

Effecting structural development in the Malaysian Islamic banking sector using conventional banking models

Riasat Amin Imon
Department of Economics
Kulliyah of Economics and Management Sciences,
International Islamic University Malaysia (IIUM), Malaysia

Abstract

To a notable extent, one of the main causes of renewed interest in Islamic Social Finance has been the academia's disillusionment with the contemporary Islamic Banking and Finance (IBF) sector's ability to break free of the conventional banking system. IBF has developed into a financial system that mirrors conventional financial practices and values, albeit with Shariah compliance. Using the Malaysian Islamic banking system as a basis, this paper makes use of extant literature and a systemic perspective to categorically identify the systemic reasons for IBF's structural development, and further proposes a practical means for achieving pointed, systemic and inclusive (stakeholder-oriented) development that has been sought in IBF. Furthermore, its propositions are grounded in a tried and tested model of conventional banking. The implications of this research are as straightforward as they are significant; that by looking at IBF development theory from a more systemic and practical perspective, there are still means to develop IBF according to its original founding values.

Keywords Islamic banking and finance development, Stakeholder model, Universal banking, Systemic development

Paper type Research paper

1. Introduction

At the time of being founded, the Islamic banking and financial system (IBF) was regarded by most Islamic economists as a mechanism that would not only espouse Islamic economic values, but through its adherence to and expediting of Islamic financial keystone values like risk and profit sharing, it would comparatively deliver more in terms of real economic value to society. Presently, after almost half a century of development, global Islamic financial reports establish that the global IBF system has amassed almost two and a half trillion US dollars in cumulative assets, while boasting a CAGR that has generally outperformed the conventional financial sector. Unfortunately, the extent to which such development has



occurred in line with fostering a risk and profit-sharing culture in economic transactions is questionable.

A closer examination of IBF's main income generators is quite telling of the nature and quality of its chosen path of development. The bulk of IBF-transactions remain in the short-term spectrum of financing (retail or consumer-debt financing), rather than addressing mid-term to long-term (equity-financing) needs. These trends are indicative of IBF developing along a path that diverges from its original founding values. Its present course of development, in fact, bears a strong resemblance to the mainstream commercial banking system, despite meeting the legal standards of Shariah compliance. The Malaysian Islamic Banking and Finance Sector (MIBFS) being no exception either, is also characteristic of all the development trends described above.

The natural questions that follow are, why global IBF has followed such trends despite strong intellectual backing to form an ethically superior financial system; and, whether it is possible for IBF to return to its original founding values? Intuitively, the answer to these two questions should be related in that, answering the former should shed light regarding how to solve the latter. In fact, determining the answers to these two questions forms the scope of this paper. In other words, this paper has two main objectives. The first is the identification of reasons for IBF development patterns, while the second is to determine the possibility of developing IBF according to standards that are more Islamic-value compatible. In order to carry out these objectives in a more expedient, pragmatic and contextual manner, the MIBFS is specifically examined as a case study.

This paper is structured according to the dual objectives identified above, thus comprising of two parts. The first part commences with the customary literature review that is centered on identifying development trends within the MIBFS, followed by theorizing about the development trends. The second part of the paper concerns the objective of pragmatically developing the MIBFS, and thus examines the literature to that extent. This is followed by the proposition of a practical theory to develop conventional Islamic banking and finance. The paper concludes with general policy recommendations.

PART A

2. Literature review

From the outset, it must be mentioned that little was found in terms of literature that addresses the overall qualitative development of the MIBFS as

a holistic system. More specifically, literature related to the development of the MIBFS takes the form of industry reports that are highly quantitative in nature (focuses on growth rate, profitability and asset accumulation). Hence, in order to conduct a literary analysis of the development patterns of the MIBFS, two bodies of specific literature require examination. The first part is a means to gauge how conventional trends may have influenced MIBFS development. Similarly, the second part is also an attempt to assess how MIBFS-development was influenced, but by Islamic intellectual discourse.

2.1. The legal framework of MIBFS: A chronological narrative

The most straightforward way to gauge how the MIBFS has developed is to create a chronological narrative of how the MIBFS has developed into its present form, based on specific areas of development. To this effect, two specific areas are chosen, namely, the legal framework of the MIBFS and the overall revenue composition of the MIBFS. These two areas are chosen because whereas the former (the legal framework) is one of the key incentive mechanisms of the MIBFS, the latter (revenue composition) is reflective of the outcomes of that legal framework. Establishing a chronological account in these areas allows for easier identification of growth trends in the MIBFS, thereby creating a basis for easier theory-generation.

