keeping their savings in IBs. Moreover, their findings demonstrated that as people gained education regarding IB products, they were more motivated to perceive IB products favorably and adopt them. According to Metawa and Almossawi (1998), religion is observed to be the main factor in banking selection criteria among respondents in Bahrain. Bley and Kuehn (2003) indicate that the preference for IB among Muslims in the UAE is primarily driven by religious beliefs, rather than by financial knowledge. Loo (2009) concludes that ‘religion’, followed by the quality of products and services, is the main factor attracting Muslims to the IB. Noonari *et al*.(2015) conclude that people favorably perceive and adopt IB products in Pakistan, mainly due to Islamic laws and culture. The number of deposits made by Muslims in Islamic financial institutions in the United Kingdom is mostly driven by religious considerations (Akbar *et al.,* 2012).

These results indicate that there is no HCB against IB products among Muslims and that there are no LoF costs to overcome with Muslim banking clients. The label “Islamic” creates a satisfactory motivation to use IB products because these products are assumed to be consistent with the prevailing religious paradigm in Muslim households (Kamiyama and Kashiwagi 2019). Loo (2009) examines the adoption of IB products by non-Muslims, and he finds that of those who do adopt IB products, the quality of these products and services are the primary reasons motivating them to adopt IB and, as expected, ‘religion’ ranked the last. Thus, our first hypothesis is developed as follows.

H1: There is a significant association between religious status and the adoption of IB products in Mauritius.

*Awareness of IB system and adoption of IB products*

The studies on HCB and LoF both suggest that greater expertise or organisational learning can reduce the tendency towards bias against “foreign” markets and investments. Therefore, to attract customers to adopt IB products, a similar investment in education should occur, through advertisements in electronic/print media, the Internet, and outdoor mediums. Accordingly, IBs must devise and implement a marketing campaign that promotes the products and services as well as their benefits. In Singapore and Malaysia, Gerrard and Cunningham (1997) and Marimuthu (2010) emphasize the importance of a strong advertising campaign to offset the lack of customer awareness about IB in order to stimulate a positive perception of IB. In addition, there is a higher potential for the success of the IB industry if its network is extended beyond Muslim customers (Khattak 2010). Hence, our second hypothesis is stated as follows:

H2: There is a positive association between awareness of the IB system and the adoption of IB products in Mauritius.

*Knowledge and understanding of IB concepts and adoption of IB products*

The knowledge and understanding of Islamic principles and IB terminology are expected to increase during the period leading to the introduction of the IB system in any country. It is believed that as people grow more familiar with the IB system's culture, their attitudes about IB products would alter. Marimuthu et al. (2010) found that respondents in Malaysia have very little understanding of IB concepts and products (about 10 percent). According to Gerrard and Cunningham (1997), the vast majority of Muslims in Singapore are knowledgeable of the basic concepts of the IB system, while non-Muslims are unaware of IB products and practices. Loo (2009) finds that many Muslim respondents surveyed demonstrated an understanding of the concept of IB system, compared to fourteen percent for non-Muslims. Tara *et al*. (2014) suggest that understanding of Islamic financial teachings has the most significant impact on the adoption of IB in Pakistan. Therefore, people who understand the concept are more likely to adopt IB products. As a result, education is a key factor in the success of the IB system with out-group members, as it is new to Mauritius. Consequently, our third hypothesis is set as follows.

H3: There is a positive association between the level of knowledge andunderstanding of IB concepts and terminologies and the adoption of IB products in Mauritius.

