



Will It Survive? Challenges Faced by Islamic Banking and Finance in Today's World

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Abstract

Despite the significant accomplishments made by Islamic banks over the past decades, there are still some notable issues from a marketing of financial services point of view that require attention in order to strengthen their market position relative to their conventional banking counterparts. Based on a review of extant literature this paper submits that with due recognition of the Islamic banks' peculiar practical and regulatory milieu, financial products development in its entire ramifications is a sine qua non for continuous but sustainable growth of the Islamic banks. This should be complemented by developing a robust legal structure that enhances operational efficiency without infringing on growth potentials.

Keywords: Islamic Finance, Islamic banks, conventional banks, challenges, issues, comparative advantage

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1. Introduction

Islamic banking and finance is seen as an ethical and fair alternative, which protects against excessive leverage while at the same time increases trust among people compared to conventional banking (Alam, 2006). The word "Islamic" should not imply it being only, or even primarily for Muslims, as in recent years it has attracted an encouraging support from both Muslims and non-Muslims. This new landmark in the world of banking started in the year 1963 with the introduction of the first Islamic bank, in Egypt called Mit-Ghamr Savings Bank (Haron and Ahmad, 2011).

Viewed as a significant achievement that was most welcomed by scholars and jurists of that time who further polished and advanced its various facets. By the end of the 20st century, Islamic banking rose to new levels and gained wide acceptance in many countries (Haron and Ahmad, 2011). Essentially, the services that these Islamic banks provide are more or less the same provided by their conventional counterparts with the only major difference being that the former is free from the elements of *riba* (interest) and *gharar* (uncertainty). Seeing the widespread acceptance of Islamic banking, many conventional banks also started operating their Islamic banking windows.

Nonetheless, the admirable success of these Islamic financial institutions over the last twenty years should not be taken for granted, especially in the face of some serious issues that these institutions currently face. These issues, according to Fuad (2011), are two pronged: the situational settings unsuited to Islamic banking operations; and issues involving the ways and practices of these banks. Iqbal (2011) recommends an early rectification of these issues before they start creeping over the credibility and a significant position of Islamic financial institutions in the market. Addressing these issues, it is expected will help preserve their advantage over the conventional banks, and also towards achieving long-lasting sustainability.

The prime focus of Islamic banks should be in anchoring their long-term foothold in the market to achieve a well-supported, operative, and sustainable model that ensures their survival. This paper, therefore, focuses on the major issues and challenges faced by Islamic banks in the 21st century. After going through the relevant literature, the paper concludes with some suggestions on way forward.

2. Literature Review

2.1 Competition from conventional banks

Fuad and Munawar (1999) had predicted that notwithstanding the likelihood of Islamic financial institutions maintaining a stronghold in many Muslim countries they are also prone to losing this position in fast-paced economies where they face tough competition by many conventional banks. In this competition, the conventional banks are now implementing *Shari'ah* compliant practices and innovative and more attractive products and services to the customers relative to their Islamic finance counterparts. In addition, many other conventional banks have been maintaining foothold in Muslim countries while providing *Shari'ah* compliant services (Choudhary, 2001). These developments quite evidently point to the fact that Islamic banking structure is promising for conventional banks that may result in huge competition for Islamic banks (Rosly and Zaini, 2008). With this discussion, the question arises: “does it predict a promising future for the Islamic banks?” The answer lies in how Islamic institutions respond to this expansion.

Competition usually enables the organizations to gear up as it puts them in a “do or die” situation. In order to survive, firms need to increase their efficiency, improve their productivity, and provide quality products to their customers. Moreover, organizations also need to stimulate innovation and help to bring out the best value for the customers. The same is true to Islamic banks as well because western conventional banks have enjoyed huge gains over their Islamic counterparts in terms of market coverage and strong foothold in banking industry. One can assume that Islamic banks are exposed to uneven competitors. In the non-financial sector, the disadvantaged firms may raise the title of infant industry for themselves to get governments' help in the form of various benefits such as tax halts or providing them with subsidies. But since no such system exists especially in the banking industry, these Islamic institutions have to fight for their own survival as their existence in the market just depends on their performance and productivity (Haron and Ahmad, 2011).

