

The Changing Face of Islamic Banking

By

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Abstract

With more than 30 years of experience, Islamic banks are now in a position of providing almost all banking facilities to their customers. Islamic products are also available in various financial markets. Islamic banking system nowadays is seen as a viable alternative to conventional system. Therefore, more and more parties have joined the bandwagon including non-Muslim institutions. This development has created a new dimension in Islamic banking system. Initially, Islamic banks were seen as institutions that operate based on religious doctrine. Today, many proponents believed that this doctrine is no longer applied by Islamic financial institutions. Majority appears to regard Islamic bank as a normal business entity with a profit maximization principle. Despite this new development, there are a number of Islamic banks that still uphold the original philosophies of their establishment. It is our sincere hope that these institutions will take the helm of the reign and become the leading institution in practicing other disciplines of Islamic knowledge.

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Introduction

In the late sixties and early seventies, Muslim communities were influenced by a common belief, known as 'back to religion spirit'. One of the main concerns among intellectuals at those times was the *riba* free attitude practiced by Muslims. Although the discussions of this particular topic started as early as the beginning of the twentieth century, no action was taken to eliminate this problem. The bold step was initiated by Dr. Ahmed Al-Naggar when he established Mit Ghamr Local Saving Bank in 1963, an institution that operates based on Islamic principles.

News about the existence and achievements made by the Mit Ghamr reached Muslim scholars and jurists throughout the Muslim world. These scholars and jurists consequently became excited about this new dimension in Islamic economics and begun to promote the idea of the establishment of Islamic banks in seminars and conferences. Consequently, political figures also started to use this new concept as a tool to awaken the public mind as well as for their personal political mileage. The establishment of Islamic Development Bank and Dubai Islamic Bank in 1975 also fuelled the burning desire among Muslims to establish an Islamic banking system in replacement of the conventional system. In view of this situation, Ayatullah Khomeini and Zia Ul-Haq made a strategic decision to fully Islamization of the economies of Iran and Pakistan when they seized power of their respective countries.

There are currently more than 400 Islamic financial institutions all over the world. Islamic banks nowadays not only operate in almost all Muslim countries but have also extended their wings to the Western world to serve both Muslim and non-Muslim customers. The big conventional banks such as Citibank, HSBC, Standard Chartered, ABN Amro and many others are no longer observers to this system. On the contrary, they are the major players and the front runners in providing more sophisticated and complex Islamic banking products and services.

Today, Islamic banking system is no longer alien to many. Literature, which describe the concept and the operation of this system are abundantly available in the market. Instead of discussing the legality of *riba*, scholars are urged by bankers to come out with ideas on how Islamic banks can provide the latest banking products to their customers. The demand for a comprehensive Islamic banking products and services comes not only from the bankers who manage the Islamic banks, but also from the authorities who wish to become the champion to this course.

It is not the objective of this article to elaborate the factors that triggered such unreasonable demands made by bankers and those in authority to both thinkers and scholars. By and large, such unreasonable demands arose due to limited or superficial knowledge of the Islamic banking system.

Moreover, majority of them western-based trained and thus, are imbued with conventional philosophies in their ways of doing things. The purpose of this article is to highlight the changing face of Islamic banking since its inception more than thirty years ago until to date. Problems and challenges will also be presented for readers' considerations. Some of these problems have been in existence since some thirty years ago and yet they continue to become a topic of discussion.

Has Islamic Banking Changed Its Face?

Currently, majority of scholars and practitioners within the Islamic banking community still believe that this system is at its infancy stage. Such a notion is ideally adopted given the relatively young age of the system, i.e. 30 years as compared to the modern conventional banking system which started more than 850 years ago when the first bank was established in Venice in 1157 AD. Similarly, in terms of products and services, these believers opine that the Islamic banking system has yet to develop a complete range of products and services similar to those offered by the conventional banks.

However, those who propagated the idea that whatever products and services available at conventional banks must also be offered by Islamic banks fall within the category of people who are impatient with time. This group is of the opinion that Islamic banks that are unable to offer compatible products and services as their conventional counterparts are deemed as inefficient and ineffective. The performance of Islamic bank nowadays is measured by its ability to copy-cat the conventional bank. They further proposed that in order to compete and remain viable, Islamic banks must possess the characteristics of conventional banks. Many assert that customers of Islamic banks have similar attitudes as that of the conventional banks' customers. Therefore, instead of creating its own branding, Islamic banks are using conventional banks products and services as the foundation in creating and carving their own brand name. This 'time impatient' concept adopted by those within the Islamic banking system could be one of the causes that have misguided the public about the true concept of Islamic banking. Today, many believe that products offered by Islamic banks are similar to those of conventional banks and the only difference lies in the terminologies used.