*Bank selection criteria and adoption of IB products*

Erol and El-Bdour (1989) conduct a study of Jordanian consumers with the goal of determining IB and CB bank selection factors. Customers of IBs prefer ‘the provision of quick and efficient service,' ‘the bank's reputation and image,' and ‘bank confidentiality,' while customers of CBs choose the same three elements but in the reverse order of preference. These factors helped in the selection of banks and the adoption of IB products. Haron *et al*. (1994) conduct a similar survey in three towns in Malaysia, where there is an equal proportion of Muslims and non-Muslims. In contrast to Marimuthu et al. (2010), respondents were not required to have prior expertise with the IB system. Muslims ranked ‘providing quick and efficient service’ as the most significant factor in their banking preferences, followed by ‘transaction speed’ and ‘friendliness of bank workers’. From the perspective of non-Muslims, ‘bank employee friendliness’ came first, followed by ‘providing rapid and efficient service' and ‘the bank's reputation and image’. Marimuthu *et al.* (2010) conclude that the factor, ranked fifth, ‘mass media and advertising’ had the least influence in the selection of banks. According to Gerrard and Cunningham (1997), both Muslims and non-Muslims rated the provision of fast and effective service as being central to the choice of banks. However, non-Muslims attach greater importance to higher interest on savings than Muslims do, as according to Islamic law, interest (Riba) is forbidden. These findings, combined with the TRA, provide guidance related to strategies by which IBs can attract out-group clients. Based on the TRA, IBs can both increase their Muslim customer base through financial services marketing efforts and attract non-Muslim customers. Since the selection criteria may differ between Muslims and non-Muslims, we cannot predict a priori the relationship between the adoption of IB products and bank selection criteria. Therefore, the fourth hypothesis is established as follows.

*H4: There is a significant association between bank selection criteria and the adoption of IB products in Mauritius.*

**Research method**

***Sample and data collection***

A questionnaire was devised based on various sources of literature, comprised of four sections[[1]](#footnote-1). The first section measured the awareness of respondents about the IB system and its products and services. Respondents were asked to indicate whether they were aware of the following IB terminologies: *Riba, Ijarah, Murabaha, Modaraba, Sharia, Sukuk, Takaful, and Musharaka*. The variables were included in the second section, which purposefully indicated the adoption of IB products and determined the preference for IB products. The third section contained a series of statements, mainly based on the Gerrard and Cunningham (1997) study, regarding the selection of banking criteria. Demographic details such as age, education, gender, and religion (being either Muslim or the out-group, non-Muslim) were included in the final section of the questionnaire. Using a cluster of random samples of Mauritians (Muslims and Non-Muslims), five trained administrators distributed 2000 questionnaires simultaneously in the central business district of Port-Louis.

To rule out the possibility of response bias, we assessed for independence between early and late survey respondents, as recommended by Oppenheim (1966). In all variables of importance, the results show no statistically significant difference (at p = 0.05) between groups. This evidence implies that non-response bias was not a problem in our study. According to Francis (2001), determination of the reliability of a measure is important because it allows for generalization of the results obtained by this measure; without reliability, validity cannot be established. We measured reliability using Cronbach’s alpha. The study variables are reliable as indicated by their Cronbach’s alpha (≥ 0.65) and based on the criteria established by Nunnally and Bernstein (1994) and Moss *et al*. (1998).

Out of the 1200 completed questionnaires, 1128[[2]](#footnote-2) were found to be usable as they were fully filled in (final response rate = 56.4 percent). Approximately 43% of the respondents (480) were Muslims. Table 1 provides the main demographic characteristics of the sample. Forty-seven percent of the respondents belonged to the age-group of 20-29 years, and twenty-three percent of the respondents were from the age group of 30-39 years. Ten percent of the respondents were aged 50 or above. Females accounted for fifty-three percent of the sample. Respondents were asked to specify their religion (Muslim or non-Muslim); non-Muslims were not required to provide their specific religion. Nearly half of the respondents (forty-seven percent) were highly educated, with thirty-seven percent possessing a degree/diploma and ten percent with advanced professional designations.

***Table 1 near here***

***Dependent variable – Adoption of IB products (ADOIB)***

The literature on IB provides some proxies for the adoption of IB products by customers. We use a five-point Likert scale to determine the views of a user group (Muslims vs. non-Muslims) regarding the relative importance of various items of adoption of IB products (ADOIB). The Likert scale showed (a) the type of IB operations, (b) the prospects for future successful IB operations, and (c) the extent of opportunities for IB should take in the country. The ADOIB for each respondent is calculated by dividing each participant’s actual score by the maximum possible score a respondent can obtain. The maximum score possible for this modified adoption equals 15 (3\*5).