2.2 Need for development of associations and strategic alliances

This next point is an issue and a solution at the same time, depending on how it is taken and understood. As it is evident that due to globalization the opposition from the conventional banks is going to get more intense even in the time ahead. Moreover, markets all over the world are speedily congregating to form a single market. Therefore, in order to grab the opportunities provided by globalization, Islamic banks need to act swiftly by strengthening relationship with conventional banks and other organization, hence developing a strong alliance. To do so, Islamic banks must focus on advanced marketing tactics not only at the consumer level but also at the organizational level. Further, Islamic banks should focus on improving their productivity by developing more efficient products and services (Siddiqi, 2008), especially, those products with a high demand in the conventional banks.

2.3 Adoption of latest technologies

The new technological innovations coming forth manifest mainly in terms of crypto-currencies and fintech has huge implications for the financial institutions. By introducing sophisticated computer systems and software the banking operations have been totally disrupted and overhauled thereby becoming more efficient and productive. While this being the case of technological revolution, at the same time talking about the revolution in communications has dramatically reduced the costs of communicating internationally. Globalization has made it possible for the capital markets to incorporate with the financial markets. The substantial use of the foreign markets has evolved the trend of using plastic cards for transactions while continuously replacing the paper currency. Similarly, the electronic registers are continuously replacing accounts registers. Thanks to the technological advancements, it is now possible to invest in other countries by saving in one country at a touch of a button (Khan and Bhati, 2008). Moreover, m-commerce has also emerged and many conventional banks have already adopted it in order to reach the customers in a seamless manner. Therefore, with all these technological advancements making their way through the market, the Islamic banks, in order to stay in business, at a competitive cost should remain indifferent from these

innovations. They should observe these advancements and should target their strategies in a way that is consistent with these developments (Iqbal, 2001).

2.4 Islamic banks and strategic alliances

While focusing on the global markets and setting a foot there is not an easy task, an alternate option is to form a strategic alliance with other well-known banks. Both the Islamic as well as conventional banks can benefit from such strategic alliances. While collaborating with the western banks, Islamic banks can benefit from their knowledge, expertise, capabilities, and refined banking techniques, which can help them to provide better products to their customers and at the same time reducing the risk of failing in an international market (Sarker, 2000). Since both the parties benefit from it, the conventional banks on the other hand will make gains from the Islamic banks infrastructure, getting the customer databases, maintaining relationships with them, and Islamic identifications of the Islamic financial institutions.

2.5 Caveat for the Islamic banks

It is important to focus on the motives of the large multinational banks that want to follow the Islamic banking practices. It is quite clear that they are likely to be leveraging on practice because of the profitable opportunities that may be linked to the rising popularity and traction generated by these Islamic institutions. There is nothing wrong with it as well, but the important thing to focus on is whether these institutions are correctly practicing the *Shari'ah* rulings or not (Sauer, 1999). Every Islamic bank is governed by a panel of *Shari'ah* board members who closely observe the practices of its bank to ensure that it follows the *Shari'ah* requirements in letter and spirit. However, the conventional banks are devoid of such board members who can keep a keen eye on their operations, so the strategic alliances with the developed Islamic institutions can at least help the conventional banks to fill this gap (Haron and Ahmad, 2011).

2.6 Increasing the size of Islamic financial institutions

The size of institutions significantly influences the efficiency and effectiveness of any institution. Many economists have proved that banks that are larger and bigger in size are able to grasp higher output and an optimal mix with great ease than the smaller sized institutions (Siddiqi, 2000). According to Templeton and Bond (1999) the large sized institutions are capable of savings in costs from 20- 50 percent thus achieving relative economies of scale compared to the small institutions, whose diseconomies of scale have been found to vary between 20 – 30 percent. Furthermore, the giant Islamic banking sector is still small compared to their conventional competitors as none of the former is today classified as global systemically important bank (GSIB)

According to Kamil (2007) there are more explanations to justify the larger size of the financial institutions. One of them is bigger funds base that serves as a significant factor prompting positive real credit rating. It reveals the commitment and guarantee of shareholders to their business. That comes easily if the bank wants to increase their added capital. Aside, the small size of institutions also serves as a major factor that contributes to the deficiency of diversified portfolio. This is because the retention of resources with these institutions is not enough to lower the risk through portfolio diversification (Hassan, 1999).

