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"INNOVATION AND TRANSFORMATION IN ISLAMIC BANKING, ACCOUNTING AND FINANCE: ISSUES, OPPORTUNITIES AND CHALLENGES"

“INNOVATION AND TRANSFORMATION IN ISLAMIC BANKING, ACCOUNTING AND FINANCE: ISSUES, OPPORTUNITIES AND CHALLENGES”

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ISLAMIC MICROCREDIT FOR WOMEN MICRO ENTREPRENEURS: IMPACT FOR SAHABAT

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Abstract

In recent years, microcredit facilities have been increasingly popular in many developing and less developing countries. Its advantageous to the lower income groups have opened the eyes of many sectors of its parts in today's competitive market. Amanah Ikhtiar Malaysia (AIM) is one of the Islamic microcredit providers in Malaysia. This paper reflects the author's empirical observation in the Women in Social Enterprise (WISE) project whereby the first author became the supervisor for students involved in the project. Using a case study method, this particular paper illustrates profiles of AIM's client or known as *Sahabat* with the endeavour to understand of how microcredit facilities were utilised in their business ventures. Findings showed that the Islamic microcredit facilities have been effectively aided the women micro entrepreneurs in Malaysia, especially the *Sahabat*. This paper concludes with exemplified lessons learned from the *Sahabat* as this is important to provide guidance as well as motivation to the nascent or potential women micro entrepreneurs in Malaysia.

Keywords: *Islamic microcredit, women micro entrepreneur, case study*

1. Introduction

Microcredit plays an important role in helping micro entrepreneurs in running their businesses. Bangladesh, for example, which has a lowest wage structures in the world have successfully implemented microcredit program in an effort to provide financial assistance to the small business owners (Rahman, 1999; Alam, 2010). The microcredit program was introduced by Garmeen Bank (Yunus, 1993 as cited in Alam 2010) and implemented to poor self-employment group members; women entrepreneurs particularly. The success of this program has showed that their target group which is women entrepreneurs have given positive results by providing financial aid in running

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their businesses (Rahman, 1999). Following to the success of microcredit program in Bangladesh, Malaysia through Amanah Ikhtiar Malaysia (AIM) has adopted the approach of using Islamic microcredit program and applied to the *Sahabat* who are the members of AIM (consisting of the less fortunate and small entrepreneurs in Malaysia). Thus, this paper examines from the exemplified lessons learned from the *Sahabat* in offering guidance and motivation to the nascent or potential women micro entrepreneurs in Malaysia.

2. Literature Review

Citing from Obamuyi (2009, pg.73), "microcredit refers to the activity in providing financial resources to those who are excluded from traditional financial system which the main mission to assist the needy (the unemployed or the poor) in the form of microcredit or savings". On the other hand, Ahmed (2004) mentions that microcredit is a one of the financial innovations that aims to help various segments of society. The concept of microcredit is also applied in Islamic financial institutions where the difference is seen in financial assistance given to the needy (Rahman, 1999) is based on *Sharia* or Islamic law (Ahmad & Hassan, 2009).

Different from conventional banking financial innovation products, Islamic microcredit is not interest-based (Ahmed, 2004) or interest-free (Alam, 2010) micro finance product. Characteristics of Islamic microcredit are also similar to other Islamic financial products in which it follows the value system of the *Qur'an* and *Sunnah* which neglect the element of *riba*, *gharar* and *maysir* (Ebrahim & Joo, 2001). In addition, Ebrahim and Joo (2001) mentions the need for Islamic microcredit are to help in increasing the economic growth of Islamic countries with developed financial markets, institutions and instruments, and also promote the slow shock risk sharing in economic output.

In Malaysia, Islamic finance institutions have evolved over the past 10 years involving government and private sectors (Laldin, 2008). Since then, the growth of Islamic financial institutions showed positive developments in Malaysia (e.g. Bank Islam Malaysia Berhad, Al-Rajhi Bank; just to name a few). However, the activities

of those Islamic financial institutions are also similar to conventional banking with more focused on big-scale function/macro finance and not to micro finance (Ahmed, 2004). Thus, there is an initiative to the establishment micro finance institutions with focused to poverty group and small entrepreneurs (Ahmed, 2004).

