



PO Box: 562, F-7, Islamabad, Pakistan

Phone: +92 51 2514555

Email: info@muslim-institute.org

www.muslim-institute.org

An Opinion Piece on

Challenges for Islamic Banking to Become Leading Financial System

by Muhammad Asim Faheem, Research Associate

MUSLIM Institute



Various forms of banking are prevalent worldwide. These include saving banks, commercial banks, central banks, development banks, exchange banks, investment banks, Islamic banks etc. Most common types of bank found in every country of the world are commercial banks and central banks. Commercial banks perform the services that several other banks perform like development projects financing, saving, investment, exchange, internet banking etc., while central banks are controlled by the government to keep hold on the financial system of the respective country. But besides this conventional interest based system of banking, a newly emerged system that makes profit and loss as its base is known as Islamic Banking.

Islamic banking is based on the Principles laid by Holy Quran and Holy Prophet (SAAW). Major principles of Islamic banking are:



- A. Interest should be prohibited in financial dealings
- B. Oppression must be avoided in financial dealings
- C. Speculation is prohibited in financial dealings
- D. Zakat must be levied on the deposits
- E. Business of Haram products must not be involved in

Islamic banking is emerging as a strong segment of Banking Industry. From the last three decades, Islamic banking has been progressing very fast. Its popularity can be assessed by the fact that it is being practiced in more than 40 countries with 250 Islamic banks and possessed total estimated assets of U.S\$ 1.3 trillion in 2011. Its annual growth has averaged around 19% over past four years. The top four markets account for 84% of industry assets. The Islamic banking growth story continues to be positive, growing 50% faster than the overall banking. Malaysia, Iraq and Saudi Arabia are the countries where Islamic banking is dominant in banking sector and their economy is progressing. But Islamic banking is still behind the conventional banking system in term of market share and number of clients so it has to do more for becoming market leader. There are number of people who are not familiar with Islamic banking and its prospects. Apart from its popularity in the world, issues and challenges faced by Islamic Banking Industry must be clearly pointed out so that policymakers are able handle the same effectively. Few Major challenges are discussed below that need the utmost attention of management of Islamic Banks for their prosperity:



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- A. One of the many challenges for them is to introduce their products to the laymen of world and convince them over the utility of the products.
- B. Islamic banking needs to eliminate the misconception of the general public that Islamic banks are performing the same services like the traditional banks. There is a great challenge involved in implementation of interest free banking and many Islamic banks adopt the activities that result in the fix return making people think that Islamic banks are just changing the name of "RIBA" with "PROFIT", therefore continuing with what the conventional banks do.
- C. Islamic Banking needs to improve their functioning by adjusting the traditional concepts and features into Islamic context.
- D. Another critical impediment is that Islamic Banking is lacking the standards in its operations such as accounting, credit analysis etc.
- E. Another major problem is that in many countries Islamic banking is lacking support of their legal systems, laws and governments. Except Iran, UAE, Malaysia, Pakistan and some other Islamic countries, governments of many countries are not supporting Islamic banking legally. In case of Pakistan, numerous judgments of the courts and Islamic Ideology Council can be cited wherein Riba has been declared illegal and un-Islamic (Irshad Khan Vs. Parveen Ajaz, P.L.D. 1987; collection of Riba is un-Islamic (Habib Bank Vs. Muhammad Hussain, P.L.D. 1987); Riba is not in public interest

(Shahbazad Chaudhry Vs. Services I.T. Ltd, P.L.D. 1988). It is pertinent to add here that Federal Shariat Court is presently hearing a petition seeking replacement of the present banking system of the country with the Islamic financial system called 'Muamalaat.'

- F.** Islamic financial institutions face problems in working in non-Islamic countries due to the absence of the regulatory body that works in accordance with Islamic principles.
- G.** Islamic banking is also facing the shortage of experts, scholars, experienced bankers, employees who are trained in Sharia to manage the Islamic banking projects. Moreover the growing Islamic financial industry faces the problem of lack of Sharia Jurists. Only limited scholars have the knowledge of Islamic jurisprudences. So the current need of Islamic banks is the availability of Muslim scholars so that they can enable Islamic Banks to reconcile their operations with true Islamic standards and also help improve public's understanding of the same. Similarly, campaigns for spreading the knowledge of Sharia among the non-Muslims are required. Moreover countries should seriously work to establish a national committee like Pakistan's Council of Islamic Ideology where Muslim jurists and economists jointly formulate policies for a financial system based on Islamic Shariah Principles.
- H.** Islamic banks are not successful in advertising interest free banking & their products.
- I.** Islamic banks need high reserves and liquidity for profit and loss operations.
- J.** Another challenge is lack of uniformity in standards of analysis of credit. Islamic banks face the problem of absence of suitable standards for their credit analysis. So, higher attention is required in this context.
- K.** Similarly microfinance system of Islamic banking should be promoted among lower middle and middle class of people through trained professionals and low cost products.
- L.** Furthermore, a big challenge for Islamic banks is to influence foreign & international banks to adopt their activities.
- M.** Another challenge faced by Islamic banking is that it is based on assets base financing i.e. it invests in assets to earn profit. Islamic banks do not follow the principle of Anticipated Income Theory, mainly being followed by conventional banks. Islamic banks invest in working capital, real estate, shares & other assets so their liquidity is highly dependent on the liquidity of all companies in which they are investing.
- N.** There is a need of proper standardized regulatory body to control the functioning of Islamic banking system in all over the world.

In nutshell, it can be concluded that Islamic Banks need to overcome the challenges discussed above through proper strategic moves if they want to expand their functioning to every single person in the world. Although Islamic Banking is behind the conventional banking system but the current rapid growth of Islamic Banking system is an indication that it wouldn't take them long to successfully compete with the conventional system. By addressing these challenges both governments as well as management of Islamic Banks can not only improve existing system but also further broaden the scope of the same.