CGAP

BRIEF

Understanding Demand for Sharia-Compliant Loans: Results of a Randomized Experiment in Jordan

The evidence on demand for sharia-compliant financial services is mixed. On the one hand, IFC-funded studies showed relatively high demand,[1] while results from Findex showed that financial exclusion due to religious reasons was minimal (Demirguc-Kunt, Klapper, and Randall 2013). One of the reasons behind these contradictory messages could be the survey instruments themselves: perhaps the issue is not so much what people want but how they were asked. For example, if you ask participants why they do not use borrowing or savings products, their responses may include "they are too expensive" or "they are too far away" even if the real reason is something more nuanced, such as intra-household bargaining issues. Similarly, if you ask Muslims if they prefer an interest-bearing loan or a noninterest-bearing loan, it might not be surprising that they would choose the noninterest-bearing loan, perhaps because they want to demonstrate piety, or maybe because they assume it means a no-cost loan.

CGAP teamed up with Yale University to address this potential survey question bias and to gain more insight into the real nature of demand for sharia-compliant financial services in Jordan. We implemented a randomized experiment with Tamweelcom, a financial institution in Jordan that was launching a sharia-compliant product. The experiment marketed loans to several thousand individuals but varied the type of loan offered to clients. The experiment probed three distinct questions: What is the demand for sharia-compliant products as compared to conventional products; how does sharia authentication affect demand for sharia-compliant products; and what is the price elasticity for demand of sharia-compliant products?

Some clients were offered a conventional loan, others were offered a sharia-compliant loan, while others had a choice of either a conventional or a sharia-compliant product. Given the choice, which one would consumers actually choose? And which features in these products would most likely influence that choice? Would it be, for example, the perceived authenticity of the sharia-compliance? Or, would it be the price of the product?

This is the first study of its kind that tests actual loan take-up, as measured by applications for a loan, of a sharia-compliant product with consumers. The results are important because they go beyond the typical survey questionnaire problems that have thus far prevented practitioners from understanding the "demand conundrum" or the persistent mismatch between results of surveys that show high demand for sharia-compliant products but limited take-up when and where these products are on offer (El-Zoghbi 2013).

This Brief explores the findings and their implications from the study in Jordan. While the results are valid only for the Jordanian market, if similar studies were done elsewhere, we may begin to see a clearer picture of demand for sharia-compliant services.

The Scenario

Tamweelcom has operated for over 15 years as one of the largest and fastest growing microfinance institutions (MFIs) in Jordan. It had over 65,000 active borrowers in 2014, more than 90 percent of whom were women. It offers group and individual microfinance loans in 11 out of 12 governorates in Jordan. Tamweelcom was interested in creating a subsidiary entity to launch a new sharia-compliant loan product. The product, a murabaha loan,[2] offered consumers the ability to finance durables such as refrigerators, stoves, and other household consumer goods at the cost of the product plus the administrative fees that the financial institution incurred. Thus the main difference between the sharia-compliant versus the conventional product relates to how the loan is disbursed. For the conventional product, the loan is disbursed in cash directly from the financial institution to the borrower, and the repayment is made of both principal and interest. For the sharia-compliant product, the client works with the bank to obtain the consumer durable and repays the cost of the durable plus any administrative fees associated to the financial institution's handling of that transaction.

1 IFC-funded studies covering five Arab countries showed significant variance: in Algeria 20 percent of respondents claimed that they did not access financial services because they are not sharia-compliant, while in the West Bank over 60 percent of respondents indicated a preference for sharia-compliant services. These results may suggest important differences across countries, but because the questions themselves are different they cannot be compared directly.

2 See El-Zoghbi and Tarazi (2013) for a more thorough description of various sharia-compliant products.

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The clients were offered the sharia-compliant version at different price points (see Box 1 for more on the product's design). By hosting separately a conventional arm and a sharia-compliant arm, the financial institution is able to offer its clients both types of products and yet the complete segregation of the sharia-compliant business from the conventional business keeps it untainted from a sharia-compliance perspective.