One of Islamic micro finance institutions that promoting the microcredit program is Amanah Ikhtiar Malaysia (AIM). The objective of this organisation is to assist groups that are less fortunate and at the same time to reduce poverty in Malaysia by means financing poor communities in rural areas. The establishment of AIM is inspired by the ideas of Prof. Muhammad Yunus by the establishment of Grameen Bank. The chronology of the establishment of AIM has taken many years until it can stand as an organisation which to carry out efforts to attract out of the rural community of the problems plaguing the poverty of their lives. Three main objectives carry by AIM that is; 1) to reduce poverty among the poor in Malaysia by providing microcredit fund to them, 2) to provide continuing financial facilities to entrepreneurs and 3) to provide guidance and training to poor households, the needy and the entrepreneurs. AIM has three products to offer to their *Sahabat* includes *Ikthiar Rezeki*, *Ikthiar Penyayang*, *Ikhtiar Bestari*, *Ikhtiar Sejahtera* and Urban Micro Finance Program. AIM has now reached to two decades age and successful in producing many small entrepreneurs and bring urban and rural communities out of poverty. The number of *Sahabat* (members) has also increased by nations and years.

Women entrepreneurs in Malaysia have proven successful in helping in increasing their family economy and the nation in general. Previous studies have shown increased participation of women in Malaysia SMEs (Alam, Jani & Omar, 2011; Teoh & Chong, 2008). For instance, in 2005, 16 percent were women-owned companies in variety fields such as in services sector, manufacturing and agricultural sector (as cited in Teoh & Chong, 2008). With regards to this positive trend of Malaysian women participation in entrepreneurship, AIM has set their mission by helping this group in developing their business (Mamun, Adaikalam & Mazumder, 2012). Women ventures in small business especially in rural areas are among the target groups of AIM by providing assistance with financial aid (Mamun, Adaikalam & Mazumder, 2012). Until now, through the microcredit program of AIM, it has increased the

microenterprise assets among the women entrepreneurs (Mamun, Adaikalam & Mazumder, 2012).

3. Methodology

This study employed a case study approach as suggested by Yin (2009) to gain an in-depth study about the research topic. This paper will specifically illustrates on how two *Sahabat* utilising upon the microcredit facilities provided by AIM for their business venture. The idiographic explanations inherent in the case study approach enabled a deeper understanding and detailed in-depth information that provided credible and valuable knowledge about the case. Primary data were gained through in-depth interview sessions with five *Sahabat* in a smart-partnership program between Ministry of Higher Education of Malaysia (MOHE) and AIM called Women in Social Enterprise (WISE). It was a program whereby certain participated universities provide students to stay 30 days with selected *Sahabat*. During their stay, students perform observation and also provide informal consultation to their 'adopted mother'. The author was assigned to supervise the students and also provide consultation to the *Sahabat*. Interview notes were then transcribed and reviewed for consistency. Inconsistencies were clarified with the entrepreneurs. The data collection method also involved establishing a case study database consisting of records and documentation of the business operation. Finally, a final case write-up documenting the business events and lessons learned was verified with the selected *Sahabat*. This paper profiles of two *Sahabat*'s business journey.

4. Findings & Discussion

Sahabat 1

Having survived on an unstable income from direct selling, Puan Siti decided to apply for a start-up capital of RM2,000 from AIM in 2007. She got to know about the microcredit financing scheme through newspapers. Inspired by her children's fascination with stationery products, Puan Siti was confident that she could never go

wrong with a stationery business. Therefore, she opened a stationery and gift shop under the name of Blueberry Tree at Taman Bandar Senawang in Negeri Sembilan.

"I managed to stock up the store with the loan and almost immediately started making a profit as children loved buying stationery. Everyone needs stationery, including adults. It's a lucrative business," Puan Siti asserted.

According to Puan Siti, she earned profits in the first few months which were used to roll stocks for the business. The mother of two continued borrow from AIM every year but always made it a point to repay the loans on time. Between 2007 and 2011, she had borrowed up to RM104,000 from AIM. It is quite a large amount for *Sahabat* like her.

Currently, she had opened two branches at Felda Bukit Jalur in Gemas and at a business complex in Alor Gajah, Malacca. Puan Siti also started sourcing for unique stationery from suppliers to improve her business.