***Independent variables***

The measures for independent and control variables in this study are shown as follows:

|  |  |  |
| --- | --- | --- |
| *Variables* | *Ex. sign* | *Measures* |
| Religion | ± | 1 for Muslim participant; 0 otherwise |
| Awareness of IB system | + | 1 if participant has heard about IB; 0 otherwise |
| Understanding of IB concepts & terminologies | + | A five-point Likert scale (very low - very high) |
| Knowledge about IB concepts & terminologies | + | A five -point Likert scale (very low – very high) |
| Bank selection criteria | ± | A five -point Likert scale (very important – unimportant) |

To test our hypotheses, we use the following multiple regression model to examine the incremental impact of each of the hypothesized independent variable:

*ADOIB¡ = β0 + β1 RELGNi + β2 AWOIBi + β3 UAOIBi + β4 KNOIBi +β5 BSELECi + e¡……(1)*

Where:

|  |  |  |
| --- | --- | --- |
| *ADOIB¡* | Overall *ADOIB* for the participant |  |
| β*0* | Constant (Intercept) |  |
| *RELGN* | Religion (‘1’ if Muslim, ‘0’ if otherwise). | (H1) |
| *AWOIB* | Awareness of IB systems | (H2) |
| *UAOIB*  *KNOIB* | Understanding of IB concepts & terminologies.  Knowledge of IB concepts & terminologies | (H3)  (H3) |
| *BSELEC* | Bank selection criteria. | (H4) |
| e¡ | The difference between the predicted and observed value of the *ADOIB* for the ¡th participant (the error term). |  |
| The expected signs of the coefficients are β1> 0, β2> 0, β3> 0, β4> 0, and β5> 0 respectively. | | |

**Results**

***Descriptive statistics***

Table 2 provides descriptive statistics for the overall ADOIB and other variables of interest for the study. The average of ADOIB for both groups (Muslims and Non-Muslims) is 0.70. Understanding of IB concepts (UAOIB) and bank selection criteria (BSELEC) are higher for both groups (0.68 and 0.66 respectively) compared to awareness of the IB system (AWOIB), while the average of knowledge of IB terminologies (KNOIB) is only 0.22 for the sample. The descriptive statistics (skewness and kurtosis) for the dependent variable presented in Table 2 indicates that the overall ADOIB is normally distributed (both skewness and kurtosis coefficients are not significantly different from zero at the 0.05 level of significance)[[3]](#footnote-3).

***Table 2 near here***

Table 3 shows the results of an ANOVA test to identify differences between faith subgroups, which indicates a significant difference (F = 42.768, p = 0.000) in the mean adoption of IB products between Muslims (0.78) and non-Muslims (0.62). The test indicates that adoption of IB products is significantly higher for Muslims than non-Muslims in Mauritius.

***Table 3 near here***

***Correlations***

The Pearson correlation matrix, shown in Table 4, reveals that all independent variables were significantly and positively correlated with the overall ADOIB. UAOIB has the highest correlation with the ADOIB (0.589), while BSELEC has the lowest correlation with ADOIB (0.231). Table 4 also shows some significant correlations across the independent variables. Most notably, AWOIB and UAOIB are highly correlated (0.502)[[4]](#footnote-4). Furthermore, RELGN is significantly and positively correlated with AWOIB, UAOIB, and BSELEC (0.361, 0.273, and 0.155 respectively).

***Table 4 near here***

***Multiple Regression Analysis***

Hypothesis 1 states that an individual’s religious status is significantly associated with his/her level of adoption of IB products in Mauritius. Table 5 indicates that person’s religion (Muslim vs. Non-Muslim) has an influence on his/her level of ADOIB in Mauritius (coefficient =0.201, p = 0.000), which implies that Muslims have higher ADOIB in Mauritius than non-Muslims (this result is also consistent with the results of the ANOVA test shown in Table 3). Thus, we find strong support for Hypothesis 1, and for the concept that home country bias pertains not only to national barriers but also religious and cultural products. Our result is in line with Kamiyama and Kashiwagi (2019), who find that customers’ religious motives affect their evaluations of a bank's compliance with Islamic Sharia Law as an indication of the customers’ religious attitudes toward Islamic banks.

