

Customers' Preferences on Ar-Rahnu: Exploring the Adoption of the Islamic-Based Pawnshop Using PLS

Maran Marimuthu*

*Department of Management and Humanities, Universiti Teknologi PETRONAS, Malaysia
Email: maran.marimuthu@petronas.com.my*

Indraah Kolandaisamy

** Corresponding author*

Abstract

Purpose: This study is to explore the factors that affect customers' switching behavior towards the adoption of *Ar-Rahn*.

Design/methodology/approach: This paper explores the factors that influence customers' preference towards *Ar-Rahn pawn-shop* in Klang Valley area. A sample of 250 respondents is adopted for this cross-sectional study using a questionnaire-survey method. Descriptive statistics analysis, bivariate correlations and partial least square (PLS) analysis are used in discussing the findings.

Findings: The PLS results indicate that religion, income, pricing, pledged assets and advertisement tend to affect customers' preference of *Ar-Rahn* pawn shop positively. Strategic location is also a significant factor to adopt *Ar-Rahn* but the farer the shop, the better the business will be.

Originality/value: This paper offers a new line of inquiry on the acceptance of Islamic pawnshop among the non-muslims in Malaysia. The paper reiterates that Islamic branding is acceptable even to non-muslims. The study also highlights that people in general expect the Islamic pawnshop to be located preferably farer from housing area and this could be due to norms and values of the local communities.

Keywords: *Ar-Rahn*, *riba*, pawn-broking, switching behaviour

Introduction

Ar-Rahn refers to the Islamic mode of pawn-broking. In a conventional way, pawn-broking is a lending activity that lends money on the basis of collateral. In order to get financing, borrower will pledge their non-financial assets, such as gold jewelry and diamond as collateral for the loan. Interest will be charged on the loan and the collateral will be used to collect any unsettled balances in the event of default. Pawn-broking is considered as a source of short-term financing and it is generally used by the lower income group to get rid of their cash flow problems. Furthermore, pawnshop is considered as an important source of microfinance in many developing countries, especially in Asia (Fernando, 2003). It is the one-stop financial center for both men and women to

obtain a quick and convenient way to borrow money. Islamic pawn-broking service has provided an opportunity to Muslim consumers to choose transactions that do not involve 'riba'. 'Riba' means interest which is prohibited in Islamic system (Memon, 2007).

This definition of 'riba' is derived from the *Quran* and is unanimously accepted by all the Islamic scholars. It is considered a form of injustice and exploitation. Islamic pawnbroker would impose a service charge or safekeeping fees on the borrower. It is different from the conventional pawnbroker which will impose interest charged on the borrower, which is prohibited in Islam. Similar to conventional pawn-broking, the borrower must pledge a valuable asset as a collateral on the loan, hence the terms pledger (*rahin*), pledgee (*murtahin*, the lender) and the pledge (*rahn*). The Islamic pawnbroker would accept the pledge on a *wadiah* concept where the pawnbroker promises to safe-keep the valuable pledge until the loan is settled. Items to be accepted under conventional pawn-broking are beyond gold and jewelry but Islamic pawn-broker can only use gold as pawned items. In the event of default, the pledged item will be sold to a third party. This procedure will be used for settling the outstanding balance while any excess be returned to the borrower.

Pawn-Broking Services in Malaysia

Pawnshop is an instrument of microfinance in Malaysia. Pawn-broking service was introduced in Malaysia in early 19th century (Ismail and Ahmad, 1997). Pawn-broking activities in Malaysia are subjected to Pawn Broking Act 1972. Conventional pawn-broking system is popular for quick cash borrowing amongst the middle or low income groups. However, it is argued that conventional pawn-broking system has several disadvantages. First, interest and other charges can be as high as 24 per cent per annum (2 per cent per month). Second, the valuation and measurement method are not transparent and subjective. Third, unclaimed gold pawned will be auctioned but the excess money will not be returned to the borrower. The first Islamic pawn broking service in Malaysia is the Foundation of Islamic Pledge of Terengganu which was formed by the Islamic Council and Malay Custom of Terengganu on the 23rd January 1992. In March 1992, *Ar-Rahn* Pawnshop, a subsidiary of Kelantan Capital Limited commenced its operations. On 21st August 1993, the Minister of Finance announced the introduction of a scheme, known as Islamic Pawn Shop Broking through the collaboration of three institutions namely Central Bank of Malaysia, Islamic Economic Development Foundation of Malaysia and Co-operative Bank of Malaysia.