"My children spend hours at stationery shops and have a habit of collecting unique stationery products. Like them, adults are also attracted to unique stationery. I then started sourcing for trendy products. To make the business even more exclusive, we introduced gifts and ornaments and true enough, our business started booming," alleged Puan Siti.

All of the Blueberry Tree branches now also provide hamper wrapping and delivery services based on demand, especially during festive seasons. Puan Siti has always being encouraged and motivated by her husband, Encik Shahrol, a former accounts clerk. To diversify their little business, Encik Shahrol sourced for school bookshop tenders and managed to secure one from SK Lavender Heights in Senawang.

Encik Shahrol also attended and successfully completed a couple of technical courses to repair mobile phones. He then put his skills to good use by opening a mobile phone sales and services counter within their shop. They also provide photocopy service to their customers. Today, Blueberry Tree makes a combined gross profit of up to RM100,000 and the couple take home a net profit of up to RM15,000 monthly.

When asking about her future plan, Puan Siti mentioned that she would like to expand her business by opening another branch for school bookshop seeing the profitable business ahead. She is optimist in her decision to enter this business which is mostly controlled by the non-Malay and also the males.

Sahabat 2

Talking about D'Kaz pineapple tart, Puan Azizah is the master chef of the juicy and delicious tart. Started in 2005, she operated at her backyard and sold the tart to her colleagues and neighbours. After received good response from her customers, she decided to concentrate on her business and grow larger. She started her business with RM100 and made her first loan to expand her business with AIM of RM2000.

Puan Azizah opened her shop, Permata Murni, in Bandar Selatan Seremban with three employees who produce at least 5000 to 10,000 tarts every day. Her enthusiasm towards pineapple business has attracted government agencies such as Ministry of Agriculture, FAMA, MARDI and SIRIM. She was assisted under the Malaysian Pineapple Industry Board which supplies her business with fresh and good quality pineapples every week. They also contribute an oven and electric blender for her mass production. Besides tart, Permata Murni also produces almond cookies, choco chip, banana crisps and other traditional snacks and frozen food. All are under the D'Kaz brand which has successfully become one of the 1 Malaysia Best products in Negeri Sembilan.

During her early business, Puan Azizah joined many trading expos and trade to promote her products. She was fortunate to have a popular artist to become her spokesperson. From that moment, her products have reached one Malaysia market and also have penetrated to Singapore. Now she moves one step further by offering other service such as hamper wrapping for her customers who would like to make her products as a special gift.

When asking about her future plan, Puan Azizah mentioned that she would like to expand her market of not only in Malaysia and Singapore but to other neighbourhood countries such as Brunei and Indonesia. Seeing a huge market, she is confident of her

capability by the assistance of AIM and other government agencies especially her supplier, the Malaysian Pineapple Industry Board.

5. Lessons and Implications

The focus of this contribution to work at the entrepreneurship interface involved a study into the key issues relating to the background of successful *Sahabat* in utilising upon the microcredit facilities provided by AIM. Furthermore, anonymous case studies of small and medium Malay-owned enterprises are sometimes difficult for prospective ethnic entrepreneurs to fully relate to. Therefore, profiles of successful entrepreneurs from the respective communities arguably help to bridge the perceived gap between academia and managerial practice (Cunningham & Lischeron, 1991).

From the outset, it might be concluded that a number of issues arise from this paper that could equally be drawn from an investigation into successful entrepreneurs within any community, for example hard work, luck, opportunity recognition and risk taking (Merrilees *et al.*, 1998).

The two *Sahabat* have effectively utilised resources, i.e. financial and managerial resources (experience) to develop and sustain their business growth (Barney, 1991). However, the case history demonstrates that an element of luck and not simply management skills and resources can influence success (Merrilees et.*al*, 1998). More important is that successful entrepreneurs like the *Sahabat* have a vision and can operationalize strategies quickly to react to changing and serendipitous events.

Apparently, the issue of opportunity recognition and exploitation for future entrepreneurs can take a variety of forms and will be subject to different environmental conditions. Prospective entrepreneurs must be able to proactively identify and address opportunities and case histories such as the two *Sahabat* provide a learning vehicle for this to take place.

The case history also offers avenues for future research. Research could be undertaken into the training requirements of Malay-owned firms. This is vital for the

government in encouraging more Malay entrepreneurs to independently grow and develop their business.

