

Islamic banking in malaysia | research introduction

[Finance](#), [Banks](#)



Chapter 1 Introduction

Background of Studies

Islamic Banking is a banking system that based on Islamic Law (Shariah). It follows the Shariah, called fiqh muamalat (Islamic rules on transactions). The rules and practices of fiqh muamalat came from the Quran and the Sunnah, and other secondary sources of Islamic law such as opinions collectively agreed among Shariah scholars (ijma'), analogy (qiyas) and personal reasoning (ijtihad).

The main principles of Islamic banking are the prohibitions of interest (usury) in all transactions, the undertaking business and trade activities must be based on fair and legitimate profit and the prohibitions of monopoly and hoarding. By doing so, Islamic banks will safeguard the Islamic communities and societies from activities that are forbidden in Islam.

Islamic Banking is one of the fast growing banking industries today, many institutions have stepped into this multi-billion dollar booming industry by establishing its Islamic wings and units. Thus it may have a good prospect in the future.

Introduction

Islamic banks have been operating like other traditional banks about four decades. Like another conventional or commercial bank, they also mobilize deposits and granting loan to other. However, there are some different between Islamic bank and conventional or commercial bank. Islamic bank running the business based on Islamic Law (Shariah). Besides, Islamic

banking also prohibited the transactions based on interest rate. Beyond the above distinct, Islamic bank are similar with conventional or commercial bank as the products and services provided are the same.

Generally, we can define the Islamic bank as a non-interest based financial institution, which complies fully with Islamic Laws and has creative and progressive financial engineering to offer efficient and competitive banking, investment, trade finance, commercial and real estate financing services (AbdulQawi, O. and O. Lynn, 2001.)

Islamic Banking is now one of the world's largest faster-growing economic sectors, comprising over 300 institutions over 75 countries. Islamic Banking refers to a system of banking, which is following the Islamic Law or Sharia principles and guided by Islamic economics. In Islamic banking, the collection and payment of interest (also commonly called 'Riba' is prohibited. In general, Islamic law also prohibits people from trading in financial risk because is seen as a form of gambling. Besides, investing in businesses that are considered as 'haram' also prohibited in Islamic law.

1. Various Concepts of Islamic Financial Products

- Profit sharing financial products
 - Musyarakah (partnership/ joint venture)
 - Involve 2 or more parties.
 - All parties invest their money in a business.
 - Distribution of profit will be shared according to the agreed ratio.

- Losses will be borne by all parties (share the losses on the basis of their equity participation).
- Mudharabah (profit sharing)
 - There is an agreement between capital provider and entrepreneur.
 - Capital provider provides money for an entrepreneur to carry out a business.
 - Profit will be shared in profit sharing based on pre-profit ratio (Variable rate).
 - Losses have to be borne by capital provider of the fund.
- Qardhul Hassan (benevolent loan)
 - Interest free loan
 - Need to repay the principal amount borrowed plus an extra amount at borrower's absolute discretion (as token of appreciation)
 - Example: Amanah Ikhtian Malaysia (AIM)
 - The Bank may use an appropriate proportion of the funds at its disposal for what may be considered as the discharge of its social responsibilities through loans to truly deserving customers for worthy economic projects with the underlying objective of support and assistance.
 - The borrower is obliged under Syariah to repay only the principal amount of the loan according to its terms and conditions.

- The Bank cannot demand the borrower to pay anything apart from the principal amount of the loan, although in Syariah it is desirable that the borrower does so at his/her own discretion.
- Wakalah (nominating another person to act)
 - A situation
 - A person nominates another person to act on his behalf.
- Hawala
 - Bill of exchange, promissory note, cheque or draft.
 - Example: a debtor passes on the responsibility of payment of his debt to a third party who owes the former a debt. Thus the responsibility of payment is ultimately shifted to a third party.
 - A mechanism for settling international accounts, by book transfers. This obviates, to a large extent, the necessity of physical transfer of cash.
- Advance purchase financial products
 - Murabahah (cost plus)
 - Short term loan
 - Involve in asset buying
 - Bank buys it and sells it back to you when it is mature.
 - The price will include a profit margin as agreed to by both parties. (Cost + profit margin)
 - It is similar to housing loan.

- Payment can pay back in lump-sum or monthly payment and the period of paying back is set by the borrower.
- Istisna (Progressive Financing)
- A contract of acquisition of goods by specification or order where the price is paid progressively in accordance with the progress of a job.
- Ijarah (leasing)
 - Leases equipment, building or other facility
 - At an agreed rental against a fixed charge (agreed by both parties)
- Deposit products
 - Wadiah Yad Dhamanah (savings with guarantee)
 - For safekeeping or saving purpose.
 - Wadiah is a Trust which means that the depositor must trust the depository.
 - Bank (depository) act as trustee
 - Depository becomes the guarantor who needs to guarantee repayment of deposit.
 - There is no interest to be provided.
 - Depository has provided the return to a depositor as token of appreciation.
 - Return (profit) given based on profit sharing (Fixed rate)
 - Mudharabah

- Deposit products based on revenue-sharing between depositor and bank, including saving products that can be withdrawn any time and time deposit products.
- Qard al-Hasanah
 - Unremunerated deposit products, usually for charitable purposes.
- Insurance products
 - Takaful
 - Islamic insurance with joint risk-sharing

History

The first modern experiment with Islamic banking was undertaken in Egypt under cover without projecting an Islamic image to avoid of being seen as a manifestation of Islamic fundamentalism that was anathema to the political regime. The pioneering effort, led by Ahmad Elnaggar, took the form of a savings bank based on profit-sharing in the Egyptian town of Mit Ghamr in 1963. This experiment lasted until 1967 (Ready 1981), by which time, there were nine such banks in the country.