The inception of the MIBFS was legally marked by the introduction of the Islamic Banking Act (IBA) on 7 April 1983. The law came into effect to chart a path of development for Malaysia's first ever full-fledged Islamic bank (FFIB), Bank Islam Malaysia Berhad (BIMB). Concurrently, the Government Investment Act (1983) was also introduced to ensure that BIMB met the national liquidity requirements (through trading of *Shariah* compliant bonds and papers). In addition, the government initiated a ten-year period of no-competition until 1993 to allow BIMB to achieve a sustainable and healthy scale of operations and bolster the MIBFS so that it may eventually hold its own against the Malaysian commercial banking sector.

This period of inception (1983–1992) was followed by a period of more competitiveness and market expansion initiated by the Interest Free Banking Scheme (IFBS) in 1993, which allowed conventional commercial banks in Malaysia to offer Islamic banking and financial services through 'windows' that were isolated and separated from the conventional bank's normal activities. The participation of conventional banks allowed the MIBFS to expand to a national scale. Another key development during this period was the introduction of the Islamic Interbank Money Market (IIMM) on 4 January 1994, which enabled Malaysian Islamic banks (MIBs) to partake in

leveraging activities.

The final phase of the legal framework development can be considered to be from 1996 until the present, which involved a period of supplementary measures to improve enforcement of the legal framework. In 1996, for example, the Bank and Financial Institutions Act was amended to better enforce *Shariah*-compliance by conventional commercial banks offering Islamic financial services. In October of the same year, Islamic financial reporting standards were introduced to ensure transparency and uniformity. Another key addition to the legal framework was the creation of the *Shariah* Advisory Council on 1 May 1997 to maintain federal oversight over *Shariah*-compliance in financial engineering and industry standards. In December 1998, the Islamic Banking Schemes (IBS) replaced the IFBS, which required that all conventional banks convert their Islamic-window-based services into independent subsidiaries. In 2001, through the Financial Sector Master Plan liberalization and deregulation of the MIBFS occurred such that the first foreign Islamic bank entered the market in 2005.

The legal framework was further bolstered by the introduction of the IFSB in 2002 to further standardize IBF procedures. In 2010, the *Shariah* Governance Framework (SGF) was introduced to ensure a more formal and comprehensive framework for *Shariah* compliance. For example, the SGF created a *Shariah*-quality control unit by mandating that all MIBs create an independent, internal audit unit. Together with the *Shariah* Committee (SC) of the bank, the *Shariah* audit unit is directly accountable to the SAC for *Shariah* compliance. In 2013, the Malaysian banking and finance laws were overhauled and replaced by the Financial Services Act (2013) (Malaysia, 2013) to oversee conventional banks and the Islamic Financial Services Act (2013) for MIBFS. On 7 March 2014, the legal framework was complemented by the addition of the “Introduction of New Products”, which oversees product development with respect to risk management. Overall, this phase has been one of more comprehensive development of the MIBFS legal framework.

A few important observations can be made based on the chronological narrative of the legal framework:

- a. The first is that the Malaysian government plays a very active and direct role in the development of the MIBFS. Ever since BIMB’s inception, the government has been key in determining aspects of the MIBFS such as the competitive landscape and even the internal corporate structures of MIBs through the SGF and other similar legislation.

Simply put, the government has determined the direction of development of the MICBS.

- b. Secondly, the creation of support provisions such as the GIA and support mechanisms such as the IIMM, indicate that Islamic banks were being fit into a financial landscape that mimics the financial framework of conventional banks, although the Malaysian financial system is touted as a dual banking system. Both systems inherently follow the same dynamics and contain the same underlying incentive-mechanisms.
- c. The formation of the IIMM is likely to have created an even stronger dependency on the conventional banking and finance development path by emphasizing leveraging and hedging that ultimately bolstered short-termism and ties with capital markets (their Islamic equivalents).

2.2. Revenue composition: A chronological narrative

The first ever Malaysian financial institution to be bound by *Shariah* principles was known as the Lembaga Urusan dan Tabung Haji (LUTH). Tabung Haji, as it is simply known today, was formed in 1962, and functions as a classical savings bank. Its main function to date is to manage the funds of those who would like to go for pilgrimage in future (Mokhtar, Abdullah, & Al-Habshi, 2008). Unfortunately, despite its pioneering status, it never formed the basis of the MIBFS when BIMB was formed in 1983.

From the very start of the MIBFS, BIMB offered both Profit and Loss sharing (PLS) as well as debt-based services. However, of the two, the latter type formed the bulk of MIB earnings, especially the BBA (or *Bai Bithaman Ajiil*) contract (Razak, Mohammed, & Taib, 2008). Ariff (1988) identified this trend within the first five years of the inception of the MIBFS, describing it as an overreliance on debt-based mechanisms, and reflecting concern over this trend (Ariff, 1989) since it represented a clear shift from one of IBF's core founding values, which emphasized risk and profit-sharing financing methods. This trend was presumably allowed to continue because of the nascent nature of the industry. This presumption is supported by the fact that there were no changes made to the legal framework to address this trend, even though the government was particularly proactive in the MIBFS.