It is also useful as an educational vehicle to further investigate characteristics associated with entrepreneurs from various ethnic communities, e.g. the generation of ownership, previous experience, sector operating, etc. Stories from successful entrepreneurs can be shared at national level that can be disseminated to various regions. It is also recommended to offer more effective ways and provide solutions of barriers to business growth that is, based on the particular ethnic composition of communities.

6. Conclusion

Through the stories of the two *Sahabat*, it is learned that microcredit plays a crucial role in helping and supporting small businesses. Financial aids provided by financial institutions, for example AIM in Malaysia, have successfully helped businesses in start-ups and develop their business in future. Through the lessons from the two *Sahabat* also with the exposure and financial support provided by the AIM has been a turning point for small entrepreneurs (e.g. women entrepreneurs) to encourage them to forge in the business that they run.

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THE IMPROVEMENT OF AR-RAHN ENHANCED PRODUCT IN ISLAMIC BANKING SYSTEM

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Abstract

In a modern economy, there is no doubt that banks play a major role in generating the economic and financial growth. The individuals, the communities and the organizations are reliant on banks as their financial resources and necessities fulfillment. Their dependence to the banks has led them to engage a variety of contracts especially a loan contract. This contract required them to bond with the banks in the long period. Therefore, the various innovation products are designed to ensure the debtors are able to engage in an Islamic way and at the same time the banks are able to attain their income generation. While the debt contract is almost impossible to be implemented in Islamic banking system nowadays as it will lead to an interest, a modification process on the innovating sale contracts that have a commercial value for the bank is the only way for them to offer a loan to the people. Thus this paper attempts to explore the potential of ar-rahn product to solve the current problem. It tries to propose the enhancement of ar-rahn existing product offered by the bank and pawnshop as a good alternative to the financing products. The explored features of the potential of ar-rahn consist of the suitability of concepts adopted in the product, the possibility of longer repayment's period, the minimization of the shariah and economic issue of ujrah fee, the possibility of offering more than RM10, 000 borrowing money and the expansion of receivable pledge item. While the exploration of those features is discussed in a foundational and ideal basis, it is hoped to stimulate further investigation in the future.

Keywords: Improvement, Ar-rahn enhanced products, Islamic Banking System

1. Introduction

The legitimacy of *ar-rahn* has been clearly stated in al-Quran and the prophetic tradition. It is further explained by the Muslim scholars from a various field and

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background since the *salafi*[3] period until the challenging modern days[4]. *Ar-rahn* is not only been discussed in the Islamic jurisprudence books but also in other discipline of knowledge such as Islamic theology and Islamic history. In Islamic theology for instance, there is a topic about the acceptance of *ar-rahn* been discussed by *Al-Tamimi*[5]. Similarly in Islamic history, *al-Sahmi*[6] was also talking about *ar-rahn* but he presented it in a narrative way during prophet days. Obviously, the concept of *ar-rahn* is well known not only among jurisprudence scholars but the scholars of other discipline of knowledge as well.

However, the needs of the practicality of *ar-rahn* in banking industry is more insisting than just a conceptual ruling in a book made previous works were not good enough to cover the shortfall. A modification process on the contracts that have both features of commercial value and *shariah* compliance are the only concern for the Islamic bank to offer a loan to the people. Although the existing *ar-rahn* product has undergone that process, a huge potential still need to be explored and infused by Islamic banks. The *ar-rahn* product should no longer become the second choice after the financing scheme, but to become an equal alternative in the market today. Thus, some features available to the existing *ar-rahn* are crucial to be reviewed for the improvement and betterment of its potential.

2. Literature Review

For in-depth research on the law of *ar-rahn*, the books of *Quranic* exegesis, *hadith* and classical text of Islamic jurisprudence specifically should become the priority of references. In *Quranic* exegesis, *Ibn Kathir* is one of the scholars that explained very

[3] Salaf according to Arabic language means the group or previous races (ancestors) or anyone else who came before us whether our parents or our relatives. In technical terms, the *Salaf* means the first and best generations of Muslims, which consists of the Prophet (p.b.u.h), *the companion, tabi` in, tabi`-tabi` in*, and their followers made up of members of the Hadith, the scholar of the guidance in the first three centuries which are honored by Allah ta `ala. See Manzur, M. b.-F.-D. (1414h). *Lisanul`Arab* (3 ed., Vol. 9). Beirut: Dar al-Sadir, Beirut. and Majd al-Din Abu Tohir Muhammad bin Ya'qub al-Firus Abada, (. (2005). *Qamus al-Muhit.* Beirut,, Lebanon: Muassasah al-Risalah li Al-Tiba'ah wa al-Tauzi', p.391

[4] The modern scholars have a tough job in adjusting the new application of *ar-rahn* to be implemented practically in banking industry.