Therefore, it is quite critical for the success of Islamic banks to focus on their size so that they are able to work efficiently and deal effectively with the giant conventional competitors that pose a continuous threat. In order to remove this threat and face other challenges effectively, more emphasis should be placed on increasing their size and for this purpose more serious thought should be given to mergers and acquisitions among Islamic banks (Akhtar, 2006).

2.7 Development of more sophisticated financial products

2.7.1 Sophistication by technology

As already discussed above that with the introduction of more sophisticated technologies in the 21st century, financial markets are becoming more complex and competition-intensive. As a result, Islamic

financial institutions are facing a continuous threat of being replaced by other banks practicing Islamic banking techniques in a more sophisticated and refined manner. Thus, in order for these institutions to take advantage of many opportunities provided by the technological advancements, and to face the challenges and the competition that are brought about by these innovations, and the entrance of the giant conventional banks in the Islamic sector, Islamic financial institutions have to adopt technology (Christian, 2007).

2.7.2 Innovation in products

There is a high need for the financial institutions to keep a keen eye on the demands of their clients that include both individuals as well as businesses. Since all people have different personalities, tastes, and preferences, so a varied range of products needs to be designed that can satisfy the wants of their clients in the marketplace while at the same time maintaining the *Shari'ah* guidelines in designing these products (Choudhary, 2001).

As of now, while there are proliferation of products and services rendered by Islamic banks, they are often not restricted to the traditional mechanisms developed years ago with slight modifications often driven by economic exigencies rather than the distinct peculiarity of Islamic banking demand and supply. Against the reality of sophisticated markets and the savvy participants in it today, sticking to a classical traditional mechanism surely harms an organization, especially when they have all the technologies to make a breakthrough and make their way to new heights (Ebrahim and Rahman, 2005). According to *Shari'ah* panels that observe the *Shari'ah* guidelines adopted by these institutions, banks can adopt any practice as long as it is within the *Shari'ah* framework.

2.7.3 Innovation in accordance with Shari'ah

Shari'ah principles have laid down several rules for dealing with different and new circumstances. Therefore, when we talk about development of new innovative financial products that satisfy the wants of people in this context, various other relevant concepts are also available. For example, *istihsan* (looking at the easiest way from those that are allowed according to *Shari'ah*), *maslaha musalah* (protection of public interest), *raf a-haraj* (eliminating adversity) and *daruriyat* (granting of concessions for the necessary products). These principles or concepts are relevant to financial engineering (Iqbal, 2011). In order to protect the basic principles of the *Shari'ah*, the concept of *ijtihad* should be in place. These concepts provide comprehensive guiding principles for taking control of issues that primarily arise in complex situations when the rules of *Shari'ah* principles are applied to novel circumstances (Sarker, 2000).

It is also true that Islam prohibits the rate of return on loans or borrowing but at the same time it does not, in any way, reject the rate of return from any legal economic activity. Here, it is very important to demarcate the difference between interest and return. The *Shari'ah* guidelines employed in Islamic banking reject or disapprove the collection of interest from loan but it approves the pre-determined rate of return that represents a source of profit for these institutions (Kamil, 2007). These profits can be defined in the concept of discount rates which depends on how much riskier a particular asset is, which is not in any way *haram* or prohibited. Also, the concept of cash flows that provides a kind of guarantee for an underlying asset is another significant instrument of financial engineering which suites the *Shari'ah* principles that encourages real sector investment (Mohsin and Mirakhor, 1987).

Although there is a possibility of revising and amending the traditional contracts in order to meet the condition in the modern era, there is much wider scope in development of new contracts for financial business. These developments of financial derivative contracts can be based on the traditional/classical contracts or can be developed totally afresh. However, the change should only be made in observing the suitability of *Shari'ah* principles with the new contracts. It is not important to maintain the pre-requisite that the contract should meet the requirements of say *mudaraba* as enclosed in the traditional *fiqh* (Rayner, 1992).

