

ETIOLOGY OF ISLAMIC FINANCIAL INSTITUTION'S SUCCESS

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Abstract

Purpose:

The purpose of this research paper is to highlight the core features of Islamic Financial Institutions plays vital role in getting competitive and strategic advantages over conventional financial sector. Indeed these institutions engage numerous stakeholders and opt different business models working in full conformity with shariah standards along with fulfillment of nation's regulations to enhance their profitability and productivity, consequently contribute in boosting the economy. The studies predict their rapid growth and exponential expansion in future but this can only be done finely through streamlining it with Shariah Rulings along with Standardize National Measures & Regulations.

Research Design/ Methodology:

This paper is conceptual and has theoretical aspect and the result generated on the basis of related literature, In-vogue Islamic Banking procedural documentations regarding different modes and shariah based texts along with elaboration of different research questions regarding the subject matter.

Results and Findings:

The study finds different indicators cum issues that need to be address both theoretically and practically with intensions to enhance the acceptability in general public and eradication of confusions of the scholars.

Conclusion:

The Shariah principles have great extended scope to accommodate all sort of businesses whether operates at Macro or Micro Level, associated with individuals or connected with public sector collective property along with having strength and potential to Islamize the Products and Services if proper Islamization Framework executed with its true Spirit.

Keywords: *Etiology, Islamic Financial Institutions, Shariah Rulings, Regulations.*

Introduction:

The concept of Islamic banking system recently emerged and counted is young as compared to matured conventional banking. Despite the principles are common to both but two principles make it different from conventional banking system; *riba* and *gharar*. *Riba* covers both interest and usury and *gharar* refers to uncertainty in transaction. Similarly, the money of capital supplier shall be invested in sharia compliant product. In simple word bank cannot extend the money to alcohol, narcotics or casino businesses. Since *riba* is prohibited, so Islamic banking have variety of instruments and financial contracts available to client such as *musharaka* and *mudaraba*; the second consists of *salam*, *istisna*, *istijrar*, *qard*, *murabaha*, *ijara*, *bai-bithaman-ajil*, *bai-al-einah*, *bai-al-dayn*, and *tawarruq*; the third comprises services based on *wakala* and *kafala*.

Objective of Islamic Banks:

Islamic banks are not only different from conventional banks in practices but also different in its philosophies and values that rooted in shariah (Islamic law). Shariah is not limited to list of guidelines necessary for making transactions in compliance with shariah practices. But its role extended to promote social and well being of the society. Islam provides a perfect architecture for civilization with guidelines on every sphere of life that compliment and supports each other. Shariah based firms like Islamic banks have goals to bring economic and social welfare while capitalistic view is to increase wealth maximization. It is also irrational that Islamic banks involve in social works with depositors and shareholders money.

Literature

Literature on Islamic banking system reveals that prime objectives of Islamic

banks are commercial and economic goals while social welfare issues are secondary in discussion. Ismail (2002) and El-Gamal (2006) assert that Islamic banks similar like other commercial banks except in compliance with shariah rules in its products. This is one view that Islamic banks are ordinary commercial firms like other banks and its prime responsibility to earn profit for its depositors and shareholders while strictly adhere to shariah compliance.

Islamic banks is one factor of Islamic economic system that based on Islamic law (shariah) and need to be understand in its entirety. It is necessary that Islamic banks have right philosophies in order to develop management practices, policies and serves as benchmark for Islamic in its compliance (Haron, 1995). This is another school of thoughts who consider Islamic banks as subset of Islamic economic system. They assert that Islamic economic system ensure just, fair and balance society that expressed in Al-Maqased Al-Shariah (see e.gChapars, 1985, Ahmad, 2000; Siddiqui, 2001, Chapara, 2000 &Naqvi, 2003). So a system that is based on moral framework of shariah , Islamic banking is also espoused social norms and welfare of society (Ahmad, 2000; MiraKhor, 2000; Warde, 2000). Therefore, Islamic banks serve socio economic purpose instead of getting interest and complying with legal requirements of country. Haron (1995), Omer and Haq (1996) suggests that Islamic banks have to maintain balance between earning and social well being of the society.

In an empirical study on Malaysian Banks by Dusuki (2008)and finds that respondent (Shariah advisors, officers, customers, depositors, Islamic banks' managers and local communities) maintain that Islamic banks works as institutions that promote social welfare and Islamic value towards employees, and customers and community. Others factors perceived to be essential to be followed by Islamic banks are sustainable development and poverty alleviation.

Research question 1:Which one approach is more rational and suitable for the growth and development of Islamic banking system? Earning approach in shariah Compliance practices OR social welfare (Al-maqasid Al-shariah) approach?