With the passage of time, the competitive landscape witnessed new entrants into the market, in the form of Islamic subsidiary banks (formerly Islamic windows of conventional commercial banks), another fully fledged Islamic bank (Bank Muamalat), and foreign Islamic banks and Islamic subsidiary banks. Despite these significant changes to the competitive

environment, little impact was felt on the debt-base of the MIBFS. Chong and Liu (2009) note the difficulty of statistically differentiating between conventional and Islamic banks because of their large debt base. This implies that though there were more players in the field, little was happening in the product innovation department with respect to equity-based financing. Bin-Bahari's (2009) study confirms this view. Whereas several additions were made to Islamic banking products, his study of the revenues generated from each type and category of products indicated a low preference for equity-based financing.

Several studies exist that establish the risk-shifting nature of Islamic banking contracts including Askari, Iqbal, and Mirakhor (2011), Mirakhor and Zaidi (2007) and Siddiqi (2000). A later study by Chatti, Kablan and Yousfi (2013) empirically assesses the degree of product diversification based on the products offered by eight different MIBs. The study finds that debt-based products are more preferable as they are comparatively more profitable. Interestingly, the paper further suggests that one of the important ways MIBs should increase profitability is by engaging more in the capital markets. This recommendation implies that the path to further profitability means an even deeper entrenchment in debt-oriented activity. Studies by Dusuki and Abdullah (2007), Dusuki and Bouheraoua (2011), Mohammed and Shahwan (2013) and Mohammed, Tarique, and Islam (2015) affirm that IBF has moved away from its founding values. To conclude the second part of this literature review, a few observations must be made:

- a. Dependence on the debt sector has been a consistent feature of the MIBFS from the start to the present.
- b. Competitive pressures have had little effect on the dependence on a debt base. In fact, the opposite is likely to be true. As competition increases, MIBs are likely to opt for risk-shifting mechanisms to minimize risk.
- c. Product innovation has been restricted to the area of retail financing. The most likely reasons for this are because of MIBs opting for a risk-minimizing strategy to compete, and also because product innovation is being driven by the conventional banking and finance sector.
- d. Market-driven incentives, in themselves, have not led to any risk/profit-sharing-driven innovation. This implies that the only likely means to introduce structural change into the MIBFS would be through external means.

2.3. A review of intellectual discourse regarding Islamic banking norms

As the title of this section suggests, the literature reviewed pertains to the normative aspects of IBF in general. This is because the critics of IBF maintain that it should structurally change to focus on Islamic values, such as, risk sharing and becoming more stakeholder-oriented (as opposed to shareholder-driven). At a macro level, one of the biggest concerns is the periodic economic and financial instability caused by the conventional financial sector (Chapra, 1985). Razak, Mohammed, and Taib (2008) qualify that (Islamic) financial systems are meant to be socially responsible. Ibrahim, Mohammad, Hoque, and Khan, 2014; Khan, 2019; Khan, Bhuiyan, Hoque, and Molla, 2015; Uddin, Khan, and Mohammad, 2015; Uddin, Khan, and Farhana, 2014; and Rosly and Afandi (2003) all hold the same view regarding the socioeconomic mandate of the Islamic financial system.

Regrettably, despite the clear ideological stance taken by these exceptional scholars, there is little literature in the way of how to move from the present context of the MIBFS to a state where it leads to favorable socioeconomic outcomes. Chapra's (1992, 2016) model, for example, calls for a grassroots level change at the economic level that is akin to a financial revolution. There are a few who refer to Islamic Banking and Finance development from the contemporary context, such as, Asutay (2012), Bacha and Mirakhor (2015) and Al-Jarhi (2005). Asutay accepts the stubbornness of IBF to change in favor of Islamic norms and calls for a new pillar of finance that can offset the problems caused by contemporary IBF. Unfortunately, this approach does not directly address the structural problems in the MIFBS.

Bacha and Mirakhor (2015) propose a model whereby the underlying assets of retail financing products are securitized and issued as *sukuk*-bundles, which are then traded in the IIMM. Although the model is based on the desired attribute of risk-sharing, the novelty of such a model being adopted purely depends on the government's discretion. Al Jarhi's (2005) proposition of an alternative banking model appears to be pragmatic as he proposes the German and Tokyo universal banking models as a means for developing IBF. Unfortunately, his proposition is based on the elimination of interest, which, though ideologically noble, becomes difficult to relate to the present context, especially since there is no clear outline on how to move from the present context to the interest-free universal banking model he proposed.