The Experiment

The experiment used marketers who were hired and trained to approach individuals at their homes (half of respondents) or in public spaces (the other half of respondents), such as malls and sidewalks, in and around six major cities in Jordan. The exact pitch used by the marketer was randomly assigned and as such allowed the study to see how these different pitches affected client behavior. The study aimed to answer three distinct questions:

1. What is the demand for sharia-compliant products as compared to similar conventional products?
2. How does sharia authentication affect the demand for sharia-compliant products?
3. What is the price elasticity of demand for sharia-compliant products?

The marketers were given a tablet computer with customized software that randomly determined the message that the marketer used with the consumer. Consumers were then able to apply for a loan immediately. The decision to apply for a loan served as the main outcome variable for the study, which is an improvement on earlier studies that simply asked people if they would prefer a sharia-compliant loan if it were available. The outcome variable here requires that the respondent actually fills out a loan application on the spot.

Between February and August 2015, a total of 6,037 consumers was reached, 57 percent of whom were men. Out of the respondents that were interested in a loan, 31 percent had an existing bank account and 21 percent had taken out a loan before. None of them was an existing client of Tamweelcom.

Results of the Experiment in Jordan

Demand for sharia-compliant loans exceeds demand for similarly priced conventional loans

The first hypothesis of the research explored whether demand for sharia-compliant loans was the same as for the conventional loan. The results show that demand for a sharia-compliant loan is higher than for a conventional loan when these products are marketed independently and cost the same. In fact, the study shows that while only 18 percent of the group offered the conventional product decided to apply for the loan, 22 percent of the group offered the sharia-compliant product applied for the loan (20 percent higher take-up than for the conventional loan).

When clients are given the *choice* between two similar products marketed together, demand for a loan didn't go up very much, with only 19 percent applying for any of the two loans. Interestingly, of those that applied for the loan, 90 percent ended up applying for the sharia-compliant loan as opposed to the conventional loan when both were priced the same. In this experiment, having a choice between two products was not more effective than being offered only one type of loan. This supports the hypothesis that sometimes increasing the option set can lead to a limited form of choice paralysis, decreasing demand.

Box 1. Experiment Design

A total of seven different treatment arms and one control arm was used.

Hypothesis 1: Demand for sharia-compliant loans is the same as for conventional loans.

1. Control: A conventional loan product for a home appliance valued between $400 and $2,100 at a rate of 1.9 percent a month for a maximum of 20 months.
2. Treatment 1: Simple sharia-compliant product for a home appliance valued at $400–$2,100 with a fee that is "equivalent to" the interest on a conventional loan at 1.9 percent a month for a maximum of 20 months.

Hypothesis 2: Demand for sharia-compliant loans depends on the authorizing entity.

3. Treatment 2–4: Simple sharia-compliant products with the same details as treatment 1, but also including a statement that the product has been approved by the government's sharia board, a nationally recognized religious leader, or the bank's sharia board.

Hypothesis 3: Demand for sharia-compliant loans depends on the price relative to conventional loans.

4. Treatments 5–7: A pitch that offers a choice between a conventional loan at 1.9 percent or a sharia-compliant product whose price is "equivalent to" a conventional monthly interest rate of 1.75 percent, 1.9 percent, or 2.2 percent.

Information on sharia authenticity does not increase demand

One of the more surprising results of the study relates to whether clients need verification of sharia-authenticity and how information on authentication influences uptake. The experiment explored three typical ways in which a financial service provider may authenticate a product—approval by a government body set up to serve this role (government sharia board), use of an internal sharia board that approves products, or approval from a respected local religious figure.