Features of Ar-Rahn

In the Islamic-based pawnshop, the loan granted is based on three concepts, i.e. *al-qardhul hassan* (loan without interest, but the borrower pays service charge), *Ar-Rahn* (valuable asset is placed as collateral for debt) and *wadiah yad dhammanah* (keeping valuable goods by guarantee). The deposit fee is based on the value of gold. Generally, types of pawned assets are all jewelries made from gold such as necklace, ear rings, rings, bangles, brooch and others. Platinum is not acceptable under *Ar-Rahn*. The rates breakdown of *Ar-Rahn* provided by Group of Kelantan Capital Limited Cooperative Bank, Cooperative Bank and Agricultural Bank of Malaysia (now known as Agro Bank).

Empirical Studies

Amin, Chong, Dahlan and Supinah (2007) contributed some interesting findings to further understand the Islamic-based pawnshop (*Ar-Rahn*). They used various factors that affect the acceptance of *Ar-Rahn*. Religion, pledged asset and customer services seem to be more important and pricing system and location of Islamic-based pawnshop are perceived to be less important in affecting the acceptance of *Ar-Rahn*. In most business activities, Muslims emphasize the 'halal' transactions (Johari, Sanusi and Rais, 2007). Islamic pawnshops must genuinely be based on *Syariah Islamiyyah* (Amin et al., 2007). Most of the Muslims will go to *Ar-Rahn* rather than conventional pawnshop because of their religion since that *Ar-Rahn* is applying the *Syariah* concept. Religious conviction is a logical key determinant of the use of Islamic financial services (Gait and Worthington, 2008).

Ar-Rahn provides a cheaper and quicker way to get short term financings. Johari et al. (2007) argued that customers who were from the higher income group would be able to buy the mortgaged items (usually gold) which were expensive or possess valuables in a large quantity. Therefore, during the transaction, the demand for high income respondents is higher compared to the demand of low income respondents. A study by Amin et al. (2007) suggests that there is a need to strengthen the customer service in order to become a successful Islamic pawnshop. Besides that, there are some considerations that need to be taken into account when operating *Ar-Rahn*. First, the transaction must be efficient and fast; second, the pawnshop must be free from the issue of discrimination; and third, customer records must be kept confidential. Improving service quality will satisfy customers and thus it retains customers' loyalty (Lee and Murphy, 2005). Conversely, bad customer services will cause customers to switch to other service providers (Lee and Murphy, 2005). Pricing is significantly associated with the pawnshop transactions (Ismail and Ahmad, 1997). This reveals that the cost of getting quick cash in Islamic-based pawnshop is cheaper, thus, little burden is carried by the customers. In the related studies, price stands out as another overwhelming reason for switching such as in insurance and banking area (Lee and Murphy, 2005). Elizabeth (2002) examines the household's decisions to change or remain with their providers of checking or saving accounts.

Innovative Islamic pawnshops should be able to diversify the pledge asset for business, which is not just limited to gold but can be other valuable assets. That was many past researcher has stated that normal pawned items include gold and platinum. Thus, it is reasonable for Islamic-based pawnshop to expand pawned item beyond gold in order to attract more customers (Amin et al., 2007; Johari et al., 2007). An advertiser's primary mission is to reach prospective customers, create awareness among the prospective customers, influence their attitudes and buying behavior (Adeolu, Taiwo and Matthew, 2005). It is known that advertisement for *Ar-Rahn* does not seem to be aggressive enough in Malaysia and thus, not many people are aware about *Ar-Rahn*. Hence, effective advertisement can help *Ar-Rahn* operations to be expanded beyond the boundary of Muslim markets and this in turn, result in greater profitability (Adeolu et al., 2005). Location is another significant factor for pawnshop development. Studies suggest that customer prefer to

conduct businesses/transactions with the nearest Islamic-based. It is because the distance between pawnshop and customer's house will incur additional cost i.e. transportation cost, (Ismail and Ahmad, 1997). Johari et al. (2007) suggest the demand for customer with long distance is higher rather than the respondent with near distance. In a conventional term, convenient location has been identified as a critical factor influencing the choice of a bank by customers (Elizabeth, 2002).

