



## **Diminishing Partnership: Bankers Strategic Response to *Shariah* Compliant Home Financing**

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### **ABSTRACT**

Diminishing Partnership (DP) is a relatively new concept in home financing based on equity compared to the established debt concept used in conventional and BBA home financing. Under DP home financing, the customer and bank share profit based on the rental value of the house instead of predetermined interest rate where the bank gains profit upfront. As such DP is claimed to be fairer and more flexible than debt financing which result in more justice, equality and cater for societal well being in line with the *Maqasid al Shariah* (Al-Ghazali, 1937). This research adopted a mixed method by using questionnaires to survey the perceptions of customers. The perceptions of bankers and *Shariah* scholars were obtained by means of semi structured interviews. Four common issues were investigated namely, concept used, method of computing and pricing, *Shariah* compliant and preference for the product. The main findings indicated that customers perceived DP home financing meet their needs better than the debt financing concept. The *Shariah* scholars also agreed that DP possesses justice, fairness and cater for the well being of individual and society. Contrary to expectation, the overall views of the bankers support the implementation of DP except for a few reservations regarding pricing and operations. The results imply that DP home financing concept is more widely acceptable by the three stakeholders compared to the existing BBA. The results provide a strategic response for bankers to promote DP home financing to their existing and potential customers as a *Shariah* compliant home financing product.

JEL Classification: G02, G21, K00, Z12

Key words: Customers, Bankers, *Shariah* scholars, Diminishing Partnership and *Maqasid al Shariah*

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## 1.0 INTRODUCTION

The growth of Islamic banking and finance in Malaysia is indeed very encouraging. The annual average rate of growth was between 18-20% per annum. The central bank of Malaysia, Bank Negara Malaysia (BNM), has set a target of 20% of all deposits and financing in the banking industry to be under Islamic banking by 2010. This is mainly attributed to demand for financing products in the retail banking sector. The development of Islamic products began in 1962 with the implementation of the savings account by *Tabung Haji* based on the concept of *Wadiah* (guaranteed custody). With the establishment Bank Islam Malaysia Berhad (BIMB) in 1983, more products were developed utilizing other concepts such as *Murabahah* (cost plus) for working capital, *Bai Bithaman Ajil* (deferred installment sale) for house financing, *Ijarah* (leasing) for equipment and vehicle financing. The concepts of *Mudharabah* (trustee profit sharing) and *Musharakah* (joint venture profit sharing) are mainly used for project financing. More products are being developed to date to meet the rapid growth of the Islamic banking and finance industry.

The development of home financing products was attributed to the high demand for houses in the residential sector market. Outstanding loans for residential property in commercial banks increased by 10.3% from RM 174 billion as at 31 December 2007 to RM 192 billion as at 31 December 2008 (BNM: 2008). Based against this back drop, commercial banks continue to play a major role in providing home financing products to meet the increasing demand of customers for conventional loans and Islamic financing. The motivation for this research is to examine the impact of using the current debt model for Islamic home financing based on the *Bai Bithaman Ajil* (BBA) home financing which remained the major financing product for past 27 years. The existing BBA operations raised several issues regarding the application of its concept, method of computation and pricing, *Shariah* compliant and preference for the product. Given these issues the study explore an alternative mode of home financing known as Diminishing Partnership (DP) which is based on equity and examine whether it can address the salient issues currently faced by BBA home financing. The DP model has been practiced by Islamic financial institutions and cooperatives in UK, Canada, US, Middle East and Australia to avoid Muslim community from engaging in *riba* (usury) and *gharar* (uncertainty) and was introduced in Malaysia by Kuwait Finance House (KFH) in 2005.

This paper will examine the perceptions of three stakeholders namely customers, *Shariah* scholars and bankers with regards to the concepts used, methods of computation and pricing, *Shariah* compliant and preference for the products. The paper is organized in the following manner. The immediate section discusses the relevant literature and issues confronting the conventional and BBA home financing. This is followed by the hypotheses development before the study design is discussed. The subsequent sections cover the analysis and results before conclusions are offered.