This deliberation on the literature regarding intellectual discourse makes it clear that there is little in the way of a formal model that aims to

categorically move the MIBFS to a more preferable value system from an Islamic perspective. Another issue that is apparent is that there are no practical models that can be compared and contrasted against the present form of the MIBFS. Without such a model, it is difficult for the government to justify a move from the conventional system. The same can be said about practitioners whose livelihood is directly connected to the MIBFS. To conclude this section, it can be said that IBF norms are strongly backed by norms that are difficult to practically realize owing to their ideological nature and/ or radical shifts required to realize them and/ or the novelty of a model. In the end, the intellectual contributions to realize IBF norms were not pragmatic enough to be seriously considered by the government or industry.

3. Theorizing about the MIBFS development process

The first objective of this paper is to determine a theory of MIBFS development. The literature review carried out in terms of the chronological development of the legal framework, revenue composition, product innovation, and intellectual discourse to initiate structural change, is quite revealing in terms of the characteristics of the industry.

3.1. Government-led growth

The first and probably most important characteristic of the MIBFS is that the government has played a crucial role in shaping the development patterns of the MICBS. From its initiation phase, through to its liberalization, expansion and consolidation phases, the government has provided legislative support, regulatory frameworks and support institutions that have allowed the MIBFS to grow and foster. This leads to another key-issue in MIBFS development, which is, on what basis has the government initiated such change in the MIBFS? Was there a particular philosophy behind its decisions to make adjustments to the legal framework?

3.2. Conventional framework

The answer to this question was already determined in the literature review section and highlights the second important characteristic of the MIBFS development, which is, that the government was developing the architecture of the MIBFS according to the conventional financial sector. This can be gleaned from different periods throughout the MIBFS existence. For example, during its early stages of development, the government created the IIMM based on the conventional banking framework. Even when observing the overall trajectory of MIBFS development, it has evolved in line with conventional standard, where the MIB starts with its main activities in retail

financing, but grows to depend more on capital market operations that involve hedging and leveraging. It is important to question why the government may have adopted the conventional financial sector as its reference point to develop the MIBFS. The most intuitive answer to this question lies in answering another related question: What are the other alternatives available to the government? This issue was explored in more depth in the second part of this literature review (pertaining to Islamic intellectual discourse). Based on that section, it was clear that the intellectual discourse did not yield plausible alternatives that could be acted upon.

3.3. Induced structural change

This also highlights another important reality regarding the MIBFS, and that is any value-oriented change such as the incorporation of risk-sharing values has to occur through deliberate intervention. Whereas the government has played a role to ensure that *Shariah* compliance is comprehensive and practically enforceable, it has not gone beyond this standard of Islamic jurisprudence. Over the past five decades of Malaysian Islamic banking, there has been no urges on the part of the market to innovate towards standards that are pro-risk-sharing. In other words, without deliberate action from the government, the incentives within the MIBFS are insufficient to motivate it towards a value system that is more preferable in Islam. Instead, the MIBFS will adopt the values of the prevailing system.

3.4. No pragmatic alternatives to initiate meaningful change

The final part of this literature review establishes that there was little in terms of the propagation of a pragmatic model that can be used as a means to attain structural change to realize Islamic norms and values in MIBFS. This is a possible reason why the MIBFS has remained structurally unchanged, despite a strong presence of literature disputing the current practices of the MICBS.

3.5. Theorizing about the MIBFS development process

Based on the characteristics outlined in the previous sections, the following generalizations are put forth:

- a. The MIBFS was initially designed according to the conventional banking and financial system because of the lack of practical viable alternatives. In spite of these deficits, IBF was expected to provide financing solutions to the Muslim world. The only viable model was the tried and tested conventional financial model which was hybridized

- to include a *Shariah*-compliance component.
- b. The MIBFS-development eventually became emulating in nature. The pressure to emulate comes from the incentive mechanisms within the financial framework that result from mimicking conventional financial frameworks and institutional arrangements. In other words, emulation is a systems-level problem that imposes itself on IBF in general, and occurs at all levels of development.
 - c. The main consequence of emulating a financial system is the adoption of its core values. Frameworks and institutional arrangements are not coincidental, but a deliberate reflection of the norms and value propositions of the economic system within which they arise. Thus, the conventional financial framework is value-loaded, and adoption of such frameworks is akin to adopting its value system. This explains why the MIBFS is based on risk-shifting practices and has a debt-based orientation. The value-frameworks are likely to cause further entrenchment of the sub-system (MIBFS) within the host-system (conventional financial system).
 - d. Thus, the way to develop the MIBFS is to provide it with an alternative, pragmatic system that is value-compatible with Islamic norms, to emulate. This may be termed as a systems-level solution to the structural problems faced by IBF in general, and the MIBFS in particular. It is important to note that a financial system that has compatible values with Islamic norms must be the product of an economic system with a similar value-system to an Islamic economy.