Research Objectives

Pawnshop is classified as one of the instruments of micro-financing in Malaysia (Ismail and Ahmad, 1997). Pawn-broking provides a convenient and quick way for consumer to get financing. As highlighted earlier, there are two kinds of pawnshop in Malaysia; conventional pawn-broking shop and Islamic pawn-broking (*Ar-Rahn*) shop. Consumer has an option to choose either one of this. However, *Ar-Rahn* is a better alternative for Muslim customers as it does not involve *riba* and it incorporates Shariah principles. Hence, Muslims are bound to opt for the Islamic pawn-broking in line with their religious practices.

Malaysia is the first which introduced Islamic-based pawnshop (*Ar-Rahn*) in the whole world (Zunaidah, 2006). However, there are very few *Ar-Rahn* shops in Malaysia as compared to the number of conventional pawnshops. Lack of awareness among the Malaysians about *Ar-Rahn* is also another contributory factor as to why many Malaysians are still not prepared to accept this kind of 'micro-financing' option which equally good, in fact, it could be better than the conventional pawnshop. Thus, understanding the factors affecting customer to switch to the *Ar-Rahn* is essentially important especially in expanding the adoption of the *Ar-Rahn* in Malaysia. Hence, the objective of this study is to explore the factors that affect customers' switching behavior towards the adoption of *Ar-Rahn*.

Research Hypotheses

- H1: Religion positively related to customers' switching behavior towards Islamic Pawning.
- H2: Income positively related to customers' switching behavior towards Islamic Pawning.
- H3: Customer service positively related to customers' switching behavior towards Islamic Pawning.
- H4: Pricing system positively related to customers' switching behavior towards Islamic Pawning.
- H5: Pledge asset positively related to customers' switching behavior towards Islamic Pawning.
- H6: Advertisement positively related to customers' switching behavior towards Islamic Pawning.
- H7: Location positively related to customers' switching behavior towards Islamic Pawning.

Methodology

This paper used primary data through a survey conducted cross-sectionally in Klang Valley. The sampling technique used in this study was convenience sampling. The sampling frame is limited to the respondents living within Klang Valley. The respondents were of different races and religions and they were above 18 years old. A five-point likert scaling was used for all the measures. A total of 250 questionnaires (self-administered) were obtained. A pilot test was also carried out to ensure the quality of the survey in terms validity of the measures used. Reliability

test, factor analysis, correlations and PLS analysis were adopted for this research. As for modeling purposes, the measures and adoption of the independent variables were consistent with some previous findings and models set (e.g. Adeolu, Taiwo and Matthew, 2005; Amin et al., 2007; Elizabeth, 2002; Ismail and Ahmad, 1997; Ismail and Sanusi, 2005; Johari et al., 2007; Lao, 2005; Lee and Murphy, 2005; Mohammed et al., 2005; Sanusi and Johari, 2006). In addition, as for the dependent variable, a measure was specially constructed to detect customers' preference using a five-point likert scaling. The theoretical framework proposed for this paper is given in Figure 1.