## 2.0 LITERATURE REVIEW

Islamic law (*Shariah*) of commercial transaction is fundamentally rooted on the premise of total eradication of *riba* (usury) and *gharar* (uncertainty). It balances the moral and material needs of a society to achieve socio-economic justice. In fact, the very objective of the *Shariah* is to promote the welfare of the people, which lies in safeguarding the faith, life, intellect, posterity and wealth (Al-Ghazali, 1937). The primary goal of Islamic economics is equitable distribution. Islam views that inequity is created by mass exploitation of resources to obtain maximum profit. Principles of Islamic commercial transaction are nurtured to check exploitation, inequities and the creation of economic imbalances in society by means of various concepts and principles to eradicate unjust enrichment. Central to the Islamic concept is justice. All transactions whether it is judicial, political or private are subject to this concept (Al Quran, Al-Hijr: 85).

Islamic economic principles promote the sharing of risk and rewards in wealth creation via equity rather than debt. It promotes entrepreneurship and creativity in the economic cycle. In the Islamic economic model, each individual is involved in the economic activity. This differs from modern capitalism where profit maximization is the sole motive and the bank is broadly content with earning interest on the loan regardless of the latter's social and financial implications to the business. In addition, the orientation of modern capitalism does not include God and society as its integral part of acquiring wealth. As such, it does not have any restriction in the way wealth is obtained. The different approaches in world view between Islam and modern capitalism is reflected in the practice of Islamic banking and finance of which the salient feature is the prohibition of *riba* (usury) and *gharar* (uncertainty).

The concept of financing in Islam differs with that of conventional financing. Loan is the main mode of financing under conventional financing using interest as a time factor for borrowed money. The Quranic injunction prohibits financial activities that have interest element and/or have no genuine

nexus to trading activities under the *Shariah* law. This implies that money in itself has no intrinsic value and can only serve as a medium of exchange. Hence, money cannot be traded as a commodity in Islam. This differs from conventional financing where money is treated as a commodity and loans are lent out with interest as its pricing mechanism. Trading “money with money” tantamount to *riba* (usury) which is strictly prohibited in Islam. *Riba* literally means an increase, addition, expansion or growth (Al Zubaydi, 1306). In *Shariah*, *riba* (usury) technically refers to the ‘premium’ that must be paid by the borrower to the lender with the principal amount as a condition for the loan or for an extension on its maturity. Ibn Manzur (1990) says that what is prohibited is the extra amount, benefit or advantage received on any loan.

*Bai Bithaman Ajil* (BBA) is among the earliest attempts to provide an Islamic based home financing product. It is by far the most predominant and widely used concept by financial institutions in Malaysia. Its concept is based on deferred installment sale whereby the banks purchase the house and later sell it to the customer inclusive of profit margin. Bank capitalizes its profit up front in the sale of the property to the customer who in turn is required to pay a fixed sum until the tenure ends. It is similar to debt financing which resulted in high cost and poses a burden to one family’s budget. Critics of this concept have accused that the existing BBA practiced in Malaysia is seen not to be in compliant with the *Shariah* principle as the bank does not take the risk of ownership and liability on the property and thus it is not acceptable by international scholars (Rosly, 2005) Besides, the reliance on interest rate as a benchmark for determining the margin to be charged defeats the ‘interest free’ concept.

The *Musharakah Mutanaqisah* or Diminishing Partnership (DP) concept was introduced to overcome the main criticisms of BBA. The DP model is based on the practice by a highly successful Islamic Cooperative Housing Corporation (IHC) in Toronto, Canada established in 1981 out of necessity to avoid the Muslim community from engaging in *riba* (usury). It is based on an equity model different from the traditional debt-based mortgage. DP focuses on joint purchase of property between customers and banks. There are four portions to the contract. First, the customer enters into a partnership (*musharakah*) under the concept of ‘*Shirkah-al-milk*’ (joint ownership) agreement with the bank (Usmani, 2007). Customer pays, for example, 10% as the initial share to co-own the house whilst the bank provides for the balance of 90%. Secondly, the customer promises to purchase the units of share Thirdly, the bank leases its share (90%) in the house ownership to the customer under the concept of *ijarah* (leasing), i.e. by charging rent and the customer agrees to pay the rental to the bank for using its share of the property. The periodic rental amounts will be jointly shared between the

customer and the bank according to the percentage of share holding at the particular time. Finally, the customer redeems the financier's 90% portion of ownership by purchasing the remaining shares until the house is fully owned by the customer. Bank takes ownership and assumes responsibility of the property until the financing amount is fully settled and customer takes possession of the property.