Shariah Board, Shariah Committee, Shariah advisor:

Islamic banks have panel of religious scholars called shariah board or shariah committee. Even some banks hired a consultant called shariah advisor. These deem to be necessary for operation and development of shariah compliant products (see e.gUsmani 1998; Ghayad 2008). There is difference of opinion among these shariah boards, shariah committee or shariah advisor on these shariah products. If one banks receives validity certificate for its one product it will give competitive edge to it over its competitors. For this validity certificate shariah scholars are paid and in some cases deal depends on product earnings. What if the shariah board/committee/advisors give verdict about the conventional product as Islamic product just for attractive price?

According rough estimates there 100 to 200 shariah scholars and 12 out of them are making millions of dollars annually. It is also found that these shariah experts are serving in too many shariah boards and even grant consultancy to direct competitors as well. This issue was address in Malaysia to restrict scholars to single board or committee. It is possible that shariah committee/boards of different banks may give conflicting rulings on different shariah interpretation. A board may reject the product certified by another board of another banks.

There is growing number of investors present globally that only invest their capital in portfolios which are not in contradiction with their religious belief. These Islamic investors are growing in numbers and in amount of capital as well and consequently reducing the assets universe to shariah compliant assets (Derigs&Marzban, 2008). Muslims lack supreme institution like Christians have their Catholic Church for guidance and opinion on religious believes. If such institution would have exist it has long been existed in Christianity would make it easy to have common decision on financial products. So, Islamic Bank, Islamic fund and index use to hire shariah experts and scholars to differentiate between shariah compliant assets and non shariah assets (De Lorenzo, 2000).

Since, there is no unique source of sharia guidelines in Islam so different opinion exist in different fiqh and even among different scholars in same fiqh as well. This difference of opinion lead to intricacies that stem from converting oral and historical sharia interpretation to measurable, quantifiable and formal rules to run Islamic banks, Islamic funds and index. Although there are complexities in conventional capital markets because of complex financial instruments and global involvement of firms but the complexities

exacerbate when conventional financial instruments such as bonds, options, forwards and swaps, restructured in sharia compliant manner. Wilson (2004) describes the screening criteria for identification for shariah- compliant product which is based on qualitative screens and quantitative screens as defined by shariah scholars. Qualitative screen refers to the conditions that companies core operation must be in business are that are sharia compliant such as alcohol and pork. Since Quran and Hadith provides clear guidelines about such conditions so little differences prevails among shariah scholars. A quantitative screen is a process that excludes the business in shariah compliant funds or index on basis threshold that how much non-shariah business is allowed if business core business in haram.

Derigs and Marzban (2008) compares Islamic indices and reveal that asset universes are different in size and constituents for indices. There are differences among scholar on quantitative screens and qualifies some assets halal for one index and the same assets are declared haram for other index. The authors concluded that there are no common or generally accepted guidelines to convert the shariah rules into system measurable investment guidelines.

Others then difference on opinion, there are some issues in Shariah Supervisory Board (SSB). Firstly SSB members receive remuneration from Islamic financial institutions and their independence is in question. Banaga, Ray and Tomkins (1994) find in their study that members of SSB may involve in legitimizing the non-compliant operations in order to ensure their presence on boards. The implications of such action is that investors will lose trust of shariah supervisory Board (SSB) and financial institutions.

Based on the above discussion below questions arises that need thorough investigation and research to provide further guidelines for Islamic financial institutions.

Research question 2: *Is Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) is good option to standardize the Islamic banking rules without the need of shariah boards/committees/advisors?*

Research question 3: *Shall every country have supreme shariah board for all Islamic banks as it is in Indonesia?*

Research question 4: *Will it solve the issues if Islamic countries have global financial standard for Islamic banking and finance?*

Shariah Scholars and Bankers:

Skilled human resource is one of the issues that Islamic banking is facing. Qualified professional are rare who are equally good in banking as in shariah law. A person, having deep understanding of conventional banking, can easily understand the product but it will be hard for to develop such product without knowing shariah law.

Shariah scholars doing very good job but the circumstance and context have been changed now to serve the Al maqasid Al shariah that they read in the books (Siddiqi, 2006) so there is need to provide proper training to sharia scholars in institutional arrangement to equip them with modern day knowledge of finance to eliminate the malfunction of converting conventional products to shariah compliant product such as bond to sukkuk and bank loan to tawarruq. Most of the sukkuk issued all over the world are in compliance with shariah but in form not in spirit (Usmani, 2008).