While looking at the contracts, the most important pre-requisite to check is that it should not contain any unlawful element that disrupts any *Shari'ah* rulings. Therefore, for this purpose the panel of *Shari'ah* members should prepare a list of these rulings and send it to the financial engineers so that they can keep all the guidelines in focus while designing any financial derivative. This checklist would contain certain rulings on what is prohibited and what elements are allowed and can be included in the development of financial

products. Financial engineering has quite wide scope that also extends to innovations in other areas. It is, therefore, significant that those knowledgeable experts who know the requirements and the particulars of the financial trade should take up this job (Saleh, 1992).

3. *Shari'ah* Facets

The element of religion or the *Shari'ah* guiding principles in Islamic banking and finance forbids the designing of new financial derivative. This is because these *Shari'ah* guiding principles serve as a guide for the development of Islamic banking instruments. Therefore, no new product receives a clean sheet until the *Shari'ah* scholars approve it. The *Shari'ah* approval is not only limited to the development of a new product. It continues even after its development and consequent use. Such regular monitoring, by the *Shari'ah* committees, ensures that the new products are being used under the *Shari'ah* guidelines and are not violating any Islamic principles (Mirakhor, 1994). It is important to note here that these *Shari'ah* checks and audits are not only mandatory because of the way an Islamic bank operates but also because it serves as a confidence-building tool for the customers. Absence of audit by *Shari'ah* committees will result in loss of confidence in the bank operations. Thus, it necessitates the use of *fiqh* scholars' expertise in understanding the requirements of financial derivatives and assessing these products (Siddiqi, 2008). Due to this imperative role, each bank has its own *Shari'ah* committee or *Shari'ah* advisors that perform the check and audit functions.

3.1 Shortcoming in *Shari'ah* committees

Quite surprisingly, research reveals that often these *Shari'ah* committees' members have not received any full-fledged training on the necessary rulings that differentiate right from wrong. These scholars have other ways, though, to obtain the pertinent information regarding any *fatwa*, one of which is that they conduct seminars and workshops in which scholars and financial specialists are invited to participate and discuss these issues (Fuad and Munawar, 2011). Islamic universities and other Islamic training institutes play an important part in setting up these meetings and seminars. Nevertheless and more importantly, these seminars have no authority to issue any *fatwa*.

In order to resolve this issue, the *fiqh* schools play the most significant part, the top amongst which is the OIC *fiqh* academy in Jeddah. These schools of *fiqh*, before taking any decision, issuing any *fatwa*, or even discussing them in any meeting take the help of many studies conducted by dedicated experts on particular issues. The lack of such expertise in the area of finance forces these scholars to resort to "*ijtihad*"¹ and "*ijma*"². These two approaches play an important part in taking decisions in areas devoid of *fiqh* expertise, such as finance (Saleh and Nabil, 1992).

This is not an ideal situation in any sense as a huge gulf lies between the opinions of *fiqh* scholars and modern specialists of finance and economics. They both anchor in different perspectives that hinder the smooth arrival at any decision. These parties not only have different personalities, but they tend to think and speak differently too. Naturally, the interaction between these two parties' results in many conflicts. Consequently, the decision-making in banks has been very slow and conservative (Kazmi, 1994).

While the *Shari'ah* committees have done a commendable work in the evaluation and implementation of classical and traditional contracts, and safeguarding the use of its products, these scholars find it difficult to pass their judgments when it comes to protection of present day modern financial derivatives or their Islamic alternatives. This complication is attributed to the lack of specialized experts having minimum working knowledge of both the modern finance and *Shari'ah* (Lawai, 1994).

3.2 Development of Islamic banking and finance discipline

For establishing any discipline, common pre-requisites are coaching, training, research and development. This is especially important for emerging disciplines such Islamic banking. As already discussed, the main complication faced by Islamic banking and finance is lack of specialized expertise and the specialists of present day economics and finance. Similarly, most people who run or manage an Islamic bank are not

¹ *Ijtihad* means to gather Islamic rulings from highly trustworthy sources.

² *Ijma* is an agreement on any specific issue by various Muslim schools of thought.

qualified in using Islamic modes of banking (Khan and Bhati, 2008). Unfortunately, there is still a huge manpower deficit to fulfill this gap.