Currently, countries such as Malaysia, Kingdom of Bahrain, United Arab Emirates, and Brunei are in the race to be the 'Islamic financial hub'. Interestingly, non-Muslim countries such as Singapore and United Kingdom have also joined the bandwagon. As a result of this intention, financial regulators of these countries are scrambling for ideas and strategies to create mechanisms and strategies that can fulfil the demand from the financial players. While the formulation of laws and regulations lies on the shoulder of the regulators, practitioners on the other hand are urged to

develop products that meet the sophisticated needs of investors as well as users of funds. As competition between jurisdictions intensifies, the copy-cat approach may be adopted by those who are responsible in developing their respective financial markets.

'Time impatient' concept also has championed the development and the growth of the Islamic banking system. It is no longer a privilege for Muslims to conduct their banking businesses with Islamic banks. To some quarters, the patronage of non-Muslims is seen as a triumph on their part. They see and use this as a yardstick to measure their success. In some countries, non-Muslim financial institutions have been awarded licenses to operate Islamic banking businesses. Regulators in these countries opine that competition is not only healthy but needed to ensure the growth of the industry. Again, time impatient concept is upheld by regulators who consider that the fastest way to develop Islamic banking system is by increasing competition and allowing non-Muslim institutions to participate in Islamic banking businesses.

The 'time impatient' concept has also created a scenario which may be unthinkable by the fore-fathers who initiated the idea of the Islamic banking system. In the Islamic financial industry today, it is uncommon for us to see non-Muslim bankers selling and promoting Islamic banking products. In most instances, it is not a pre-requisite for bankers to give a full explanation on the terms and conditions of contract when the customer is granted an Islamic banking facility.

It is also uncertain as to whether the process of 'ijab' and 'qabul' between bank and its customer is strictly being adhered to. In practice, the conclusion of contract on a particular transaction is sufficient with just the signing of the letter of offer from the bank. It is also interesting to note that the letter of offer usually contains only one sentence to describe the nature Shariah principle governing the facility. No further explanation is given to the customers. In most cases, other terms and conditions are very much similar to those of the conventional facilities.

To the ordinary Muslims, the legality and permissibility of the transactions adopted by the Islamic banks should be unquestionable since each Islamic bank has its own Shariah Board. It is a standard practice that any transactions or new products be examined and approved by this Board before it is made available to the public. However, the views presented by these independent scholars and jurists should be made known to the public in the event that the existing Islamic banks are breaching their responsibility in promoting the true course of Islam economics.

Notwithstanding the critical remarks and comments made by those who believe that the current Islamic banking system has derailed from its original functions and objectives, Islamic banks continue to become an

efficient and effective alternative to the conventional system. More and more Shariah compliance products are being made available to customers. Similarly, number of players in this industry has grown significantly. According to Iqbal and Molyneux (2005), for the past 30 years, the development of Islamic banking was manifested by the followings:

- a) Banks and financial institutions in those countries where the promotion of an Islamic financial system is receiving active government support.
- b) Islamic banks and financial institutions in the private corporate sector working in the mixed environment.
- c) Islamic banking and practices by some conventional commercial banks and non-bank financial institutions.
- d) Multinational financial institutions working on Shariah principles.

Iqbal and Molyneux also believed that the Islamic banking system has gradually transformed its face with the time-line as shown in Table 1 at the end of this article.

Although Islamic banking system has gain footing in every part of the Muslim countries, the stage of development varies between countries. For example, Malaysia is considered by many as the champion in promoting this alternative system. According to Nor Mohd Yacop, the second Finance Minister of Malaysia, Islamic banking system in Malaysia has entered the third wave of its development. The first wave was the introduction and development of Islamic banks, the introduction capital and financial market was the second wave, whereas, the implementation and the growth of financial assets through waqf, trust, credit-micro, and zakat is considered the as the third.