Thus, the MIBFS development trends are the result of its structural dependence on the conventional Malaysian banking and financial system. In order to stop this systemic dependence, a pragmatic alternative banking and financial system is necessary to act as a role model. However, does a banking system that upholds values similar to Islamic norms, truly exist? This issue is addressed in the second part of this paper.

PART B

4. Choosing the appropriate system to emulate

The second part of this paper addresses the other objective identified earlier, which is to identify possible ways to develop the MIBFS according to its core value system. As outlined earlier, a meaningful approach to addressing the systemic problem of the MIBFS is to find an alternative banking system with an Islamic value system that it can follow. Unfortunately, this is unlikely to

happen for two reasons. The first is because of the impossibility of finding an existing Islamic economic system with a financial system that espouses its values. The solution to this issue is a compromise that involves choosing an economy and financial system that is closest to the Islamic value system. Granted, this may not result in a comprehensive solution, however, progress may occur in a relative sense, where at least some criteria are being fulfilled in comparison to the previous situation.

The second reason finding a compatible banking system may be difficult is because not every banking system emerges directly out of the value system of its economy. Globalization has ensured the mobility of corporate governance designs and structures, which have been adopted by economic systems that are of a different value-orientation. For example, the Malaysian conventional financial system has evolved to adopt many mainstream (Anglo-Saxon) banking features and practices, even though its market values are relatively more conservative. Similarly, though many European countries like France and Italy operate on a Rhenish-capitalistic model, their banking systems are modeled after the mainstream (Schmidt, Bülbül, & Schüwer, 2014). This means that there may be incongruencies and asymmetries between the values of a host-system and its sub-system. This problem can be mitigated by carefully examining the roots of the financial system of interest. The mainstream Anglo-Saxon banking model has been adopted almost universally, which makes alternative (non-mainstream) banking models more easily identifiable.

Taking the above considerations into account, this paper has selected the German banking system (GBS) for MIBFS emulation. The values of the German economic system and the features of its banking system are examined in a literary overview in the next section.

4.1. Literature review of the German banking system

This literature review first examines the nature of the German economic model from a systems perspective and outlines the structure and unique features of its banking system. Next, it highlights the value-compatibilities of GBS with the Islamic value system. Finally, the performance of the GBS is examined to determine its overall capability to be a source of development. The German economic system, like many countries in Europe, is a variation of Rhenish capitalism. However, Hall and Soskice (2001) maintain it as the ideal representation of a Rhine capitalistic economic system, since it has strictly preserved its unique blend of social and market values. The German economic system is also known as a social market economy (SME). Its paradigm contrasts from the free market principles of Anglo-Saxon

(American) capitalism in that market freedom is checked by social balance (Müller-Armack, 1989). More specifically, the German economic system follows a variation of liberalism called *ordoliberalism* that is diametrically opposed to the contemporary definition of liberalism. Whereas *ordoliberalism* manifests through a stronger presence of the government, the Anglo-Saxon concept of liberalism is contingent upon less government intervention (Bonefeld, 2012). Its national policies are guided by social market principles and *ordoliberalism*.

The German banking system is also unique as it has preserved its original banking model (classical banking system) while also evolving to incorporate modern banking practices (Koetter, Nestmann, Stolz, & Wedow, 2004). The result is the unique Three Pillar Banking System (3PBS), which, because of its comprehensive nature, is also referred to as a universal banking system (Hackethal, 2003). The first pillar consists of the commercial arm of banks, which are no different from the Anglo-Saxon banking model. The second pillar is composed of savings banks. In contrast to the commercial banks, which operate at a global scale, savings banks are much smaller and operate within a designated region. Although the decision-making mechanism follows conventional corporate governance models, the ownership base is much wider in that it consists of stockholders as well as regional government representatives (Koetter, Nestmann, Stolz, & Wedow, 2004). These banks typically provide medium term to long term finance to regional businesses. Owing to the wider stakeholder base, decision making tends to be more inclusive. The third pillar of the GBS involves cooperative banks, which are no different in terms of their operation to traditional cooperatives. Decisions are jointly made with the best interests of the banking, business and social community of the region in mind. Once again, the decision making is more inclusive owing to the overlapping interests of the stakeholders that make up the ownership base of the cooperative bank. Like savings banks, they are regionally focused and provide medium to long term funding to regional businesses.