There are Muslim countries like Malaysia, Turkey, and Pakistan that have taken the initiative by producing graduates in this field. Catering to the demand of Islamic banking in the recent years, many universities are flocked by students enrolling in this specific field. Optimistic, but not enough! Because the courses being offered to students do not seem to be streamlined to achieve this objective (Iqbal, 2011). This is reinforced by the fact that many Islamic banks were not able to find any suitable candidate to manage their operations or to represent their *Shari'ah* panel.

Apart from the above mentioned, Islamic banks also lag behind with regard to extensive and scholarly research. Some of the Islamic institutions do possess small research units but none of them actually contributes towards product development. This adequately explains the slow development of new financial derivatives in Islamic banking. Further, despite the number of many research development institutions operating all over the world none of them received any support, financial or otherwise, from Islamic banks for the said purpose. It could be argued that Islamic banks never felt the need to coordinate with these research institutions (Christian, 2007).

Another very significant component in carrying out scientific research for creating financial derivatives is the availability of useful and realistic information. Collection of authentic information has failed to receive any importance from the Islamic banks, which killed whatever little efforts it was attracting. As a result, information on the accomplishments and activities of Islamic institutions greatly lacks (IOSCO, 2004). Islamic banks have also failed to develop any training institutions that can result in adequately trained employees. The Islamic bank employees/managers just attend some short courses, on-the-job training, or a workshop in an attempt to acquire necessary skills, but such measures are devoid of full-fledged training. Moreover, most of the people managing Islamic banks often come from conventional banks thereby lacking adequate proficiency in managing Islamic institutions. So, it becomes extremely important for the Islamic banks to recruit and train the right people who can work proficiently while devoting their full commitment to the *Shari'ah* principles in their operations (Baqar, 2005).

3.3 Need for diversification of Islamic financial instruments

According to Siddiquie (2008), Islamic financial institutions have offered a variety of financial products. Broadly, these instruments can be categorized into fixed return, variable return, and profit sharing, with each having its own advantages and disadvantages. Out of these, only the fixed and variable return instruments have been used extensively while use of the third has been quite restricted. Thus, it would be beneficial for Islamic institutions to diversify their modes of financing which translates into diversification of the profit sharing approach.

According to many scholars, one serious problem faced by Islamic banks is their excess reliance on the fixed return modes. This problem is equivalent to a crisis for Islamic banking system, says Iqbal (2011). The prodigious use of fixed mode financing by the Islamic institutions, while limiting the use of other instruments that could have provided more profitable opportunities, has led to adverse outcomes for the Islamic banks. Some of them are as follows:

3.3.1 Rise in default payments and the issuance of fines:

Overwhelming use of fixed modes of return has made Islamic banks capable of decreasing the effects of risks arising from business on the cash flows. The same use of debt in comparison to equity could also create some serious problems (Johnson and Murphy, 1987). According to Askari and Iqbal (1995) *murabahah* contract primarily helps the banks in creation of debt obligations against the buyer enterprises. No doubt, it is allowed to charge a high price in sales on credit in comparison to sales on cash. The *murabahah* contract, therefore, creates a fixed debt only after they enter into the contract. If, however, the buying firm defaults on their obligations then, according to *Shari'ah* rulings, banks cannot charge any extra penalty on the defaulted amount. This induces dishonest buyers to default on their payments deliberately.

Muslim scholars have discussed this problem and they have arrived at the conclusion that if any buyer defaults on payments, the banks are allowed to issue penalties but the amount recovered from the penalties

should not be used for benefitting the bank in any way. On the contrary, many other scholars argue that when buyers default on their payments it accounts to damage the bank; so the recovered amount is a kind of compensation for the bank against that damage, as Islam permits the compensation to the loss parties. Illiquid structure:

Another complication because of profuse use of fixed-based financing is that it is not transformable into negotiable financial derivatives. That is, when the banks create a debt obligation, it is not transferable to another person except at the condition of par value. This makes the whole Islamic banking system highly illiquid and hence serves as one of the major barriers in the creation of Islamic financial products. Until the time negotiable instruments are structured, it is highly likely that the Islamic financial system will remain embryonic (Fuad and Munawar, 2011).