The DP concept is *Shariah* compliant as it promotes true spirit of Islamic banking by emphasizing on the welfare of the people and takes care of the well being of society (Ahmad, 2000; Siddiqui, 2001; Rosly and Bakar, 2003). Since the DP rests on profit and loss sharing and not on debt as in BBA, DP is seen as not causing hardship and harm to customers. Bank takes ownership and assumes responsibility of the property until the financing amount is fully settled and customer takes possession of the property. This addresses the principle that should be observed in Islamic sale transaction whereby the seller must take possession of the goods and liability before it is sold to the buyer. The use of rental rate in place of fixed interest also addresses the criticism faced on BBA which still uses conventional benchmark to date. The major differences between DP over BBA are that the customer is not indebted to the bank over a long period and the basis for rental is on the value of property. Hence, it eliminates the use of interest which is forbidden in Islam. Furthermore, DP is also flexible and the customer can own the house earlier by purchasing additional bank's share.

There were at least three previous studies that evaluate the perception of customers on BBA and DP. Junaidi (2003) conducted a survey of four banks and 35 customers in Brunei. The result indicated that banks have mixed feelings in the implementation of DP. Conversely, customers were eager to replace BBA with the DP concept. Two studies were conducted in Malaysia. Ahmed (2006) studied the perception of Muslims academic and non academic staff on both products in IIUM using survey method based on 66 useable samples. The descriptive results indicated that there was a stronger preference for DP home financing compared to BBA. However, no hypothesis was formulated to ascertain the differences between BBA and DP. Smolo (2007) administered an on line survey using 78 bank officers and customers as samples. The result indicated that there was a stronger preference for DP compared to BBA. Results further indicated that the BBA practiced in Malaysia was similar to the contentious sale known as *Bai Inah* (sale and buy back). Respondents preferred DP as it was reflective of the *Maqasid al Shariah* (purposes of *Shariah*). Similar to the previous study conducted by Ahmed (2006), the results obtained were only descriptive without proposing any hypothesis to investigate the differences between BBA and DP.

### 3.0 HYPOTHESIS DEVELOPMENT

Based on the literature review five hypotheses were developed to test the perception of customers on home financing based on BBA and DP home financing concepts.

#### 3.1 CONCEPT – DEBT VERSUS EQUITY

Debt concept in Islam is based on actual buying and selling and is classified under the contract of *Murabahah* and *Bai Bithaman Ajil (BBA)*. The difference between debt financing in Islam and conventional loan is that there is real purchase of asset. Otherwise, it means that the bank is using money as the asset (commodity) in the buying and selling transaction which tantamount to *riba* (usury). The equity concept differs from debt as it falls under the contract of partnership such as *Mudharabah*, *Musharakah* and *Musharakah Mutanaqisah*. Under this arrangement, customer and bank share their capital to purchase the asset. Profit is not determined up front as in debt financing but realized gradually based on the profit sharing ratio agreed between them. Hence, the customer is not indebted to the bank at the onset as in conventional and BBA home financing. The purpose of asking the respondents' opinion on the differences between debt and equity concept is to evaluate their preference between these two concepts in their choice for home financing. Hence the first hypothesis used to test this concept is:-

$H_1$ : *There is a difference in customers' perception on the concept of debt and equity between BBA and DP home financing.*

#### 3.2 METHOD OF COMPUTATION AND PRICING BETWEEN BBA AND DP

The profit rate for BBA home financing is benchmarked on market interest rate or Based Lending Rate (BLR) which prices money as a commodity. We take an example of a customer who wishes to purchase a house for RM 250,000 and paid (10% of the purchase price) to the developer as down payment. The bank provides financing for the balance of RM 225,000 for 20 years at profit rate of 10 % per annum. Using the present value of annuities formula similar to conventional financing, the monthly installment computed is RM 2,171.30 payable for 240 months and the selling price to the customer amounted to RM 521,112. The difference between RM 521,112 and the original financing of RM 225,000 i.e. RM 296,112 is the total profit earned by the Islamic bank in this transaction. The profit amount

is capitalized upfront and remained fixed unlike under conventional loan, where the interest varies and unearned until the elapse of time.