We next examine whether financial services marketing practices can overcome the costs of the LoF in attracting out-group clients. Hypothesis 2 postulates that a person’s awareness of the IB system (AWOIB) is positively associated with his/her level of ADOIB. Table 5 indicates a positive and significant (coefficient = 0.103, p = 0.05) association between AWOIB and the level of ADOIB in Mauritius, suggesting that awareness of the IB system is an important factor of their adoption of IB products. Therefore, Hypothesis 2 is supported, consistent with the Theory of Reasoned Action (TRA).

Hypothesis 3 posits that there is a positive association between a person’s understanding of IB concepts and terminologies (UAOIB) and his/her level of ADOIB in Mauritius. The results shown in Table 5 (coefficient = 0.358, p = 0.000) indicate a significant and positive association between UAOIB and ADOIB, suggesting that customers’ understanding of IB concepts affects their adoption of IB products, providing support for our third hypothesis. Another proxy for the awareness of IB practices is the knowledge of IB concepts and terminologies (KNOIB). Hypothesis 3 also predicts a positive association between a person’s KNOIB and his/her level of ADOIB. Table 5 shows a positive and significant coefficient (0.253, p = 0.000), suggesting that knowledge of IB basic terminologies is positively associated with the adoption of IB products in Mauritius. This result is also consistent with Hypothesis 3.

Hypothesis 4 states that a person’s bank selection criteria (BSELEC) in an economy would be associated with his/her level of ADOIB. The results of the regression analysis, shown in Table 5, indicate a positive and statistically significant (coefficient = 0.112, p = 0.01) association between BSELEC and ADOIB, indicating strong support for Hypothesis 4. Our results are consistent with previous studies in IB (Gerrard and Cunningham 1997; Marimuthu *et al.,* 2010).

Table 5 shows that the overall regression model is significant at p < 0.01 level (F = 47.562). The adjusted R² revealed that 0.453 of ADOIB is explained by the independent variables. Our adjusted R2 statistic (0.45) is consistent with previous studies related to the adoption of IB in Muslim minority countries (Rammal and Zurbruegg, 2007; Akbar *et al.,* 2012).

***Table 5 near here***

***Robustness test***

To explore these findings further and to test the robustness of the previous analysis, we again employ multivariate regression analysis. We regress the adoption of IB against the independent variables for Muslim and non-Muslims separately. The following regression equation is used to obtain the model for each group of respondents.

*ADOIB¡ = β0 + β1 AWOIBi + β2 UAOIBi + β3 KNOIBi + β4 BSELECi + e¡……(2)*

The results, shown in Panel A of Table 6, reveal that for Muslim group (Model 2a), the adoption of IB products is positively and significantly associated with the AWOIB (coefficient = 0.188, p< 0.05), UAOIB (coefficient = 0.398, p< 0.01) and BSELEC (coefficient = 0.175, p< 0.05). KNOIB is positively, but not significantly, associated with ADOIB for Muslims (coefficient = 0.116, p = 0.131) in Mauritius. Panel A also shows that the overall regression (Model 2a) for the Muslim group is statistically significant (F = 19.454, p< 0.01). The adjusted R² reveals that 38.3 percent of the variation of the dependent variable (ADOIB) is explained by the independent variables. Hence, for Muslim Mauritians, the TRA suggests that financial services marketing (perhaps at a more sophisticated level) or the introduction of new products and services may assist in bringing in new Muslim clients.

Panel B in Table 6 shows that for non-Muslim group (Model 2b), the adoption of IB products is positively and significantly associated with both the UAOIB (coefficient = 0.298, p < 0.01) and the KNOIB (coefficient = 0.391, p < 0.01). Therefore, Hypothesis 3 is supported for the non-Muslim group. Non-Muslims can be incentivized to use IB products versus CB products when financial services marketing efforts facilitate knowledge and awareness of IB products, lowering the perception of foreignness relative to the CB system they are familiar with. On the other hand, neither AWOIB nor BSELEC have a significant influence on the ADOIB by non-Muslims in Mauritius. This result indicates that individual learning is the key to IB product and service adoption.

Finally, the results of the robustness test show that the overall regression in Model 2b for the non-Muslim group is statistically significant (p < 0.01; F = 25.447). The adjusted R² reveals that the independent variables explain 37.8 percent of the variation in the dependent variable (ADOIB). Therefore, our findings suggest that the home country bias associated with regulatory, normative, and cognitive aspects of the LOF can be offset through financial services marketing efforts which raise awareness of, and knowledge of practices related to Islamic banking.