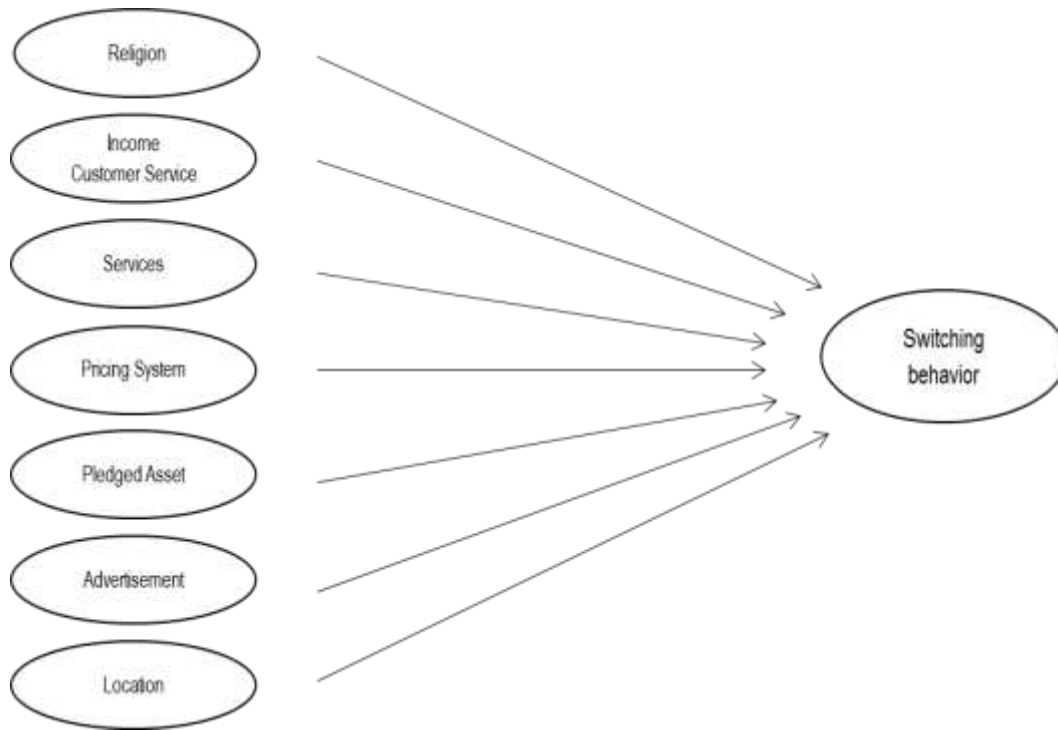


Figure 1: Theoretical framework

$$CWB = \alpha + \beta_1rel + \beta_2inc + \beta_3CS + \beta_4ps + \beta_5pa + \beta_6adv + \beta_7loc$$

Analyses and Discussions

Preliminary Analysis

This section presents the demographic characteristics of the respondents in the present study. The results of this analysis are illustrated in table 1. Based on the results, both male and female were quite equally distributed. About 40 per cent were married, 58 per cent were single. Representation of various races and religious groups were quite evenly distributed.

Table 1: Respondents' profile

	Demographics	Percentage (%)
Gender	Male	48.8
	Female	51.2
	Total	100
Age	18-24	39.2
	25-34	36.0
	35-44	20.4
	44 and above	4.4
	Total	100
Marital Status	Single	58.0
	Married	40.4
	Divorce	1.6
	Total	100
Occupation	Executive	26.0
	Non-Executive	48.0
	Self-Employed	13.2
	Others	12.8
	Total	100
Yearly Income	Less than RM 24,000	60.8
	RM 24,000 – RM 42,000	26.0
	Above RM 42,000	13.2
	Total	100
Religion	Islam	42.8
	Buddha	29.2
	Hindu	18.4
	Christian	8.8
	Others	0.8
	Total	100
Race	Malay	42.0
	Chinese	36.8
	Indian	21.2
	Total	100

Main Analysis

Data collected for the present study was analyzed by using partial least square (PLS) method. This technique was used due to three main reasons. First, PLS can handle both reflective and formative factors (Chin 1998). Second, PLS sets minimum restrictions on data distribution characteristics and sample size. Third, PLS is suitable for an exploratory research and alternative method for theory testing (Hair et al. 2014).