4.2. Relative benefits of the German banking system over mainstream banking from an Islamic perspective

One of the main criticisms of mainstream banking systems is that ownership and governance models have the interest of the shareholder at heart. Known as shareholder-based models, these structures are criticized for lacking a social mandate as there is no direct obligation to other stakeholders of society. It is true that the savings and cooperative banks of the GBS are not the perfect representation of a stakeholder model, but comparatively, they

have more representation than mainstream banks (and MIBs by extension) as they include a regional mandate. As such, there is a commitment to ensure that the welfare of the bank does not come at the cost of the regional welfare and vice versa (Schmidt, Bülbül, & Schüwer, 2014). Such a model also ensures that regional projects are longer term in nature and promote regional development.

Another unique characteristic of German savings and cooperative banks that is not often considered as important is that they are required by law to operate within a specific geographical region or province (Schmidt, Bülbül, & Schüwer, 2014). This has three important implications. First, this ensures that finance is more uniformly available across all regions of the country, ensuring more balanced regional development. Second, bank concentration tends to be lower limiting competition to a certain level, and also limiting the size of banks. The limited scale of banks may have implications on the cost of lending, but it also ensures that the bank is not large enough to ignore smaller business funding requirements. Finally, a regional focus ensures that deeper relationships are forged between different stakeholders, which can be argued to have a positive effect in the efficacy of lending and repayment rates. It is the benefit of such relationships that could possibly outweigh the loss in scale economies.

Another characteristic of the conventional financial system that the MIBFS has adopted is a short-term focus on financial transactions that has led to it focusing on debt-financing (Mirakhor, 2010). The savings and cooperative banks of the GBS, in contrast, focus on medium to long term financing methods. This focus on equity financing has in turn promoted long term real benefits such as a larger productive base that promotes consumer welfare, more job opportunities, higher incomes and trickle-down effects. One cannot help but feel that this form of growth is more balanced and promotes real economic growth.

The final significant benefit of the GBS is its notable performance during times of financial crises. Studies conducted by Schmidt, Bülbül, & Schüwer, (2014), Koetter, Nestmann, Stolz, & Wedow, (2004) and Gulzar (2016) establish that the two unique pillars of the GBS were surprisingly unscathed and stable during the subprime mortgage crisis. Although profitability initially fell, it did so only marginally and recovered much earlier than the commercial pillar. This is to be expected since savings banks and commercial banks were insulated from the global effects of the crisis owing to their regional focus. In contrast, of the five studies conducted specifically on the effects of financial crisis on the MIBFS, Čihák and Hesse (2010), Karwowski (2010), Kassim and Majid (2010) and Wahid and Dar (2016) find

that crisis is generally more destabilizing, whereas Kaleem (2000) concludes that the MICBS is relatively more crisis proof (compared to the Malaysian conventional banking system). However, Kaleem's study was indirect in that it was measuring the efficacy of monetary policy during a crisis period.

Thus, from an Islamic value-perspective, the second and third pillars of the GBS can relatively add more value in terms of being more inclusive (thereby directly catering to the welfare of more stakeholders); a regional focus that balances the welfare and relationships of regional stakeholders; a long-term focus that promotes equity financing and long term real economic welfare; and finally, more real economic and regional stability at times of financial crisis.

4.3. Relative benefits of the MIBFS over German savings and cooperative banks
There are two areas where the MICBS may be considered superior to the savings and cooperative banks of the GBS, the first being with respect to the use of interest-rates. Whereas the GBS relies on interest rates, the MIBFS does not. However, as noted by El-Gamal (2003) and Chong and Liu (2009), the MIBFS is still based on the base interest rate even though it does not explicitly do so. Thus, the interest-free point must be accepted with a grain of salt.

The second area where the MIBFS may be considered superior to the latter two pillars of the GBS is in terms of profitability and performance. A study conducted by Gulzar (2016) in this regard finds the MIBFS to be significantly more profitable and efficient. She attributes these qualities to the fact that the MIBFS is committed to profitability, whereas the German banks are more committed to social goals, and therefore compromise on profitability and efficiency standards. This finding, too, must be accepted with caution as the ratios used by Gulzar to gauge comparative efficiency and profitability included data from the conventional mainstream financial sector. Thus, it is likely that efficiency and profitability of subsidiary Islamic banks may have been influenced by the conventional parent bank.

5. Overall conclusions

The newfound interest in Islamic social finance conveys the impression that all hope is lost in bringing the MIBFS closer to its founding values. This paper proves that there has been an oversight in this regard. This oversight may have been caused by a "black-and-white" approach to addressing Islamic economic and financial problems, wherein the solution to an exclusively Islamic problem must lie within purely Islamic sources and constructs. This oversight may also have been caused by lumping all conventional banking

systems into one as “western” or “conventional”, thereby overlooking the shades of grey within conventional economic and normative systems. The consequences of such oversight are serious as there is a tendency and risk of overlooking pragmatic solutions that exist within conventional frameworks.

