ISLAMIC BANKING SCHEME: A NEW SILVER BULLET IN BANKING INDUSTRY

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Abstract

Islamic banking scheme is one of the most recent banking system in this industry. Directing banking based on Shariah principles is known the Islamic banking and more than 100 various Islamic financial products and services is offered by different banks around the world through utilizing multiple Islamic concept and principles. Accordingly, this study is an attempt to show and conceptualize this banking scheme in detail. Besides, it is an effort to indicate to the opportunity that Islamic banking system can provide for different countries, even non-Muslim nations to motivate banks’ customers to trust the banking industry again, which in turn the world economy could be saved.

Introduction.

Islamic banking as one of substantial and fastest growing industry (Abedniya & Zaeim, 2011) has spread across the most part of the world and has been accepted by Muslims as well as non-Muslims (Iqbal & Molyneux, 2005). These types of banking have been carried out as a compulsory type of banking and finance in some countries. Actually, Islamic banks are known as ethically funded institutions that have been found in different parts of the world and so far in Sudan, Iran and as well to some extent Pakistan, the entire banking scheme has shaped based on Shariah rules (Karim, 2001).

According to Mirakhor (1989), Islamic banking development has mainly taken two forms. In the first form, an attempt has been done in order to establish different Islamic financial institutions along with traditional banking structure. Accordingly, Islamic banks in Muslim countries as well as Islamic investment and holding companies, operating mostly in non-Muslim countries in which in two cases their operations is on the basis of specific Islamic regulations. In the second form, high attempt has been made in order to restructure the entire financial system to be in accordance with Islamic principles. In view of that, the whole economy and its institutions, together with financial structure are transformed into the Islamic arrangement.
Conducting banking based on Shariah principles is known the Islamic banking and more than 100 various Islamic financial products and services is offered by different banks around the world through utilizing multiple Islamic concept and principles (Jamshidi & Hussin, 2012). Additionally, Islamic banking in context of Islamic countries seems to be at improving phase and tremendous growth opportunities exist as this system is more and more acquiring prominence and as well there is potentiality to be new banking method.

Actually, Islam allows loans based on interest free method for charitable usage as well investment and trading based on profit and loss and risk sharing. In other words, principles of Islamic economy attempt to share risk and provide rewards for wealth creation by using equity rather than debt (Razak & Taib, 2011). Actually, the most noteworthy aspect of Islamic banking refers to sharing the risk of activities among the bank, investor and borrower without charging interest (A. Ahmad, Rehman, & Saif, 2010). In fact, the main idea behind this refers to that investors are required to make effort to find project that seems to be appropriate, adhere to Shariah principles and share in success or failure of the project (Imam & Zubairu, 2011).

Islamic banking principles

According to Cihak and Hesse (2008), Islamic banking could be described as provision as well as use of financial products and facility which conform to Islamic religious laws and practices. In fact, as said by (Samad, 2004), due to being newcomers to the market, many are skeptical regarding Islamic bank's performance and several reasons exist for this. Firstly, Islamic banks are known as non-conventional financial organization that interest as the cornerstone of the conventional banking system is strictly prohibited under Islamic banking structure.

Secondly, Islamic banks act under dual constraints in which they not only have to obey conventional business regulations, but also Islamic principles. Lots of discussion has been made regarding why banking industry needs an Islamic banking system and the reason that support existence of this new financing scheme. Yussof and Daud (2011), believed that Islamic banking emergence as a most important Islamic financial institution was due to two necessities namely economic and religious.

Accordingly, religious necessity indicates that all financial and economic activities have to be based on interest free principle while the economic requirement declares to the provision of a new viewpoint on the banker role in improving investment as well as influencing income distribution and economic stabilization (Al-Jarhi, 2006). In recent years, the occurred financial crisis and the damages which were provided by the conventional banking system has led to more attention of scholars, bankers and clients to Islamic banking as a new option of banking industry.

Meanwhile, the latest financial crisis not only shed serious doubts regarding suitable functioning of conventional banking, it also raised the attention of different groups of people and scholars to Islamic banking, since some reports indicated to their better performance during the recent crisis (Hasan & Dridi, 2010).

Islamic investment services

Over the past decades, due to being in compliance with Shariah, Islamic banks have developed specific services in order to avoid concept of interest as well as implying a certain level of risk sharing (Beck, Demirgüç-Kunt, & Merrouche, 2010). According to (Dar, 2003),
there are four types of financial products that can be used as substitutes of interest which are sale-based, investment-based, service-based and finally rent-based.

In contrast, K. Ahmad, Rustam, and Dent (2011) have considered brand selection regarding Islamic banks. Accordingly, young generation of Malaysia was investigated and it was found that religion has an important role in selecting Islamic banks however, the difference of Islamic and conventional banking was poorly understood by these young students. Besides, their preferences were brand, ease of use as well as customer interaction quality. These two studies and similar studies to them have also focused on the potential link of both religions as well as structured service quality on attracting users of this system.