In the case of DP home financing, rental rate replaces interest rate as the benchmark to determine the profit. Rental rate is based upon the actual market value of the property. The rental rate differs between each type of house, location and amenities available. For example a single storey house would have lower rental in rural area than in town area. A condominium would have higher rental than single storey house due to the facilities available. The rental reflects actual value and not interest rate which is the price for money. Using the same example, we assumed that customer owns 10 percent shares of the house amounting to RM25, 000 initially. The bank owns the remaining 90 percent, i.e. RM 225, 000. The rental rate agreed was RM 1,744.42, i.e. 8.37 %<sup>1</sup> The customer pays another RM 190.17 monthly<sup>2</sup> to redeem the bank's share in 20 years (Meera and Abdul Razak, 2005). This gives the total monthly payment as RM 1,934.59. The payment schedule for the DP home financing facility is indicated in Table 1 below:

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<sup>1</sup> 8.37% p.a obtained by  $RM\ 1,744.42 \times 12 / RM\ 250,000$ .

<sup>2</sup>  $RM\ 190.17$  obtained by i.e.  $0.0069 \{250,000 - (1.0069)^{240} \times 25,000\} = RM\ 190.17$ .  
(1.0069)<sup>240</sup> - 1

TABLE 1  
Payments Schedule for Diminishing Partnership Home Financing

Month	Rental Division								
	Monthly Rent (RM)	Monthly Redemption (RM)	Total Payment (RM)	Customer's Ratio (%)	Customer	Financier	Customer's Equity (RM)	Financier's Equity (RM)	Financier's Cash flow (RM)
	A	B	C=A+B	D	E	F	G	H	
0							25,000.00	225,000.00	(225,000)
1	1,744.42	190.17	1,934.59	0.1000	174.44	1,569.98	25,364.61	224,635.39	1,934.59
2	1,744.42	190.17	1,934.59	0.1014	176.98	1,567.44	25,731.76	224,268.24	1,934.59
3	1,744.42	190.17	1,934.59	0.1029	179.55	1,564.87	26,101.48	223,898.52	1,934.59
-	-	-	-	-	-	-	-	-	-
240	1,744.42	190.17	1,934.59	0.992	1,730.46	13.95	250,000	0	1,934.59



Table 2 below compares the differences between BBA home financing and DP. As can be seen, the balance in BBA after 10 years was higher than DP because bank capitalized its profit upfront in BBA.

TABLE 2  
Comparison between BBA and DP

Types of Financing	BBA Financing	DP Financing
Profit rate / Rental Rate	10% per annum	8.37 % per annum
Financing amount	RM 225,000	RM 225,000
Monthly payment	RM 2,171.30	RM 1,934.59
Total cost of payment in 20 years	RM 521,112	RM 464,301
Total profit earned by bank <sup>1</sup>	RM 296,112	RM 239,301
Balance after 10 years	RM 260,556	RM 156,889

Thus, it would be appropriate to examine the perception of customers on the method of computation and pricing between BBA and DP home financing using the next two hypotheses:-

H<sub>2</sub>: *There is a difference in customers' perception on the method of computing profit between BBA and DP home financing.*

H<sub>3</sub>: *There is a difference in customers' perception on the use of profit and rental in pricing between BBA and DP home financing.*

### 3.3 SHARIAH COMPLIANT

The current practice of home financing in Malaysia does not genuinely fall under the concept of buying and selling required by the *Shariah* as the banks do not buy the house directly from the developer and hence do not have possession of the property. Instead, it falls under the contentious sale of *Bai Inah* (sale and buy back) as the customer first purchases the house from the developer and sells the house to the bank for cash. The bank then sells the same house to the customer inclusive of its profit on deferred payment basis. This practice of *Bai Inah* has subjected BBA mode of financing to criticism from international *Shariah* scholars. In contrast, the DP home financing, does not involve *Bai Inah* as in this mode of financing, both the bank and customer jointly purchase the house and own it. Hence, the bank takes possession and risk of ownership meeting the *Shariah* requirement of *iwad* (equivalent counter value) for a bona fide sale. Thus, the following hypothesis is developed to investigate customers' awareness on issues regarding *Shariah* compliant between BBA and DP home financing:-

H<sub>4</sub>: *There is a difference in customers' perception over the belief that bank's real purchase and ownership risk between BBA and DP home financing is Shariah compliant.*