A ‘light’ systems-level analysis of the MIBFS development patterns has led to the exploration of practical alternative strategies that are, albeit their imperfections, still capable of bringing meaningful, structural change through emulation of the right system. Instead of viewing change in absolute terms, it could be realized in more relative, gradual terms. By altering the scope of analysis to a systems level, the nuances of different banking systems, such as their values, become more appreciable, for example, the relatively better stakeholder representation, commitment to regional welfare and real economic development in the form of focusing on longer term equity financing are all values that are espoused in Islam.

In terms of adopting meaningful change, the Malaysian Islamic finance industry should not feel threatened by the emulation of the GBS. This is because in order to follow the GBS, the MIBFS requires additions to its present framework (in the form of a savings and cooperative pillar with regional focal points), rather than any form of deconstruction or elimination. The development of such pillars not only stand to develop the MIBFS, but also the real economic landscape in terms of SME growth, more potential employment, expansion of the economic productive base and overall socioeconomic welfare.

Finally, it is hoped that this research fosters the realization that there are likely to be other economic systems that harbor values that are compatible with Islamic ones, and whose banking systems may serve as a potential source of development for the IBF system in general.

Notes

- a. In comparison to conventional banking and finance contracts
- b. If the yardstick is defined as the degree of risk or profit-sharing based financial transactions
- c. The act of bundling of the *sukuk* papers disperses the risk across different individuals

References

- Al-Jarhi, M. A. (2005). The case for universal banking as a component of Islamic banking. *Islamic Economic Studies*, 12(2) & 13(1), 1-65.
- Ariff, M. (1988). Islamic banking. *Asian Pacific Economic Literature*, 2(2), 48-64.
- Ariff, M. (1989). Islamic banking in Malaysia: framework, performance, and lessons. *International Journal of Economics, Management and Accounting*, 2(2), 67-78.
- Askari, H., Iqbal, Z., & Mirakhor, A. (2011). *New Issues in Islamic Finance and Economics: Progress and Challenges* (Vol. 753). John Wiley & Sons.
- Asutay, M. (2012). Conceptualising and locating the social failure of Islamic Finance: Aspirations of Islamic moral economy vs. the realities of Islamic finance. *Asian and African Area Studies*, 11(2), 93-113.
- Bacha, O. I., & Mirakhor, A. (2015). *A risk sharing banking model*. Paper presented in the Inaugural Annual Symposium on Islamic Economics and Finance. The World Bank & IDB Istanbul.
- Bin-Bahari, Z. (2009, July 2-3). *The changes of product structure in Islamic banking: Case study of Malaysia*. Paper presented in the Islamic perspectives on management and Finance (UK), organized by School of Management, leicester University. downloadable: www.eprints.usm.my.
- Bonefeld, W. (2012). Freedom and the strong state: On German ordoliberalism. *New Political Economy*, 17(5), 633-656.
- Chapra, M. U. (1985). *Towards a just monetary system* (Vol. 8). Virginia, United States: International Institute of Islamic Thought (IIIT).
- Chapra, M. U. (1992). *Islam and the economic challenge* (No. 17). Virginia, United States: International Institute of Islamic Thought (IIIT).
- Chapra, M. U. (2016). *The future of economics: An Islamic perspective*. Kube Publishing Ltd.
- Chatti, M. A., Kablan, S., & Yousfi, O. (2013). Are Islamic banks sufficiently diversified? An empirical analysis of eight Islamic banks in Malaysia. *Islamic Research & Training Institute (IRTI)*, 21(2), 23-54.
- Chong, B. S., & Liu, M. H. (2009). Islamic banking: Interest-free or interest-based? *Pacific-Basin Finance Journal*, 17(1), 125-144.
- Čihák, M., & Hesse, H. (2010). Islamic banks and financial stability: An empirical analysis. *Journal of Financial Services Research*, 38(2-3), 95-113.
- Dusuki, A. W., & Abdullah, N. I. (2007). Maqasid al-shari'ah, Maslahah and corporate social responsibility. *The American Journal of Islamic Social Sciences (AJISS)*, 24(1), 25-45.