The Thoughts of Earlier Thinkers

As mentioned earlier, Islamic banks are considered as the end product of the Islamic resurgence which started within the Islamic communities especially during the end of 1960s and early 1970s. One of the most important issues widely discussed during this period was the transformation of the economy from a capitalist to an Islamic economic order. Since the elimination of interest has generally been the first step in the Islamization of the economy, it is perhaps only natural that the formation and the operation of Islamic banks be given more attention. Interestingly, it was a consensus among the first generation of scholars that the foundations of Islamic financial institutions be based on religious doctrines. Below are examples of some of the earlier thoughts of scholars.

Muazzam Ali (1988, p.3) has the following opinion:

"The 'Islamic Economic Order' is based a set of principle found in the Quran. No matter what aspect of the Islamic Economic Order is introduced, for practical operations it has to base itself on the Quranic concept of social justice. The Islamic financial system, therefore, cannot be introduced merely by eliminating riba but only

by adopting the Islamic principles of social justice and introducing laws, practices, procedures and instruments which help in the maintenance and dispensation of justice, equity and fairness."

Khan (1983) believed that:

"The existence of Islamic banks is to promote, foster and develop the banking services and products based on Islamic principles, Islamic banks are also responsible for promoting the establishment of investment companies or other business enterprises as long as activities of these companies are not forbidden by Islam. The main principles of Islamic banking comprise of prohibition of interest in all form of transactions, and undertaking business and trade activities on the fair and legitimate profit. Islamic banks are to give zakat and to develop an environment, which benefit society.

The religious doctrines made a significant influence on the establishment and the operations of some of the pioneering Islamic banks. Dar Al-Maal Al-Islamic Trust (a holding company for many earlier Islamic financial institutions) has incorporated both social and profit into its objectives as shown below:

- 1. To put before to all Muslims, contemporary Islamic financial services, helping to execute their financial dealings in strict respect of the ethical individual and social values of Islamic Shariah, without contravening the heavenly imposed prohibition of dealing in riba.*
- 2. To serve all Muslim communities in mobilizing and utilizing the financial resources needed for their true economic development and prosperity within the principles of Islamic justice assuring the right and obligations of both the individual and the community.*
- 3. To serve the 'Ummat Al-Islam' and other nations by strengthening the fraternal bonds through mutually beneficial financial relationships for economic development and the enhanced environment for peace.*

Dubai Islamic Bank for example, had the following objectives during the earlier years of its establishment:

"The main objective of Islamic Bank is to prohibit the Muslims from dealing with interest or usury which has been strictly prohibited by Allah and to protect them from one of the biggest sins..... Therefore, the Mission of the Islamic Bank is to protect the Muslims from this evil which has changed their life to unhappy economically, social and political situation."

Similarly, Islamic Bank Bangladeshi Limited has the following objectives:

- Our aims are to introduce a welfare-oriented banking system and also to establish equity and justice in the field of trade and commerce.*
- We extend co-operation to the poor, helpless and low-income group of the people for their economic upliftment.*
- We play a vital role in human resource development and employment-generating particularly for the un-employed youths.*

In the case of Bank Islam Malaysia Berhad, during the early years of its establishment, the bank had the following objective (BIMB, 1985):

"To provide banking facilities and services in accordance with Islamic principles to all Muslims as well as the population of Malaysia. The Islamic principles mentioned here are essentially those belonging to the body of Shariah rules on commercial transactions that relate to banking and finance. The bank's efforts to provide these banking facilities and services are undertaken within the framework of its viability and capability to continuously grow and expand."

Due to the incorporation of religious doctrines into corporate objectives, some Islamic banks have engaged in social activities for the communities. For example, since its establishment, Jordan Islamic Bank has continued to undertake social activities such as levies for Jordan universities, provision for scientific research, scholarships for tertiary education, donations, qard hassan loans, and financing for craftsmen. Similarly, Islami Bank Bangladeshi Limited has the following programs:

- Islami Bank Hospital
- Islami Bank Technical Institute
- Income generating projects
- Humanitarian projects
- Relief & Rehabilitation
- Dawa activities
- Special projects

Has Islamic Bank Changed Its Focus?