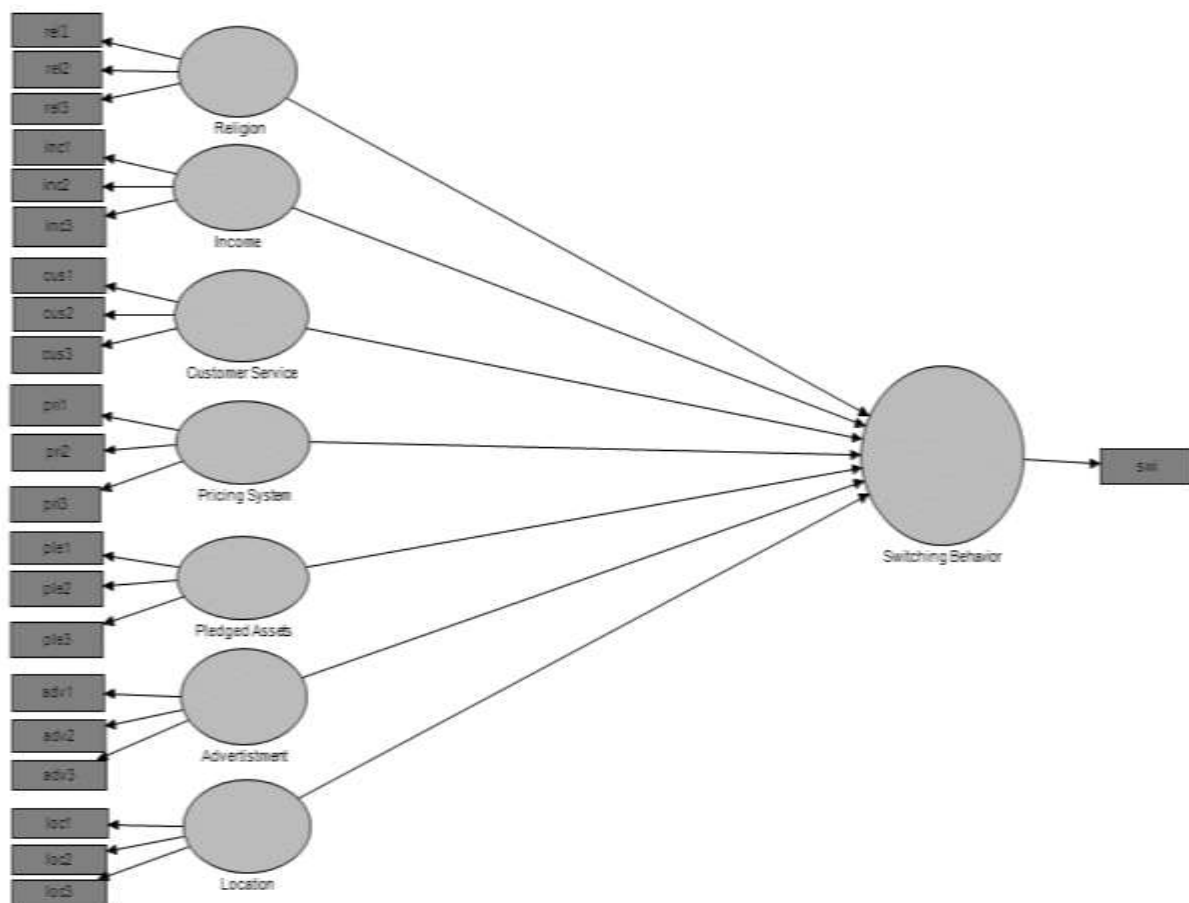
The Smart PLS Version 2.0 with two-step approach was adopted to analyze the data (Hair et al. 2013; Hair et al. 2014; Ringle, Wende and Will 2005). The first step concentrated on the evaluation of measurement model, and followed by the evaluation of structural model. The direction and significance of path coefficients were evaluated through bootstrap procedure.

Measurement Model

Convergent Validity

First, convergent validity which refers to the extent of a measure correlates positively with other measures of the same construct was tested. It assessed the factor loadings, composite reliability and average variance extracted (Hair et al. 2014). Based on the results in table 2, all items were loaded on their respective construct and exceeded the recommended value of 0.6 (Chin et al. 1997). The composite reliability values (see table 2) which measures individual reliability and provide better estimate of variance shared by respective indicators, ranged from 0.850 to 0.974, which exceeded the recommended value of 0.7 (Hair et al. 2014). The average variance extracted values were in the range of 0.553 to 0.925 which indicates that the construct explains more than half of the variance of its indicators (Hair et al. 2014). Table 3 shows the results of convergent validity.