Islamic banking practices have close resemblance with conventional finance and profit rate is as alternative name for interest rate(See for example Yusof and Fahmy, 2008; Abozaid and Asyraf, 2007; Meera and Larbani, 2009). Meera and Dazuljastri (2005) posits that there are doubts in operation of Islamic banking today that whether they in compliance with shariah practices. Chong and Liu (2009) conducted study on Malaysian banks and concludes that minor portion of Islamic banks is adhere to profit and loss sharing (PLS) rule and rate of large amount of deposit of Islamic banks are pegged to conventional deposits rate. One of the reasons for non-compliance is shortcoming of qualified professionals having equal hand on Islamic fiqh and financial knowledge.

The Khaleej Times (2008) conducted a survey and find that there 250 to 300 shariah experts. Out of these 15 to 20 are popular and have membership in majority of the boards which consequently overburden the shariahboards and it become difficult to grant approval on time (Malik, Malik & Mustafa, 2011). Limitation of time and lack of supportive staff with shariah scholars create hindrance in performing their job effectively (Khan & Chapra, 2000). Ullah

(2014) identified in his study on non compliance with shariah status of Islamic banks in Bangladesh that lack of knowledge, lack of sincerity of staff, poor shariah audit, lack of research and lack of strong SSB having full time skillful members are factors that lead to non compliant.

Literature reveals that there is need of qualified financial experts whom possess equal expertise in Islamic fiqh and modern financial knowledge.

Research Question No.5: what are the steps deem to be necessary to get qualified professional to eliminate non shariah practices in Islamic banking?

Growth and Development of Islamic banking:

Islamic banking enjoying a growth of 15 to 20% but have very little share in the worldwide banking. Islamic banks are in Muslim and non-Muslim countries like England and USA. Islamic banks prove itself to safe in global financial crises but again the industry does not attract customers in Muslim and non-Muslim countries. Khan (1986) concludes that survival of Islamic banks is possible through offering quality services to its customers. Islamic banks must not take it for granted that customers remain loyal because of Islamic words but customers have tendency to shift from Islamic banks to conventional banks in case of failure to provide them high quality of services. Ahmad and Haron(2002) suggests that Islamic banks have to adopt the marketing techniques of conventional banks to effectively market its product and services.

Islam (2017) conducted his study in India on customers awareness towards Islamic banking concludes that majority of the respondent are unaware about the operation and working of Islamic banking system. The study further reveals that customers have strong tendency and willingness to opt for Islamic banking if they informed properly and offered quality services. The results of the study suggest that Islamic banking need to increase awareness through effective marketing.

Banking growth lies in order attract customer and increase its deposits but Islamic banks are weak in promoting awareness through effective marketing. There is potential growth for Islamic banks in India as US\$ 1.5 trillion is unclaimed interest on deposits of muslims because they refuse to get interest

and use it (Maswood and Choudary, 2015). While on other hand total assets worth of 400 Islamic banks in 58 countries is more than US\$ 1,5 trillion in 2014 (GFD Report, 2014).

There is need to investigate the reasons that why Islamic banks fail to attract customers in muslim majority and non muslim countries as well.

Research question 6: Is effective marketing of sharia compliant product is panacea to all problems?

Conclusion:

This paper is an endeavor to highlight issues in Islamic banking Industry across the globe. Though, Islamic banking industry is growing industry but still facing problems to capture the opportunities. The most important fact that is noticed in literature Islamic banking objectives are debatable. Some scholars are agreed that Islamic banks are to be considered as normal business entities and its objectives is to be earn profit while remain adhere to shariah guidelines. Another school of thought assert that Islamic banking is a part of Islamic economic system and objectives of Islamic banks are to be align with Al-maqasid Al-shariah. Very limited empirical research is available in this area and need to be explored.

The second issues that need to be address is shariah supervisory board (SSB), shariah committee or shariah advisor role in Islamic banking growth and reputation. The SSB of different Islamic banks have difference of opinion which has impact on the asset universe. This difference of opinion also results in different classification shariah compliant product (halal) and non-compliant shariah (haram). This inconsistency may cast doubt on the reputation and create distrust and insecurities in investors. So there is need to investigate the determinants of unification and standardization of practices.

Third issue is about expertise in Islamic banking system. Very limited people are equally good in modern days finance and Islamic fiqh. It is crucial that

Islamic world have institute that provide trained human resource in Islamic finance because shariah experts will contribute to structure shariah compliant products. Empirical research is needed to provide suggested solution to get expertise in Islamic finance.

Last issue is awareness of general public about Islamic banking in muslim and non-muslim world. Growth is only possible if people are aware and informed about the services, products, operation and practices of Islamic banks. Muslims have wealth and need be attracted through effective marketing strategies and Islamic banks fail to do so. It is also potential area of interest for empiricist to conduct survey on customers' preferences towards Islamic banking.



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