To date, Islamic banks no longer enjoy privileges from the authorities or the government as they have been doing so during their early years of establishment. Whether the policy taken by these authorities is appropriate or otherwise is subject to individual's own interpretation. For example, Bank Islam Malaysia Berhad was given a monopolistic status for a period of ten years before the Central Bank of Malaysia liberalized the industry by allowing four commercial banks to offer Islamic banking products and services. At present, foreign institutions are allowed to operate their Islamic banking businesses by establishing subsidiaries or branches in Malaysia.

Similar step was also taken by the Bangladeshi authority. Islami Bank Bangladesh Limited, the first Islamic bank in Bank in Bangladesh, was also given a monopolistic status for more than 15 years. Today there are four Islamic banks operating in that country.

Interestingly, authorities in most Muslim countries are not only dismantling the wall that has been protecting Islamic banks but have also allowed non-Muslim institutions to set-up Islamic banks. Most big conventional banks are not only venturing into Islamic banking businesses, but they are also actively involved in other Islamic financial businesses such as Islamic capital market, Islamic insurance, and Islamic trust business.

The process of liberalization in Islamic banking system has raised many fundamental issues. For example, many people no longer regard Islamic bank as an institution based on Islamic doctrines. Instead, they believe that Islamic bank is just an ordinary financial institution that provides products and services which do not contravene with Shariah. Similarly, social objective is no longer ranked pari passu with the profit motive. Profit motive is considered as the sole objective of Islamic banks as they regard this as the only key performance indicator in measuring productivity and efficiency.

While there are Islamic banks that still remain to their original course, some are changing their mindsets and re-branding their image to suit the changing financial landscape and business environment. For example, Islamic Bank Bangladesh Limited, has the following mission and vision (IBBL, Annual Report 2005):

Mission:

"To establish Islamic Banking through the introduction of a welfare oriented banking system and also ensure equity and justice in the field of all economic activities, achieve balanced growth and equitable development through diversified investment operations particularly in the priority sectors a less developed areas of the country. To encourage socio-economic uplift and financial services to the low-income community particularly in the rural areas."

Vision:

"Our vision is to always strive to achieve superior financial performance, be considered a leading Islamic Bank by reputation and performance."

- ☐ *Our goal is to establish and maintain the modern banking techniques, to ensure the soundness and development of the financial system based on Islamic principles and to become the strong and efficient organization with highly motivated professionals, working for the benefit of people, based upon accountability, transparency and integrity in order to ensure stability of financial systems.*
- ☐ *We will try to encourage savings in the form of direct investment.*
- ☐ *We will also try to encourage investment particularly in projects which are more likely to lead to higher employment."*

Bank Islam Malaysia Berhad (BIMB), for example, due to massive losses it incurred between 2004 and 2006, has changed its focus to five pillars of 'Core Brand Values', namely, 'Leader', 'Professional', 'Dynamic', 'Caring, and 'Trustworthy.' BIMB also changed its vision and mission as follows ([www. bankislam.com.my](http://www.bankislam.com.my)):

Vision:

"To be the Global Leader in Islamic Banking."

Mission Statement:

1. To continually develop and innovate universally accepted financial solutions in line with Syariah Principles;
2. To provide a reasonable and sustainable return to shareholders;

3. To provide for a conducive working environment and to become an Employer of Choice for top talents in the market;
4. To deliver comprehensive financial solutions of global standards using state-of-the-art technology;
5. To be a responsible and prudent corporate citizen.

BIMB defines global leader as being the ultimate guidance and source of reference for innovative Shariah-based products and services. Similarly, taking into considerations the changing business environment,

Dubai Islamic Bank has also changed its vision and mission as follows (DIB annual report 2006):

Our Vision:

"To be the leading provider of innovative financial services in accordance with the legislation of Allah."

Our Mission:

"We are proud to be the first Islamic Bank worldwide, that has translated true Islamic economic principles into practice, out of the firm belief in the need for mankind of the economic system based on the Final Revelation. By partnering with our customers in Halal earnings, employing the best business practices, the latest financial services, technologies and placing our Trust in Allah, we are confident of our success."

Since profit maximization has now been adopted as the key performance measurement by most Islamic financial institutions, Islamic and conventional banks do not differ much. This has encouraged managers in Islamic bank to adopt whatever strategy they deem suitable in order to generate maximum profit.

Similarly, the human capital of Islamic bank needs to be seen as professional as those of conventional bank. Therefore, more and more conventional bankers are taken aboard by Islamic banks, thus more and more conventional thought is encroaching into Islamic banking system.