- Dusuki, A. W., & Bouheraoua, S. (2011). The framework of Maqasid al-Shari'ah and its implication for Islamic finance. *Islam and Civilisational Renewal*, 2(2), 316.
- El-Gamal, M. A. (2003). Interest and the paradox of contemporary Islamic law and finance. *Fordham Int'l LJ*, 27(1), 108-139.
- Gulzar, R. (2016). *German banks: More Islamic than Islamic banks?* Unpublished Master dissertation: INCEIF, Kuala Lumpur. Retrieved from <https://ikr.inceif.org/handle/INCEIF/2385>
- Hackethal, A. (2003). *German banks and banking structure. Working Paper Series no 106*. Finance & Accounting, Johann Wolfgang Goethe-Universität Frankfurt A. M.
- Hall, P. A., & Soskice, D. (Ed.). (2001). *Varieties of capitalism: The institutional foundations of comparative advantage*. OUP Oxford.
- Ibrahim, M., Mohammad, K. D., Hoque, N., & Khan, M. A. (2014). Investigating the performance of Islamic Banks in Bangladesh. *Asian Social Science*, 10(22), 165-174.
- Iqbal, Z., & Mirakhor, A. (1999). Progress and challenges of Islamic banking. *Thunderbird International Business Review*, 41(4-5), 381-405.
- Kaleem, A. (2000). Modeling monetary stability under dual banking system: The case of Malaysia. *International Journal of Islamic Financial Services*, 2(1), 21-42.
- Karwowski, E. (2010). Financial stability: the significance and distinctiveness of Islamic banking in Malaysia. In Minsky, *Crisis and Development* (pp. 207-244). Palgrave Macmillan, London.
- Kassim, S. H., & Majid, M. S. A. (2010). Impact of financial shocks on Islamic banks: Malaysian evidence during 1997 and 2007 financial crises. *International Journal of Islamic and Middle Eastern Finance and Management*, 3(4), 291-305.
- Khan, M. A. (2019). Crowdfunding for entrepreneurship development through Islamic Banks: A systematic literature review for developing a model. *Saudi Journal of Business and Management Studies*, 4(6), 532-540.
- Khan, M.A., Bhuiyan, M.Z.H., Hoque, N., & Molla, R.I. (2015). Motivational and socio-economic factors that influence the goals and business performances of entrepreneurs in Bangladesh. *Malaysian Accounting Review*, 14(2), 79-98.
- Koetter, M., Nestmann, T., Stolz, S., & Wedow, M. (2004). *Structures and trends in German banking. Kiel Working Paper no 1225*.
- Malaysia, B. N. (2013). *Islamic Financial Services Act 2013*. Kuala Lumpur, Malaysia: Bank Negara Malaysia.

- Mirakhor, A. (2010). *Whither Islamic finance? Risk sharing in an age of crises*. MPRA Paper No. 56341. Oxford Centre for Islamic Studies.
- Mirakhor, A., & Zaidi, I. (2007). Profit-and-loss sharing contracts in Islamic finance. *Handbook of Islamic banking*, 49(1), 2-37.
- Mohammed, M. O., & Shahwan, S. (2013). The objective of Islamic economic and Islamic banking in light of Maqasid Al-Shariah: A critical review. *Middle-East Journal of Scientific Research*, 13, 75-84.
- Mohammed, M. O., Tarique, K. M., & Islam, R. (2015). Measuring the performance of Islamic banks using maqasid-based model. *Intellectual Discourse*, 23, 401-424.
- Mokhtar, H. S. A., Abdullah, N., & Al-Habshi, S. M. (2008). Efficiency and competition of Islamic banking in Malaysia. *Humanomics*, 24(1), 28-48.
- Müller-Armack, A. (1989). The meaning of the social market economy. In Germany's *Social Market Economy: Origins and evolution* (pp. 82-86). UK: Palgrave Macmillan.
- Razak, D. A., Mohammed, M. O., & Taib, F. M. (2008, June 24-26). *Consumers' acceptance on Islamic home financing: Empirical evidence on Bai Bithaman Ajil (BBA) in Malaysia*. Paper presented at IIUM International Accounting Conference IV (INTAV), Marriot Putrajaya Hotel, Malaysia.
- Rosly, S. A., & Afandi A. M. (2003). Performance of Islamic and mainstream banks in Malaysia. *International Journal of Social Economics*, 30(12), 1249-1265.
- Schmidt, R. H., Bülbül, D., & Schüwer, U. (2014). Savings banks and cooperative banks in European banking systems. *Bezpieczny Bank*, 2(55), 38-49.
- Siddiqi, M. N. (2000). Islamic banks: concept, precept and prospects. *Review of Islamic Economics*, 21-36.
- Uddin, M. M., & Khan, M. A., & Mohammad, K. D. (2015). Interest-free banking in Bangladesh: a study on customers' perception of uses and awareness. *Abasyn Journal of Social Sciences*, 8(1), 1-16.
- Uddin, M. M., Khan, M. A., & Farhana, N. (2014). Banking services and customer perception in some selected commercial banks in Bangladesh. *Indonesian Management and Accounting Research*, 13(1), 1-15.
- Wahid, M. A., & Dar, H. (2016). Stability of Islamic versus conventional banks: A Malaysian case. *Jurnal Ekonomi Malaysia*, 50(1), 111-132.

Corresponding author

Riasat Amin Imon can be contacted at: riasat@iium.edu.my