Both Islamic and conventional banks are active sided by side around the world. Meanwhile, the importance of Islamic banking and finance is no longer deniable in context of Islamic countries (Jamshidi & Hussin, 2013). Moreover, different Islamic countries are not only committed to develop Islamic banking system, but also would attempt to complete Islamic financial system. Indeed, it is one of economic and financial vision of Islamic governments to expand a progressive and robust Islamic banking industry, which is rooted based on Islamic core principles that lead to serve the requirement of nations’ economy in best manner.

Today Iran and Malaysia seems to be succeeded in applying this banking system. This could be due to the fact that Islamic banking system and Islamic finance as well is emerged as a vital component of general financial system, which is able to contribute and enhance growth and improvement of economy. Although activities in Islamic banking system is conducted based on Shariah principles in which payment or receipt of interest is strictly prohibited, but Islamic banks are allowed to represent similar products and services with conventional banks offered products (Jamshidi & Rezaei, 2012; Naser, Jamal, & Al-Khatib, 1999).

It seems that Islamic banking system is different from conventional system due to prohibition of interest (riba) in Islam because banks are not permitted to offer fixed amount of rate of return on deposit or charging interest on loan as well (Chong & Liu, 2009). Law of shariha prohibits riba (interest or usury) which officially based on Jurist Muslim school is defined as “trading of two goods of the same kind in different quantities, where the increase is not a proper compensation” (El-Gamal, 1997). Different services is launched for the bank customers by considering these basic rules and regulations by Islamic banks.

**Islamic banking conceptualization**

The concept of Islamic banking is old although this system has been represented in the last quarter of twentieth century (Naveed Azim Khattak and Kashif-Ur-Rehman, 2010). Prohibition of interest or usury (riba) in all type of transaction, undertaking business and trade activities on the basis of legitimate and fair, giving zakat (alms tax), cooperation for advantage of society, prohibition of monopoly and development of halal aspect could be categorized as main principle of Islamic banking system.

In other words, the main basic difference between Islamic and non-Islamic banks refers to the fact in which Islamic banks make their operation based on equity participation that predetermining return rate has not been guaranteed while non-Islamic banking system is based on both debt and equity system which are driven by interest. Echchabi and Olaniyi (2012), argued that in fact, Islamic finance is built based on three main principles which are prohibition of riba (usury), the prohibition of gambling and gharar (ambiguity) and lastly protection of community members by promotion of loss and profit sharing. During the last three decades
Islamic banking system has been emerged as a viable and competitive substitute of conventional banking system.

In some studies, this discussion seems to be different since the authors have concentrated on a specific region to provide more comprehensive outcomes. In view of that, Olson and Zoubi (2008) have tried to identify whether it is possible to distinguish between Islam and conventional banks in the Gulf region solely based on their financial characteristics. Accordingly, it was clear that although several financial ratios had similar mean between two types of banks but nonlinear classification technique was able to properly differentiate conventional from Islamic banks in out-of-sample tests at about 92% success rate.

Moreover, Grosjean (2011) has proved that low level of financial development in the Ottoman Empire has nothing to do with Islamic religion itself, but it relates to Islamic institutions. On the other hand, due to the fact that Malaysia has been able to provide a successful dual banking system in which both conventional and Islamic schemes have supplied their services to the public, a number of scholars have concentrated on the potential achievement of this country. (Sufian, 2009) has analyzed productivity changes of the Islamic banking sector in Malaysia by applying non-parametric Malmquist productivity index technique.

The study proved that Islamic banking sector in Malaysia has experienced productivity progress in their earlier foundation years prior to their declining in the latter years. In other words, in the early years Islamic banks have achieved more productivity by attracting more customers compared to recent years. Part of this could be due to the fact that conventional banks are allowed to distribute Shariah compliant products and therefore increasing the completion among these two banking sectors have reduced the productivity of Islamic banks.

**Islamic banking and customers**

Sometimes, the focus has been on Islamic bank customers and the level of their desire as well as satisfaction has been discussed. The linkage between customer satisfaction and customer loyalty as well as intention to switch of bank customers in the Malaysian Islamic banking industry was investigated by Amin, Isa, and Fontaine (2011). They proved that customer satisfaction positively influenced customer loyalty while negatively influenced intention to switch, however, it was higher for non-Muslim customers compared to Muslim customers. In order to prevent the problem of a useful product or system remaining “under-used” customers do not need to expend significant effort on using Islamic banking services.

It seems that Islamic bank consumers and specifically non-Muslim customers care more to quality of provided services to them than Muslim customers that Shariah compliance is more important to them, although they also care to quality of services by these banks. There have been conducted other miscellaneous, particularly in the area of a specific product, service or even academic subject. Kamla (2009) has pointed to some important attributes in regards to Islamic accounting. He argued that minima critical theorizing and narrow instrumental as well as mechanical emphasizing in most of the Islamic accounting studies show that Islamic accounting studies has been diverted from its main proclaimed moral and social character.

In another study, the adoption of Islamic mobile phone banking and potential impact of religious commitment was tested by Sun, Goh, Fam, and Xue (2012). The study targeted young adults of Southeast Asia and generally proved that casually religious and also non-Muslims considered utilitarian attributes of services while devout Muslims were socially-oriented regarding this services adoption.
References