The evidence shows that there is no significant relationship between which certifying body is used to authenticate the sharia-compliance of the product and the demand for the loan. The responses to the marketing pitches using information on authentication seem to show that "more is less" in this case, where the simplest treatment, in which the marketers don't mention who the certifying entity is, actually elicits the highest level of demand.[3]

Demand for sharia-compliant loans declines as price increases

Not surprisingly, the study reveals that as the price for the sharia-compliant loan goes up, demand for the product goes down. On the other hand, it finds that those individuals who are more "religious"[4] have higher demand for the sharia-compliant product and are less sensitive to increases in the price of the loan. In other words, individuals that are more religious are willing to pay more for access to sharia-compliant loans. Being "religious" has the same impact on demand as decreasing the price of the loan by 16 percent.

The experiment tested a small price-band ranging from the equivalent of 1.75 percent to 2.2 percent interest per month. Even when the sharia-compliant loan was priced at 2.2 percent per month (versus 1.9 percent per month for the conventional loan), 75 percent of clients still preferred the sharia-compliant loan.

This price band is possible for a product such as murabaha, which has quite limited operational implications for the financial institution. Understanding price sensitivity across different types of sharia-compliant products would be useful for financial services providers that want to expand their suite of offerings to accommodate different needs of consumers.

What are the implications of these results?

While undoubtedly there are limits to what we can extract from only one study at one point in time in one specific country that is also impacted by a unique political and social situation, these results are still meaningful in that they move us one step closer to understanding the complexities around the demand for sharia-compliant loans. Implications of this study include the following:

- **Access is key; other features seem secondary.** The big issues that we originally thought were drivers of the choice to take-up a product in Jordan—sharia authentication and price—turn out to be less important than simple access. The implications of this are generally good for providers in the country as it seems the formula may be less complex than originally thought. The message seems to be simple: "get the product out there, use a simple marketing pitch, and don't mix it up with your conventional offerings."
- **Different people have a greater willingness to pay.** It may come as no surprise that more religious individuals have a greater demand for sharia-compliant loans in Jordan. Interestingly, many of them are willing to pay extra for this feature. Since sharia-compliant loans may cost an institution more than a conventional loan, this research shows that those costs could be passed through to customers without eliminating the market for the product.

The Next Steps

This type of experimental design should ideally be replicated in other contexts to see if the results have validity beyond Jordan. In addition to contextual issues, several of the results in this study are counterintuitive and require further probing; sharia authentication is one such issue. Does information on authentication of sharia-compliance matter to consumers elsewhere? Does authentication matter at all? If so, what authentication method actually adds value to the offer?

The other surprising result is around the number of choices. While other studies have documented that too many choices can confuse consumers, most of these studies have tested much larger sets of choices.[5] In this experiment the choice was limited to only two options. Why would these choices not increase overall demand?

3 Although the results show that the simple sharia-compliant method brings in 23.2 percent of respondents and the other types of authentication bring in an average of 21.6 percent of respondents, this difference is not statistically significant.

4 It is very difficult to collect information about piety. In the study, researchers asked individuals if they watch religious TV and used that as a proxy for piety.

5 See Schwartz (2004) on the paradox of choice and Bertrand et al. (2010) for an empirical example.

Does the mention of a conventional loan reduce the "authenticity" of the sharia offer? Does the mention of the conventional offer make the consumer more aware of the limited difference between the sharia and the conventional offering, reducing the innovation of the sharia-compliant offer? Does the offer of a conventional loan alongside the sharia loan reduce the trust in the provider itself and its credibility as a sharia-compliant provider?

Finally, the results around price sensitivity are interesting for those who care about sustainability of sharia-compliant operations, but can benefit from additional exploration. Although the study found that "religious" individuals are less price-sensitive to increases in the cost of the sharia-compliant loans, it is not able to see if they are less price-sensitive in general, or if this is specific to sharia-compliant products. Another issue is how to target those clients who value these loans the most. It may be possible that finer characterizations of religious adherence could reveal even more about the behavior of individuals who would use these products most.

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