Figure 2: Research model



Discriminant Validity

Discriminant validity refers to what extent the latent construct is differs from other constructs. Discriminant validity can be assessed by comparing the squared correlations between the constructs and the variance extracted for a construct (Fornell and Larcker 1981). Referring to table 3, the squared correlations of each construct were less than square root of the average variance extracted by the indicators of measured constructs, indicating evidence on discriminant validity. In summary, the reflective measurement model of the present study had achieved the requirements in terms of convergent validity and discriminant validity.

Structural model

The structural model which refers to causal relationship among the constructs in the model was assessed by examining path coefficients and R^2 value (Hair et al. 2014). Based on the results in Table 4 and Figure 2, religion ($\beta = 0.429, p < 0.01$), income ($\beta = 0.197, p < 0.05$), pricing system ($\beta = 0.131, p < 0.05$), pledged asset ($\beta = 0.226, p < 0.01$), advertisement ($\beta = 0.1333, p < 0.05$) and

location ($\beta = -0.282, p < 0.01$) were significantly related to customers' switching behavior. This explains 35.8 percent of the variance, thus supporting H1, H2, H4, H5, H6 and H7 of the present study.

The remaining hypothesis was statistically insignificant. The path between customer service and customers' switching behavior was statistically insignificant ($\beta = 0.053, p > 0.05$). Thus, H3 was not supported.

Table 2: Factor loadings and reliability

Items	Loadings ^a	CR	AVE	Cronbach α
rel1	0.974	0.974	0.925	0.959
rel2	0.960			
rel3	0.951			
inc1	0.913	0.930	0.817	0.892
inc2	0.895			
inc3	0.903			
cus1	0.905	0.852	0.663	0.771
cus2	0.614			
cus3	0.890			
pri1	0.783	0.786	0.553	0.600
pri2	0.793			
pri3	0.645			
ple1	0.823	0.864	0.679	0.764
ple2	0.855			
ple3	0.793			
adv1	0.717	0.850	0.655	0.802
adv2	0.788			
adv3	0.912			
loc1	0.908	0.936	0.829	0.902
loc2	0.944			
loc3	0.877			

CR composite reliability, AVE average variance extracted

^a Standardized loading

Table 3: Inter-construct correlation

Constructs	1	2	3	4	5	6	7	8
1. Religion	0.962							
2. Income	0.014	0.904						
3. Customer service	0.008	0.026	0.814					
4. Pricing system	0.001	0.166	0.067	0.744				
5. Pledged asset	0.017	0.070	0.127	0.163	0.824			
6. Advertisement	0.005	0.004	0.104	0.009	0.001	0.809		
7. Location	0.047	0.005	0.037	0.116	0.039	0.005	0.910	
8. Switching behavior	0.128	0.061	0.023	0.050	0.124	0.018	0.006	1

Note: Diagonals represent the square root of the AVE of the reflective scales while the off-diagonals represent the squared correlations between constructs

Table 4: Summary of the structural model

Path	Description	Hypothesis	Path coefficient	t value	Results
REL → SWI	Religion → Switching behavior	H1	0.429	7.950**	Supported
INC → SWI	Income → Switching behavior	H2	0.197	2.890**	Supported
CUS → SWI	Customer service → Switching behavior	H3	0.053	0.724	Not supported
PRI → SWI	Pricing system → Switching behavior	H4	0.131	2.056*	Supported
PLE → SWI	Pledged asset → Switching behavior	H5	0.226	3.356**	Supported
ADV → SWI	Advertisement → Switching behavior	H6	0.133	1.952*	Supported
LOC → SWI	Location → Switching behavior	H7	-0.282	3.500**	Supported

Note: t-values > 1.65* (p < 0.05); t-values > 2.33** (p < 0.01)