Consistently, UAOIB appears to be the most important predictor of adoption of IB for both groups (Muslims and non-Muslims), followed closely by KNOIB, AWOIB, and BSELEC. Surprisingly, while KNOIB is not significantly associated with the ADOIB for Muslims, it is positively associated with the ADOIB for non-Muslims. This can be explained by the existing level of knowledge within Muslims in Mauritius, which is comparable to that of Muslims elsewhere, including Australia, UK, Singapore, Malaysia, and Pakistan. There is already basic knowledge of IB concepts and terminologies and there is little variation in the adoption of IB practices based on knowledge among Muslims in Mauritius. However, there is inertia with CB practices because IB products are new to Mauritius, so the TRA suggests that in order to obtain new Muslim clients, Islamic banks must emphasize the superiority of their products and services and introduce new products and services to entice new Muslim clients. Taken together, the findings reported in Tables 5 and 6 suggest that BSELEC negatively impacts the adoption of IB by non-Muslims, consistent with HCB and LoF. Based on the TRA, this may also be overcome, albeit at a cost, through financial services education and marketing.

***Table 6 near here***

**Discussion**

To examine the likelihood of adoption of Islamic banking products and services among the Mauritian population, we first document a bias against IB products by non-Muslims, which can be attributed to a product market home country bias based on religious orientation and perceived liability of foreignness. Consistent with Loo (2009) and Kamiyama and Kashiwagi (2019), our results show that marketing of IB products is positively associated with the perception and adoption of these products. Though being a concept more than 1,400-years-old, an IB system was only recently introduced in Mauritius, and while they had a long time series of experience with CB, the Mauritian population had not been extensively exposed to the IB system.

Our results indicate that out-group customers will consider adopting a new service if they have an awareness of it, which increases familiarity and lowers the cognitive and normative elements of the liability of foreignness. Tan and Lee (2014) state that financial services marketing can lower information asymmetry and increase trust, thereby playing an important role in making customers aware of the existence of a specific service. More importantly, if there is adequate awareness of the products offered, the religious orientation of the client may become less important. In other words, education through marketing overcomes the LoF and the HCB is defined in terms of a preference for products typically found in ones’ religious regime.

Our findings support the prediction of the TRA. An individual is likely to adopt IB products if he/she understands the concepts and terminologies of IB system. Without a proper understanding of IB concepts and terminologies, individuals would not risk dealing in IB products, especially when less “foreign” CB alternatives are readily available. IB gives Muslims the opportunity to keep their financial transactions consistent with their religion. However, we document that religion is only the third most important factor influencing the choice of IB products for Muslims. As explained by TRA, a person’s social environment has an important influence on the intention to adopt a product or/and service (Echchabi and Olaniyi 2012).

Our study also reports a positive and significant association between bank selection criteria and the adoption of IB, but only for Muslim customers. These results support the results reported by Haron and Ahmad(2000), who find that Malaysian bank customers attribute much importance to fast and reliable service, the speed of transaction, and friendly personnel. Marimuthu *et al*. (2010) find that ‘cost/benefit’ and ‘convenience’ ranked among the top factors cited by Malaysian customers when choosing a bank.

IB must capitalize on financial services marketing factors pertinent to-out groups such as raising awareness of IB, improving understanding and knowledge of basic IB principles, and factors affecting bank selection criteria to broaden their customer base. In so doing, they can attract both new Muslim and non-Muslim clients. The findings show that ‘awareness about the IB system’ is positively associated with the intention to adopt IB products. Several means such as advertising, disseminating information on websites and holding talks about IB products can increase awareness about IB. Cheteni (2014) reports that 52 percent of respondents in South Africa were aware that both non-Muslims and Muslims can utilize IB; 66 percent believed that it is based strictly on religion. Ramdhony (2013) reports that it seemed to be a common belief that IB serves only Muslim banking clients. However, our findings suggest that awareness of IB products facilitates adoption by non-Muslims as well. Rammal and Zurbruegg (2007) argue that advertising can play a significant role in making the population familiar with the availability of high quality IB products. Effective advertising will invoke the curiosity of potential customers that may lead them to search for more information about IB and possibly adopt IB products. Further, understanding basic IB concepts and terminologies can trigger the adoption of IB products; banks can launch information campaigns to boost understanding of IB terms. To obtain new Muslim clients, who have a long history of CB in Mauritius, Islamic banks can leverage the support of various Islamic social groups to reiterate the principles of IB system and Islamic finance. As a result, Muslims will gain a better understanding of the IB ideas and terminologies and will remind Islamic followers that IB products are available in their communities.