In 1972, the Mit Ghamr Savings project became part of Nasr Social Bank which, until the date, is still in business in Egypt. In 1975, the Islamic Development Bank was set up with the mission to provide funding to projects in the member countries. The first modern commercial Islamic bank, Dubai Islamic Bank, opened its doors in 1975. In the early years, the products offered were basic and strongly founded on conventional banking

products, but in the last few years the industry is starting to see strong development in new products and services.

Islamic Banking is growing at a rate of 10-15% per annum and with signs of consistent future growth (Islamic Banks and Financial Stability: An Empirical Analysis, 2008). Islamic banks have more than 300 institutions spread over 51 countries.

The earliest form of Islamic Banking in Malaysia was set up by Perbadanan Wang Simpanan Bakal-Bakal Haji (the Pilgrims' Management and Fund Board) in 1963. This institution was set up for Muslim to save and assist them to perform a pilgrimage in Makkah as well as to encourage them to participate in investment opportunities and economic. While the first Islamic bank established in Malaysia was Bank Islam Malaysia Berhad (BIMB) which commenced operations on 1 July 1983.

The government of Malaysia had introduced a systematic process to implement a proper Islamic financial system among the people in Malaysia. The first phase is the period of familiarization during year 1983-1992, and this is the time that Bank Islam Malaysia Berhad established. During this period, BIMB has developed itself as one of the most respectable financial institutions in the country, and been listed on Kuala Lumpur Stock Exchange (KLSE) on 17th January 1992.

The second phase was happened in year 1993-2003. In these ten years, the government on Malaysia was aimed on creating a more conducive environment for competition among the banks and give banks to try to

capture the market share. During year 1993, the conventional banks were allowed to offer Islamic banking services by setting up “ Islamic windows” or “ Islamic banking scheme (IBS)” to attract the public especially Muslim to involved in.

The third phase that commenced from 2004 was the period of further financial liberation. At this time, the government gives the opportunities to foreign Islamic banks to operate in our country by issuing a license to them. Malaysia is the first country that implements dual banking that Islamic banking system and conventional banking system operate side by side.

Problem Statement

The Islamic banking nowadays is gaining rapidly and going popularity. Many local and foreign banks in Malaysia are offered and open special Islamic Banking counter. In this research, I will focus on the performance, problems and prospect of Islamic banking in Malaysia. There are lots of issues about Islamic banking in Malaysia, such as public acceptance, factors of selection toward the services and products, risk management and others. This will be discussed in the next chapter which is literature review. Even the Islamic banking has been introduced in our country over 20 years, but there still have to meet some problem. Based on the above, the research problems are listed as below:

- Lack of knowledge among public about the prospect of Islamic banking in Malaysia

- Lack of understanding about Islamic banking makes the people do not involve in it.
- Islamic banking has a different risk profile than the conventional bank due to the Islamic prohibited of interest.
- Public acceptances of Islamic banking are not strong.

Research Objective

- To study the problems and performance of Islamic Banking in Malaysia
 - Islamic Banking has emerged as a new reality in the international financial scene since the 1970s and has been established in Malaysia over 20 years. The emergence of Islamic banking is often related to the revival of Islam and the desire of Muslims to live in all aspects of their life in accordance with the teachings of Islam. This paper is designed to study about the performance of Islamic banking and determine how well it.
- To analyze the prospect and growth of Islamic Banking in Malaysia

Islamic banking has a significant growth in Malaysia. Many local banks as well as foreign banks are now providing Islamic banking and finance services to the public. The factors that determine the prospect and growth need to be studied. As a country that consisted of a dual banking system, Malaysia plays an important role as an example to other countries on how to maintain this kind of banking system. This may give the opportunities to Islamic banking to expand and continue to growth.

- To find out the public acceptance and awareness of Islamic Finance Product among Malaysian

The public acceptance is playing an important role to determine the succession of Islamic banking in Malaysia. Most of the people are dealing with the conventional banking because the interest rate provides a constant return for the customers. Islamic banking advocate interest free makes people think that there is no return by invest their money in Islamic banking services and products. Thus the public acceptances need to be raised as this will only bring a good prospect and future for Islamic banking industry.

- To study the factor influence the selection of Islamic Banking.

Currently Islamic bank strategically offering high quality products and services to satisfy their customers due to the strong competition, a customer expectations for high quality services and rapidly changes of technology. Factors that are reflecting to customers' perception and satisfaction on Islamic Banking need to be investigated. This study hope to analyze and determine the perception, quality of services, availability of services, confidence in bank and social and religious perspective about the Islamic banking system.

Scope of Studies

The scope of studies of this research paper is a focus on the problems, performance and prospect about Islamic banking industry in Malaysia. This paper also introduces various Islamic financial contracts provided and give a briefly describe about the products and services. Besides, this research also

discussed about the factors of selection on Islamic banking and some current issues through the literature review.

Organization of Research

This research is divided into three sections, which includes:

- The use of literature review to find out what is the current situation about Islamic banking industries. By review these journals, I can easily identify the performance, problems and prospect about Islamic banking industry in Malaysia. This would be the first part of research. After this step, a framework will be developed and to understand the variables.
- Once the framework is being done, a questionnaire will be created to understand the revolution and the impact of Internet Banking for the users. This questionnaire will then be distributed for results.
- The third part of the research will be analyzing if the results of questionnaires scientifically and come with conclusions and reasons of particular happening. Once this is being done, then we will formulate various measures that could be done to make the situation more favourable.