### 3.4 CUSTOMER PREFERENCE FOR THE TYPE OF HOME FINANCING

Customers' preferences between BBA and DP home financing depend on how would gain from the features of the products. Customers perceived BBA home financing as similar to conventional financing as both modes of financing cause them to be indebted to the bank. Hence, customers would face hardship if they are not able to pay their monthly installments. Nonetheless, due to the equity concept in DP home financing, they perceived that the product is fairer as both bank and customers are joint owners. Another reason for their preference of DP home financing over BBA could be because of the bench mark used. In the case of DP, the actual rental rates reflect the real value of the property based on the types and locations of the property. However, for BBA home financing the interest rates charged do not reflect the value of the house as it is based on the price of money. Furthermore, as DP home is based on profit sharing, it enables customers to own the house earlier by purchasing more of the bank's share. This would reduce the period of financing. In the case of BBA home financing the bank had already included its profit upfront as it is based on debt financing. Hence, the acid test to find out which concept is the preferred choice by customers would be tested in the last hypothesis:-

H<sub>5</sub>: *There is a difference in customers' perception in seriously considering applying for BBA and DP home financing.*

## 4.0 METHODOLOGY

### 4.1 RESEARCH DESIGN

There are two types of research designs. One for customers' survey, whilst semi structured interviews were used for the bankers and *Shariah* scholars. The research instrument for the survey is questionnaire using five points Likert scales. The questionnaire contained a total of 10 questions i.e. five each for BBA and DP respectively. The variables measured are concepts used method of computation and pricing, *Shariah* compliant and customers' preference. A pilot test was carried out on 30 IIUM postgraduate students. There was minor rewording needed and subsequently rectified. This study adopted a convenience sampling technique using post graduate students

because of the need to explain the product features for BBA and DP home financing. This is very important especially for DP home financing as it was newly introduced. Hence, all the respondents need to have the knowledge of the product features before filling the questionnaires. The choices for post graduate students was appropriate due to their income level and working experience and were representative of existing and potential house buyers. According to Singhapakdi et al. (1966), students are considered a valid sample for exploratory study and when items in the questionnaires are relevant to the respondents who answer.

The selection of *Shariah* scholars and bankers were made based on judgment sampling technique. In the case of Islamic finance, this was inevitable since the number of experts on Islamic finance is limited and due to unavailability of a sampling frame consisting of experts listing. According to Sekaran (2003), it is best to select respondents who possess the required knowledge and skills in their respective area. Since the objective of this study is to investigate the opinions of the experts and practitioners on DP and comparing the model with BBA, it is therefore considered sufficient to select six *Shariah* scholars and six bankers. In order to ensure the validity of the respondents' opinion the selection criteria for *Shariah* scholars were based on their qualifications, area of specialization and working experience. They should have a minimum of Master's degree and specialize in teaching of *fiqh* (Islamic law) and/or *muamalat*. In selecting the bankers, their positions and work experiences were considered. They should be directly involved with product development or supervising the Islamic Banking department/division.

#### 4.2 DATA COLLECTION

The survey questionnaire was carried over a period of two months from August to September 2007. A total sample size of 300 respondents was targeted based on past studies (Haron et al., 1994; Metawa et al., 1998), pertaining to customers' perception. The interview was carried out using semi structured questions. Permission was requested to audio tape the interview using a media device. The questions asked were similar with the variables of the survey questionnaires as the intention to gain a better understanding of customers' perception. Some of the questions asked were regarding their opinions on the theoretical and practical aspects of debt and equity. Their views were also requested on the aspects of operations and issues that arise during its implementation. The interviews were conducted at the respondents' office with an average period of one hour per session. Data collected was transcribed into field notes and analyzed using matrices (Miles

and Huberman 1994, p. 240). Each matrix is built based on the answers to the research questions provided by each respondent. The process involved selecting, simplifying and coding the data collected into common themes. The process also involves identifying certain key words and phrases, direct quotes and counting their frequencies. The information gathered were placed under the respective matrices and further examined based on the research objectives and research questions.

## 5.0 FINDINGS

### 5.1 CUSTOMER SURVEY

#### 5.1.1 PROFILE OF RESPONDENTS

A total of 320 respondents participated in the survey, however only 300 questionnaires i.e. 94% were useable and the remaining 20 were excluded from the analysis. The respondents' distribution by universities indicated that 47% were from IIUM (n= 140), 30% from UiTM (n= 90) and 23 % from UPM (n= 70). Forty percent of the respondents were house owners while the remaining sixty percent indicated that they intend to buy a house in future. The demographic breakdowns of the respondents are indicated on Table 3 below.