**Conclusion**

We use the introduction of Islamic banks into the traditional conventional bank system in Mauritius as a natural laboratory to examine the adoption of products and services by those to whom such products and services are “foreign”. For Muslims, there is little regulatory, normative, or cognitive distance associated with Islamic banking because they typically have at least a minimal familiarity with Arabic terminologies, and they know the basic concepts of IB. However, nontrivial regulatory, normative, and cognitive distances exist between CB and IB for non-Muslims. Thus, we document HBC and costs associated with the LoF facing IB in attracting out-group customers. Our findings show that education lowers the cost of the LoF to those to whom the product is currently “foreign”, and this can be done through financial services marketing.

One implication of this study is that although the correlation of returns worldwide has increased and the gains from global diversification are lower now than in the past, there are markets which are still available for diversification (such as IB products) to increase risk-adjusted returns (Chiou *et al*., 2009). Therefore, to incent non-Muslims to adopt IB products, educational and awareness campaigns, and the exploration of the development of new IB products should occur.

The significant influence of bank selection criteria on the adoption of IB expressed by respondents is a signal to potential IBs entering markets with significant out-group populations. To attract customers, IBs should meet the expectations of all customers regarding location, provision of fast service, and customer satisfaction, among others.

Religion has a significant influence on the intention to adopt IB products for Muslim customers, and this result has further implications for banks in crafting their marketing strategy. For instance, banks can segment the market for IB products into Muslims and non-Muslims or offer a broader selection of financial service products. A strategy that targets Muslim clients can reap better results by increasing the adoption rate of IB. For instance, Muslims pay more attention to bank selection criteria than non-Muslims do. A targeted marketing approach would include attributes favored by Muslim customers.

There are several implications of the study’s findings for both academics and practitioners. The study contributes to the literature on Islamic banking, specifically on the motivation of Muslims and non-Muslims to adopt IB products, which is highly relevant for Islamic banks worldwide that seek to offer similar services and attract new customers. More broadly, our results provide implications related to the successful marketing and adoption of new financial services products across markets, where customers do not recognize benefits to themselves due to cultural, religious, or ethnic barriers. In other words, our findings yield information for wealth managers seeking to overcome the LoF and HCB, except in this case, the bias is not towards the home country per se, but rather towards one’s prevailing faith.

This study is subject to several limitations. One potential limitation is its focus on individual retail customers. Corporate customers are also important to banks. Obtaining the views of corporate clients will provide a broader picture of the adoption of IB products in Mauritius. Another limitation arises from the fact that the study investigated only five factors that influence the adoption of IB products. Future research can include additional factors to the list of predictors, so that a comprehensive model can be built to explain the adoption of IB products across countries. Interviews with individual and corporate customers can be carried out to have better insights into the factors that lead to the adoption of IB products.

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1. The questionnaire can be provided upon request. [↑](#footnote-ref-1)
2. The sample size is comparable to previous studies in the same field including Gerrard and Cunningham (1997), Loo (2009), Khattak and Rehman (2010), Abdullah *et al*. (2012), and Tara *et al*. (2014). [↑](#footnote-ref-2)
3. A rule of thumb for the normal distribution of the data based on the statistic value (z) for the skewness and kurtosis is that a calculated statistic value should not exceed the critical z value ± 2.58 at the .01 probability level and ± 1.96 at the .05 probability level. [↑](#footnote-ref-3)
4. Variables exhibit complete collinearity if their correlation coefficient is 1 and a complete lack of collinearity if their correlation coefficient is 0. In our study, the correlation coefficients among the independent variables did not exceed 0.502. [↑](#footnote-ref-4)