Attempts are being made by the jurists to overcome this barrier by the development of Islamic contracts that include *ijara*, *salam*, and *istisna'* contracts. Unfortunately, their usage has not brought any significant change so far. Thus, the only hope left for the survival of Islamic financial system is in the development of equity based financial derivatives and the securing of already existing derivatives (Zamir, 2011).

3.3.2 Short-term nature of Investments:

Conventional banks work on small reserves and hence favor investments for a shorter period. This is because they keep it as a cushion in order to meet any emergent obligation. Contrarily, Islamic banks largely practice and prefer short-term investments. This can also be attributed to the over-whelming use of fixed modes of financing. This *Murabahah* contract is by nature a short-term contract and converting it into financial derivatives does not change its nature (Rayner, 1992).

Although it is possible to develop a *Murabahah* contract that features installments that are carried on for many years, but the requirements that this *Murabahah* contract adapts are short term in nature. Therefore, the contracts entered by the banks are mostly short-term in nature. Consequently, large number of short-term investments is amassed in *Murabahah* contracts resulting in short-term natured associated assets (Rosly and Zaini, 2008).

This possessing of short term assets should not be considered a problem as it makes complete sense if we see that the debts of financial institutions are also short-term in nature. However, the banks also need to own long-term assets (venture capital, for example). Conventional banks fulfill these requirements by different financial securities markets, but such financial markets lack in Islamic structure (Sarker, 2000).

According to Saleh and Nabil (1992), Islamic institutions are considered as the alternate solution for the conventional banking as well as for the financial securities market. Since the Islamic banks are not permitted to possess bonds based on interest, thus a substitute has to be found. Equity-based financing as a major instrument seems to be a logical solution to achieve this objective (Siddiquie, 2008). This problem takes on a precarious path by the fact that in many countries where Islamic banks control the major realm, there is still a lack of the full-fledged securities market. Therefore, complete employment of profit-sharing mode is mandatory to get rid of unlawful element of *riba* (interest) from the financial marketplaces.

3.4 Establishment of equity based institutions

From the above discussion, it is quite clear that the Islamic financial institutions should come up with equity-based institution in order to completely curb the problem of *riba* in the banking system. At the same time, it is important to emphasize that fulfilling all such needs is not only the responsibility of Islamic banks but also of the Islamic financial system as a whole.

Every business in some way needs long-term assets, in commercial banks this need is fulfilled by securities market and other equity enterprises (Haron and Ahmad, 2011). Unfortunately, even in most Muslim countries where Islamic banks control the major sphere of the market, there is no such equity institution available that could meet the long-term needs of Islamic financial institutions. Apart from this, the number of other institutions that provides equity primarily through the exchange of the stock (insurance companies, mutual funds, and pension funds) is also quite small. These companies have only recently been developed in the Muslim countries but their small size hampers their efficiency (Iqbal, 2001).

According to Kamil (2007), the use of pension funds is usually restricted for the public domain and there is very little availability of such funds to the private sector. Islamic financial institutions have largely ignored

the need of equity-based institutions for reasons that should not have been overlooked. While looking at the importance of equity-based institutions for the growth of economy it becomes quite important for Islamic banks to develop these institutions in order to ensure their survival in financial market. Therefore, it becomes quite important to mention that there is a high demand for equity-based financing in the Islamic financial system. This trend can be seen worldwide, with the customers abandoning their classical and customary bank accounts and quickly grabbing the opportunities to move into equities. As a result, even the stock markets have observed massive growth with sizeable increase in the stock prices. According to Saleh and Nabil (1992) because of the growth in equity markets, a substantial rearrangement of capital is taking place whereby mutual funds and insurance schemes plans are also inflating.