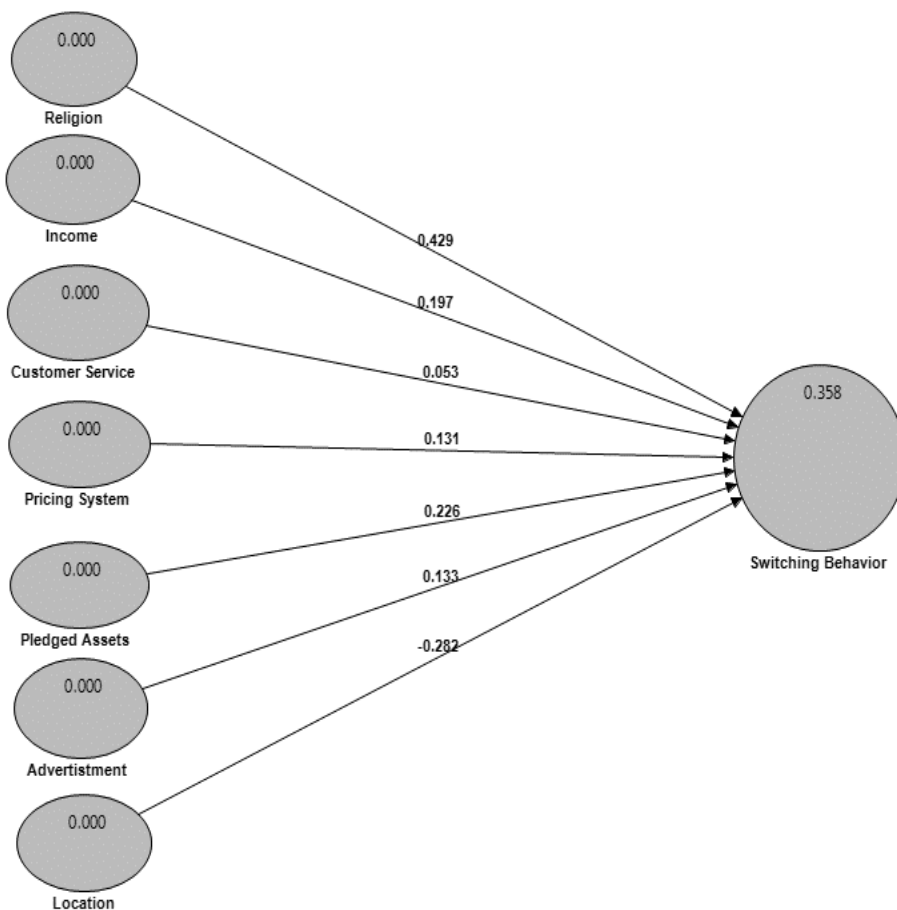


Figure 3: The structural model

Discussion and Conclusion

In essence, religion does have impact on the preference of the *Ar-Rahn* shop in Klang Valley. Meanwhile, it is agreed that level of income also has a significant impact on the adoption of *Ar-Rahn* and this mainly involves the lower income group people. It cannot be denied that pricing is also perceived to be an important factor on the adoption of the Islamic pawning. Meantime, conditions imposed on pledged assets do have impact on the adoption of the Islamic pawnshop. Advertisement has impact on the adoption of *Ar-Rahn*. However, location is inversely correlated with switching behavior.

In essence, the results offer some unique understanding about the expectation of the customers. Firstly, as for the Islamic pawnshop, customers are not concerned about the services rather the operational aspects may become their main concerns, that include income, pricing and location as well. Interestingly, customers prefer *Ar-Rahn* shop located farer or probably away from their housing areas as they probably don't want to be seen by their neighbors. Undoubtedly, people have positive views towards the *Ar-Rahn* operations and as such, this could be another important source of micro financing not only for the Muslim community but also for all segments of communities.