[5] See al-Tamimi, A. a.-R.-W. (1991). *Al-Iman wa al-Radd 'Ala Ahl al-Bid'* (3 ed., Vol. 1). Riyadh: Dar al-'Asimah: Riyadh, p.19

[6] al-Sahmi, M. b. (1989). *Al-Maghazi* (3 ed., Vol. 2). Beirut: Dar al-'Alami, p.482

well about *ar-rahn* regarding surah *al-Baqarah* verse 283.[7] *Bukhari* and *Muslim* alone have recorded at least ten to eleven text of various degree of hadith about *ar-rahn* in their respective books, *Sahih Bukhari* and *Sahih Muslim*[8]. Similarly, the jurists from every age and school of thoughts have contributed tremendous and magnificent works through discussion of a particular topic. They were devoted throughout their life in seeking truthful inputs for every angle of the Islamic law. The great names such as *al-Shaybani* and *al-Sarakhsi* of Hanafi, *al-Mawardi, al-Syirazi, al-Rafi'i* and *al-Nawawi* of Shafi'i, *al-Dasuqi, al-Dardir, al-Khalil* and *al-Qarafi* of Maliki as well as *Ibn Qudamah* of *Hanbali* are indeed become "*a living legend*" to the modern scholars in Islamic law. Age by age, the great collection of *ar-rahn* issues had flourished through the meticulous process and methodology developed by them. The reviewing process, the debate of the issues, the comparative methods, the evidences they used and the principles of jurisprudence that they held became the extraordinary efforts that nobody could deny.

The breadth of *ar-rahn* discussion as what has been reviewed by al-Du'ailaj (1986)[9] in his thesis is probably the most comprehensive works ever exist in the academic research. The concepts, the principles, the rulings, the pillars and the issues related *ar-rahn* has been explained in details through his work. Meanwhile its views, evidences and determining conclusion from the long debate of jurists in schools or inter schools were presented in a very structured format. It is also serves the simplified idea of a huge collection of views from jurists of four schools and obviously make later researcher easily to digest its rulings.

For the time being, the works of Masae (2011)[10] and Shakhanbeh (2010)[11] are the latest efforts of bringing the conceptual ruling into a practical contract in a modern

[7] al-Qurashi, A. A.-F. (1999). *Tafsir al-Quran al-Azim* (2 ed., Vol. 1). Riyadh: Dar Taiyyibah Li al-Nasyar wa al-Tauzi', p.727

[8] See the various text of hadith about ar-rahn through al-Bukhari, *Al-Jami' al-Musnad Al-Sahih al-Mukhtasar min umur Rasulillah wa sunanihi wa ayyamihi*, no: 2068, 2200, 2252, 2386, 2509, 2511, 2512, 2513 and al-Naisaburi, M. i.-H.-H.-Q. (n.d.). *Al-Musnad al-Sahih al-Mukhtasar bi al-Naql al-Adl An al-Adl ila Rasulillah* (1 ed., Vol. 3). Beirut: Dar Ihya al-Turath Al-Arabi. No: 1603/124-126, p.1226 & 1919

[9] al-Du'ailaj, M. b. (1986). *A Pledge in Islamic Jurisprudence (Original text: الرهن في الفقه السلامي)*,. Riyadh: University of Imam Muhammad bin Saud al-Islami.