Further, Sauer (1999) highlights that customers who save are gradually identifying the opportunities provided by the profit-based financial instruments. Investments made in the stock market are becoming less risky over the years. Savers have also started to admit the reality that since the World War II stocks have the capability to create higher return than any other financial instrument. Mutual funds are also quickly making their way to the market with other equity instruments. Therefore, such environment is quite suitable for the development of equity based transaction and market instruments (Omar and Iqbal, 2011). It, therefore, necessitates the Islamic financial system to remind itself of these developments taking place internationally in the financial markets (Lawai, 1994). As a solution, Islamic institution should realize the opportunity and take part in the privatization plans being carried out in most of the Muslim countries. The private parties are undertaking large number of public firms, with attractive records and optimistic projections. The Islamic financial institutions should take benefit from this prospect (Baqar, 2005).

It is worth noting that, Islamic jurists have issued ruling forbidding Islamic institutions to acquire even a small proportion of equity stake of a business dealing with even a minute amount of *riba* (Baqar, 2005). This ruling, on one hand, accurately reflects what Muslims must refrain from, but on the other hand puts a huge limitation on the settlement of capital. Hence, it closes the door for a significant market to Islamic institutions and exposes many giant organizations in Islamic countries to foreign possession. This problem demands serious consideration so that a suitable and satisfactory way out is found (Ebrahim and Rahman, 2005).

3.5 Development of legal robust structure/framework

In many Muslim countries, western-inspired laws govern banks and other companies. These laws may contain elements inconsistent with Islamic financial framework. Christian (2007) argues that even if these banks alter their agreements in conformance to Islamic framework, the underlying laws will still conflict with the Islamic financial system. It is impractical if these parties integrate all the Islamic rulings into their agreements, as it will make such agreements more costly. Further, if any complications arise by incorporating these principles, the local laws usually override that could violate the Islamic rules. This scenario requires a robust framework that exclusively deals with bad debts and default payments. Hence, it becomes imperative to introduce the distinctive laws that put the practice of Islamic financial system in place. In addition, those institutions that do not want to duly adopt the Islamic banking framework should at least endorse some rules that help in facilitating the operations of a diversified structure (Haron and Ahmad, 2011).

It is important to emphasize that the efficient and effective operation of the Islamic banking does not only necessitate the development of a well-developed framework but the governments should also extend their help by developing and implementing right policies to govern such framework (Alam, 2006). The governments in Muslim countries in order to enforce such policies should create a conducive atmosphere for the operation of Islamic financial institutions. No doubt, there are many concrete complications in this path. However, systematic rearrangements, specifically in the monetary and fiscal areas are necessary to provide the Islamic institutions with enough space to function efficiently (Johnson and Murphy, 1987).

4.0 Conclusion

Although Islamic financial system is progressing in many Muslim countries, the complications faced by these banks in recent years need to be observed and addressed instantaneously and simultaneously. Some of these issues are absolutely against the *Shari'ah* principles and thus need an intense discussion (Alam, 2006). There is a dearth of attention given to Islamic banks in applying the approved *Shari'ah* principles. Unless this grave dearth is filled, Islamic banking would only be looked as nothing more than an imitation of the conventional banks; particularly when in both systems the cost of funds is primarily the same blurring the distinction even

more (Choudhary, 2001).

The foundation beliefs of the Islamic financial system should be seen as very dissimilar from that of the conventional banks. Conventional banks operate wholly with the aim of gaining profit and increasing their financial numbers; whilst the Islamic banks should operate for the benefit of the society and represent themselves as financial institutions that work for achieving profit as well as maximizing the benefits of the society (Askari and Iqbal, 1995). When Islamic banks depict such picture, people will get assured that Islam is rightly called the religion of peace, which not only promotes the relationship between man and God but also emphasizes on promoting the relationship amongst humankind. When the society sees the positive impact of Islamic banking on the society as a whole, they would be more motivated to adopt Islamic banking practices not as an extension or substitute over the conventional ones, but as a major choice for financial transactions. This picture is only possible if the Islamic banks actually build this kind of system first (Choudhary, 1996).

To achieve this purpose, it is necessary to develop a firm alliance between the regulatory parties and other parties confined by laws. This will ensure formation of new laws consistent with *Shari'ah*. As a final point, all participants of the Islamic financial framework must have complete trust and confidence in this structure, work with integrity and morality, and have thorough confidence that it is a complete and comprehensive framework over the conventional financial structure (Haron and Ahmad, 2011).

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