References

- Abdul Ghafar Ismail and Nor Zakiah Ahmad (1997), "Pawnshop as an Instrument of Microenterprise Credit in Malaysia", *International Journal of Social Economics* Vol. 24 No. 11, pp.343-1352.
- Adeolu, B. A., Taiwo, A. and Matthew, A. A. (2005), "The Influence of Advertising on Consumer Brand Preference", *Journal of Social Science* Vol. 10 No.1, pp. 9-16.
- Adil Salahi. (2004), *More about Gambling and its Prohibition*. Retrieved July 20, 2008, from <http://www.arabnews.com/?page=5andsection=0andarticle=45775andd=3andm=6andy=2004> (accessed 10 May 2015)
- Amin, H., Chong, R., Dahlan, H. and Supinah, R. (2007), "An Ar-Rahn Shop Acceptance Model (ARSAM)", *Labuan e-Journal of Muamalat and Society* Vol. 1, pp. 88-101.
- Bank Negara Malaysia. (2009), *Islamic Banking Concepts: Central Bank of Malaysia*. Retrieved January 10, 2009, from <http://202.186.124.25/index.php?ch=174andpg=467andac=368>
- Bank Pertanian Malaysia. (2008), Ar-Rahn Scheme. Retrieved January 12, 2009, from <http://www.bpm.com.my/article.cfm?id=560>
- Bank Rakyat website. (2008), Ar-Rahn Scheme. Retrieved January 12, 2009, from <http://www.bankrakyat.com.my/arrahnu>
- Elizabeth, K. K. (2002), *Household Switching Behaviour at Depository Institutions: Evidence from Survey Data*. Retrieved June 2, 2008, from <http://www.federalreserve.gov/Pubs/feds/2002/200244/200244pap.pdf>
- Fernando, N. A. (2003), "Pawnshop and Microlending: A Fresh Look is Needed", *Focal Point for Microfinance* Vol. 4 No. 1, pp. 1-8.
- Gait, A. and Worthington, A. (2008), "An Empirical Survey of Individual Consumer, Business Firm and Financial Institution Attitudes Towards Islamic Methods of Finance", *International Journal of Social Economics* Vol. 35 No. 11, pp. 783-808.
- Ismail, A. G. and Ahmad, N. Z. (1997), "Pawnshop as an Instrument of Microenterprise Credit in Malaysia", *International Journal of Social Economics* Vol. 24 No. 11, pp. 1343-1352.
- Ismail, A.G. and Sanusi, N.A. (2005), "A framework for regulating pawnshops: Why do, what area and Syariah view", *Proceedings of Malaysian Finance Association (MFA)'s 7th Annual Conference*, 9-10 May, Kuala Terengganu, Terengganu.
- Johari, M. S., Sanusi, N. A. and Rais, M. I. B. (2007), *The Demand of Pawnbroking Services: Evidence from Malaysia*. Retrieved June 2, 2008, from <http://ibacnet.org/bai2007/proceedings/Papers/2007bai7490.doc> (accessed 11 March 2016)
- Kamal Naser, Ahmad Jamal and Khalid Al-Khatib (1999), "Islamic Banking: A Study of Customer Satisfaction and Preferences in Jordan", *International Journal of Bank Marketing* Vol. 17 No. 3, pp. 135-151.
- Kumpulan permodalan Kelantan Berhad. (2008), Retrieved January 12, 2009, from <http://www.pkb.net.my/arrahn/tata.html>
- Lao, J.J. (2005) Unexplained pawn pricing behavior: A study of Las Vegas pawnshops. *MIT Undergraduate Research Journal* Vol. 12, pp. 45-53.

- Lee, R. and Murphy, J. (2005), *From Loyalty to Switching: Exploring the Determinants in the Transition*. Retrieved June 2, 2008, from http://smib.vuw.ac.nz:8081/WWW/ANZMAC2005/cd-site/pdfs/3-Consumer-Beh/3-Lee_Murphy.pdf (accessed 5 June 2015)
- Memon, N. A. (2007), "Islamic Banking: Present and Future Challenges", *Journal of Management and Social Sciences* Vol. 3 No. 1, pp. 1-10.
- Mohammed, N., Daud, N.M.M. and Sanusi, N.A. 2005. Analisis skim *Ar-Rahn*: Satu kajian perbandingan dengan pajak gadai konvensional. *Prosiding Seminar Kewangan dan Ekonomi Islam: Pengukuhan dan Transformasi Ekonomi dan Kewangan Islam*, 29-30 Ogos, Esset-Bangi, Selangor Darul Ehsan, 211-220.
- Peter, J. P. (1979) Reliability: A Review of Psychometric Basics and Recent Marketing Practices. *Journal of Marketing Research* Vol. 16, pp. 6-17.
- Sanusi, N.A. and Johari, M.S. (2006) Prestasi perkhidmatan *Ar-Rahn*: Kajian kes MGIT. *Proceedings of National Seminar in Islamic Banking and Finance: Islamic Wealth*

Reproduced with permission of copyright owner.
Further reproduction prohibited without permission.