Concluding Remarks

Islam permits and encourages its followers to be involved in trade activities. As stated in the Quran, *"But Allah hath permitted trade and forbidden usury..."* (Al-Baqarah 2:275). From the religious prospective, the establishment of Islamic bank is considered a righteous move for two reasons. Firstly, its existence is in the line with the divine revelation, i.e. to be involved in trade. Secondly, Islamic bank provides an avenue for Muslims to perform banking business in the Islamic way, i.e. free from the element of *riba*.

Scholars, however, believe that the elimination of *riba* is only part of the Islamic business practices. Being established as an Islamic business entity,

Islamic banks should conduct their business with the objective of making profit and at the same time conform to Islamic business principles. The principles of Islamic business comprise of honesty, and trade is to be conducted in a faithful manner. The meaning of Islamic business can best be understood from the metaphorical content of Verse 29 of Fatir (35:29) which says:

"Those who rehearse the Book of Allah, establish regular prayer, and send (in charity) out of what We have provided for them, secretly and openly, hope for commerce that will never fail."

The above Verse teaches Muslims that the godly man's business will never fail or fluctuate because Allah guarantees him the return, and even adds something to the return out of His own bounty. Analogically, honest trade will lead to the earning of profit in this world as well as in the hereafter.

All these do not apply to those who believe that Islamic banking is just another way of doing banking business. They opined that Islamic bank is just an ordinary business entity which is conducting banking business that does not violate Shariah. This is in line with the doctrine of 'ibahah' (Doctrine of Universal Permissibility), i.e. everything is permitted unless clearly prohibited by God.

Notwithstanding the current development in the Islamic banking system, there are a few Islamic banks that are still discharging their moral obligation towards the Muslim society. It is our hope that these banks shall continue to uphold the principles of Islamic business and ultimately become the pioneering institution in exploring and applying other discipline of Islamic knowledge such as Islamic management, Islamic marketing, and Islamic human resource.

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www.bankislam.com.my

www.dib.ae

www.islamibank.bd

Table 1**Time-line of the Development of Islamic Financial Industry**

1940 -	Critique of interest from Islamic perspective
1950 - 1960	• Muslim economists offer ideas for interest-free banking possibilities • Non-bank applications of interest-free start
1960 -1970	• Profit-sharing models of interest-free banking defined • Experiments of bank-like institutions(the Mit Ghamar Local Saving Bank, Egypt in 1963) • Trade-based modes of Islamic finance developed
1970 - 1980	• First Islamic commercial bank(Dubai Islamic Bank) established • First Islamic multilateral development finance institution (IDB) established in Jeddah • Pakistan declares its resolve to Islamize entire financial system • New modes of Islamic finance developed
1980 - 1990	• Islamic banking industry witnesses very rapid growth, posses USD\$100 billion mark • Two more countries, Iran and Sudan, declare intention to Islamize entire financial system • Islamic investment fund start • Conventional banks including major international banks start offering Islamic products/window concept • Development of new modes of Islamic finance continue • Academic institutions around the world start Islamic finance teaching • IMF, World Bank get involved
1990 - 2000	• Development of Islamic financial architecture continues • Accounting, regulatory and control issues gather steam • Islamic Financial Services Board(IFSB) established • First Islamic Rating Agency established • Public sector resources mobilization through Islamic modes gained momentum
2000 - 2010	• Exponential Growth and Global Expansion • The Explosive Rise of the *Sukuk* (Islamic Bonds) Market • Institutionalization and Standard-Setting Architecture • Resilience during the 2007–2008 Global Financial Crisis (GFC) • Product Innovation and Replication of Conventional Products • Regulatory Integration and Legal Frameworks
2010 - 2020	• Rapid Asset Growth and Geographic Expansion

	• Resilience and Stability Post-Global Financial Crisis • Diversification and Maturation of the <i>Sukuk</i> Market • Integration of Fintech and Digital Transformation • Alignment with Sustainable and Value-Based Finance • Persistent Structural Challenges
2020 - onward	• Accelerated Digital Transformation and Islamic Fintech • Integration with ESG (Environmental, Social, and Governance) Criteria • Enhanced Crisis Resilience and Asset-Backed Stability • Focus on Value-Based Intermediation (VBI) and Social Finance • Regulatory Evolution and Standardization