TABLE 3  
Demographic breakdown of the respondents

Profile of Respondents	Frequency	Percentage (%)
Gender		
Male	164	54.7
Female	136	45.3
Marital status		
Single	158	52.7
Married	137	45.7
Divorced	5	1.6
Age		
Below 20	-	-
20-30	166	55.3
31-40	98	32.7
41 and above	36	12
Race		
Malay	183	61

Chinese	45	15
Indian	7	2.3
Others	65	21.7
Religion		
Islam	250	83.3
Buddha	41	13.7
Hindu	4	1.3
Christian	5	1.7
Qualification		
Diploma	3	1
Degree	251	83.7
Master	46	15.3
Working experience		
< 1 year	63	21
1- 5 years	87	29
6-10 years	74	24.7
11-20 years	69	23
> 20 years	7	2.3
Monthly Income		
< 3000	134	44.7
3001-5000	96	32
5001-10,000	53	17.7
10,001-20,000	13	4.3
>20,000	4	1.3

### 5.1.2 ANALYSIS OF CUSTOMERS' PERCEPTIONS ON BBA AND DP HOME FINANCING

The descriptive statistics obtained from the survey to analyze customers' perceptions on BBA and DP is described on Table 4.

TABLE 4  
Customers' perception of the features and operations of BBA home financing

Level of measurement / Percentage	Disagree (%)	Neutral (%)	Agree (%)	Mean	Std Dev.
1a The debt concept used in BBA home financing is similar to that in conventional home financing	36.3	16	47.7	3.16	1.22
1b The profit sharing concept in DP home financing is not similar to that in conventional home financing	7	15	78	3.98	0.90
2a The method of computing profit in BBA home financing is similar to conventional home financing.	34	15.7	50.3	3.26	1.20
2b The method of computing profit in DP home financing is not similar to conventional home financing.	9	14.7	76.3	3.91	0.90
3a The pricing for BBA home financing is similar to conventional home financing except that profit rates replace interest rates	19.7	18.3	62	3.58	1.11
3b The pricing of DP home financing is not similar to conventional home financing as rental rates replace interest rates	6.4	16.0	77.6	3.96	0.85
4a BBA home financing is not <i>Shariah</i> compliant because there is no real purchase of property and bank does not take ownership risk	13.3	22.7	64	3.69	1.05
4b DP home financing is <i>Shariah</i> compliant because there is real purchase of property and bank takes ownership risk	3.3	21	75.7	3.99	0.80
5a If I apply for home financing, I would seriously consider taking BBA home financing	44.7	35	20.3	2.58	1.17
5b If I apply for home financing, I would seriously consider taking DP home financing	6.3	21.7	72	3.99	0.95

Measure of reliability was determined by means of Cronbach alpha coefficient which suggests acceptable internal consistency lying between 0.70 to 0.80 (Nunnally, 1978). Hence, hypothesis test was conducted to measure the significance of the following variables.

### 5.1.3 HYPOTHESIS TESTING

Statistical paired t-tests were used to test the five hypotheses that had been developed for BBA and DP, the results of which are shown in Table 5.

TABLE 5  
Differences in perceptions between BBA and DP home financing

No	Hypothesis	Mean BBA	Mean DP	Mean Diff	T	p-value
H <sub>1</sub>	<i>There is a difference in customers' perception on the concept of debt and equity between BBA and DP home financing.</i>	3.166	2.013	1.153	11.705	0.000
H <sub>2</sub>	<i>There is a difference in customers' perception on the method of computing profit between BBA and DP home financing.</i>	3.256	2.090	1.166	12.935	0.000
H <sub>3</sub>	<i>There is a difference in customers' perception on the use of profit and rental in pricing between BBA and DP home financing.</i>	3.583	2.043	1.540	16.573	0.000
H <sub>4</sub>	<i>There is a difference in customers' perception over the belief that bank's real purchase and ownership risk between BBA and DP home financing is Shariah compliant.</i>	2.310	3.990	-1.680	-19.537	0.000
H <sub>5</sub>	<i>There is a difference in customers' perception in seriously considering to apply for BBA and DP home financing.</i>	2.580	3.996	-1.416	-16.095	0.000