[10] Masae, S. (2011). *Pawning practices in Muslim societies of Pattani, Thailand, according to Islamic perspective (Original text: Amalan pajak gadai dalam masyarakat Islam Pattani, Thailand menurut perspektif Islam.* Kuala Lumpur: University of Malaya.

system. The works of Masae (2011) that focuses on the traditional pawn broking in southern Thailand is about to bring a traditional practice of *ar-rahn* into a mainstream model. The analysis he made about *ar-rahn* practice in the society was sufficient and it can be seen through the expansion of the pledge in the contract as what have been suggested and discussed by the *salafi* jurists' long time ago. However, the discussion of the practice of *ar-rahn* in *Koperasi Islam Ibn Affan Pattani* (Koifap) was lacking of suggestion in developing a good model of *ar-rahn* especially to become a good alternative to the existing financing products and services. Meanwhile, the work of Shakhanbeh (2010) had brought up an idea on how the collaterals in kind can be a sort of investment agent. This idea came as a result of the huge size of collaterals in banks and therefore the potential of *ar-rahn* contracts could be expanded and enlarged in term of size of amount convoluted. Shakhanbeh had examined the investment legality by reviewing the scholars' views in accordance with *shariah* rules. It is one of the options for the bank to overcome the difficulties and problems it faces regarding the disposition of these collaterals since the bank does not have the title to these assets.

The research on the utilization of the pledged item is indeed crucial. Thus, many researchers had worked on it and obviously it was not a new idea. Previously, Meera (2009)[12] has suggested that the needs of the conversion of the unredeemed gold items into gold dinars and pushed back into the economy. While in this way the gold can be sold for market price, he claimed that it can be made into a mode of investment for the people and if circulated as a complementary currency, it can further encourage economic activity, production and employment in the economy. Another detailed work of the pledge's utilization has been done by Yunta (2007)[13]. He discussed the law and the views of jurists on these issues and found that it was permitted with certain condition.

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[11]Shakhanbeh, S. A. (2010). *Collaterals in kind and the extent of the legitimacy of its investment by Islamic bank (Original text: الضمانات العينية الرهن و مدى مشروعيات استثمارها في المصارف الإسلامية)*,. Jordan: Arabic Academy for Finance and Banking.

[12] Mydin Meera, A. K. (2009). Integrating al-rahn with the gold dinar: the initial building-blocks towards a gold-based economy. In A. K. Mydin Meera, *Real money: Money and Payment systems from an Islamic perspective* (pp. 221-235). Kuala Lumpur: IIUM Press

[13] Yunta, A. H. (2007). *The ruling of pledge utilization: Its applications in Shariah Pawnshop of Makassar, South Sulawesi" (Original text: Hukum Permanfaatan Harta Gadaian Aplikasinya dalam Pegadaian Shariah di Makassar, Sulawesi Selatan.* Bangi: Universiti Kebangsaan Malaysia.

The works of Mukhlas (2010)[14] about *ar-rahn* is interesting. He examined the composite contracts of *Murabahah* and *ar-rahn* at Islamic pawnshop branch Mlati Yogyakarta Sleman and I found it shall be able to serve the alternative of the financing products in terms of the amount of borrowing cash and the competitive profit rates. However, he suggested that certain barriers need to be examined such as the legal issue of conflict within the *muqtada al-aqd* of the composite contracts, the knowledge of the operators and the good facilities of pledge storage. The concerns over the Islamic legal problems are actually shared by Khir (2011)[15] when he stated that there is a need for modification of this product in the future. He mentioned this contractual arrangement involves *tawarruq* (through commodity *murabahah*) is a form of *hiyal*-based contract and allowable on a temporary basis only. Hence, it cannot be used continuously without looking for a new alternative.

Even though Shakhanbeh (2010), Mukhlas (2010) and Yunta (2007) have studied a variety of composite contracts in *ar-rahn* products, certain issues are necessary to be discussed further. For instance, Mukhlas (2010) has studied the gold that bought by the customers (pledgor) from the pawnshop they engaged (using *murabahah*) could provide financial assistance to the customer. However, the issue of the existence of the gold bar as a pledge and the higher price from a normal market price resulted from earlier purchasing of gold (between pawnshop and gold manufacturer) could contributing to the situation of *gharar*. The profit amount of *murabahah* determined by the pawnshop could possibly represent the gold price in the future if it is bonded in a long term. The sample of calculation on how the pawnshop gained from the deal is insufficient as the sample shown for a short term basis. This fretfulness arises when it comes to the long term (such as 20 years) as the existing of financing selling price determined by the bank's today is representing the expected selling price in the future. If this happened, once again the issue of *hiyal* will emerge.