p < 0.05

## 6.0 DISCUSSION AND IMPLICATION

The *Shariah* scholars view that it is important for the bank to have ownership and possession of the house before it is sold to the customer. This follows the same requirements for a legitimate sale mentioned in the literature whereby there must be an underlying real asset to be traded (Al-Zulhayli, 2003; Usmani, 2007). However, bankers felt that there is nothing wrong with the buying and selling of BBA although it does not involve real asset. This could be because they are more familiar with conventional financing where money can be traded for money. The findings explained the reason why the customers felt that the existing BBA home financing is similar to conventional loan as money is being traded for money which is not permissible by the *Shariah* because money does have intrinsic value (Usmani 2001; Ayub, 2007; Aziz, 2009). This controversy is resolved in DP home financing as both scholars and bankers agreed that bank takes ownership and possession of the house which is the real asset and not the exchanged of money. The property is jointly owned between the bank and customer by means of equity sharing until the end of the financing period. Likewise, majority of the customers viewed that the concept of DP home financing differs from BBA home financing as bank takes ownership and possession of the property (H<sub>1</sub>). On the method of computation and pricing of BBA both the *Shariah* scholars

and bankers agree that the current practice is similar to conventional loan which is based on time value of money formula.

This findings explains the results of the survey whereby majority of customers felt that there is not much difference between the method of computing profit between BBA and conventional home financing with the exception of profit rates replacing interest rates (H2). This is because the formula used for computing the interest/profit for both products are benchmarked against market interest rates. This is supported by studies made by Chong and Liu (2009); Kaleem and Md Isa (2003) and Bacha (2004) which show there are similarities between the benchmark used in Islamic financing and conventional financing. Conversely, the method for computing profit in DP is different as actual rental rate takes into consideration factors such as size of the house, locations and amenities surrounding it. A comparison between the balance outstanding after 10 years of financing between BBA and DP as indicated in Table 2, clearly indicates that financing using DP is lower as the profit amount is not capitalized upfront as in BBA home financing. Majority of the customers felt that taking into consideration the real factors to determine the actual rental rate of the house in DP is fair and different from profit rate in BBA because it avoids the current interest rate as a bench mark (H3). Moreover, they can make use of their rental portion to redeem the bank's share of property. In addition, the customer can purchase additional share to own the house earlier. Nonetheless, bankers expressed their reservation that further study should be done in determining a fair rental benchmark due to the unique characteristics of each house.

There are also issues on *Shariah* compliant in BBA home financing highlighted during the interviews with *Shariah* scholars and bankers. The scholars said that the current practice of BBA home financing is structured as *Bai Inah* (sale and buy back) which is a contentious sale as the banks bear no risk in buying and selling the same property to the customers (Rosly, 2001; Mohamed, 2005 and Dusuki, 2007). However, only three of the six bankers (50%) seem to be aware of this issue. This could be due to lack of knowledge on the details of *Shariah* ruling which falls under the purview of the *Shariah* scholars. It is surprising that customers seem to be more aware on the issue as indicated from the survey that majority of them felt that bank does not take ownership and possession in the existing BBA home financing.(H4). The issue of *Bai Inah* can be avoided with the implementation of DP home financing as bank and customers jointly own the property based on their respective equity portion until it is fully settled. This is agreed upon by the *Shariah* scholars and bankers during the interviews. As banks take risk, liability and effort in owning the property, they fulfill the requirement of *iwad* (equivalent counter value) of a valid sale which entitle them to earn the profit from the transaction (Rosly, 2005; Sanusi 2006)



## 7.0 CONCLUSION

The results of this research are in line with opinion of scholars that the purpose of the Islamic banking system is to provide justice and the accomplishment of the socio-economic goals of Islam (Chapra, 1985; Mirakhor, 2008). In doing so, it should avoid injustice and hardship to customers and follow the ethical principles aiming at eradicating all kinds *zulm* (injustice) in financial dealings (Siddiqi, 1983). This is supported by the last hypothesis which indicates that there is a significant difference in customers' willingness to apply for BBA and DP home financing (H5). The descriptive statistics revealed that only 20.3 % of the customers would seriously consider taking BBA home financing compared to 72% seriously considering taking DP home financing. This is indeed a surprise as BBA was introduced 27 years ago in the industry and hence should be getting greater support compared to DP which was only introduced 5 years ago. The higher response for DP indicates that customers are more satisfied with its features that reflect fairness, justice, cater for societal well being and equitable distribution of wealth and income in line with *Maqasid al Shariah* which promote the welfare of the people, by safeguarding their faith, life, intellect, posterity and wealth (Al Ghazali, 1937) The overall results of this research emphasized the need for banks to be innovative in its product development and also sensitive to the changing needs and wants of customers by introducing more value added features that are available in DP home financing compared to BBA (Chapra, 2008) (Saeed *at el*, 2001). The results of this study provide bankers with the strategic response needed for *Shariah* compliance home financing.

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