As the repayment of the debt should be preserved, the banks might be struggled to determine the appropriate rate of *ujrah* or profit. This dilemma could arise when the

[14] Mukhlas. (2010). *Implementation of Islamic Mortgage by using Murabaha and Rahn contract: A study on Islamic pawnshop branch Mlati Yogyakarta Sleman.* Surakarta: Universitas Sebelas Maret, p.87

[15] Khir, M. F. (2011). Revisiting the Fiqh Characterizations of The Rahn-Based Islamic Microcredit Product. *ISRA International Journal of Islamic Finance, 3*(2), 151-157.

bank is only allowed to secure its principal sum of financing[16], not the financed principal sum plus a profit margin as mentioned in PSA[17]. Through the composite contract of *ar-rahn* and *murabahah*, banks will secure their financing at purchasing price. If this happened, the bank will face the troublesome if customers are defaulting as the pledge is only secure the financing amount at a purchasing price. In the case study of Mukhlas (2010), the pawnshop probably in a risk if the customer defaulting the monthly payment and thus unsecure the total amount of financing which determined at a selling price. For example, the gold of 60 gram that worth RM10,000 at a purchasing price is sold to the customers plus profit margin 10% a year is about RM11,000 can only be secure for RM10,000 but not RM11,000. Even the value of gold that the pawnshop restrained at their possession could be appreciated along the way of financing period; the pawnshop has to give back the surplus to the customers from the pledge auctioning or selling. Unless the section 241 to be adjusted, this composite contract seems inappropriate to be held in the Malaysian law. This situation has been labeled earlier by Uzaimah (2006)[18] as one of the failures of *Maqasid Shari'ah* to be fulfilled by the law. The new system or law probably needs to be designed to give the fairness for both contracting parties (bank and customer) when it comes to the loan in the long period.

In the perspectives of law, the effort of Shakhanbeh (2010) and Uzaimah (2006) in discussing the principle of *ar-rahn* and its application at the bank was respectable and seems to be appropriate in providing cash to the customer in a big volume and a long period. However, the contract of *ar-rahn* in this paper is focusing on the development of *ar-rahn* product as a whole instead of *ar-rahn* contract that been included in other financing products. The adhesive of *ar-rahn* contract into the financing products is bringing *ar-rahn* product into nowhere. It is not similar to the other contracts to be put into the *ar-rahn* product. It is about the matter to prioritize and to strengthen. This

[16] Sec. 242-243 of National Land Code (Act No 56 of 1965).

[17] Property Sale Agreement. Under the PSA, the bank sells the property to the customer at an agreed price that will be paid by the customer on deferred basis. In pursuant to the PSA, the bank requires the customer to execute a registrable charge in favour of the bank in order to secure the payment of sale price. This registrable charge acts similar as a pledge that will be registered under the virtue of section 241 of the National Land Code. See Saiful Azhar Rosly et al, "The Role of Khiyar al-'Ayb in al-Bay' Bithaman Ajil Financing", *International Journal of Islamic Financial Services*, vol. 2 no. 3 at http://islamic-finance.net/journals/journal7/art1.pdf

[18] Uzaimah Ibrahim and Shafinar Salleh. (8-10th August 2006). The objectives of al-rahn and their achievement in charge/mortgage in Islamic home financing: an analysis". *The International Conference on Islamic Jurisprudence and the Challenges of the 21st Century*. Kuala Lumpur: IIUM.

work is giving the special interest on the *ar-rahn* product as its carries different spirit and philosophy. Even though, Mukhlas has studied the contract of *Murabahah* and *ar-rahn* in the *ar-rahn* products, the legal issue as stated earlier and the accessibility of getting big volume of loan is not yet to be resolved. Thus, the new work regarding this interest is significantly important in knowing its potential at certain extents it could.

The study conducted by Salleh (2005)[19] and Mohamad (2004)[20] is not so contributed to the development of potential of *ar-rahn* product. This can be seen when their findings are investigated about the execution of *ar-rahn* product at the pledge institutions and its validity related to the concept of Islamic pledge. If one wishes to know the applicability of *shari'ah* compliance in a particular institution, then this study could provide it. Except for the issue related to elements of coercion in giving *hibah* for pledge redemption at MGIT found by Mohamad (2004), the other aspect seems 'not a new thing' in her research. Meanwhile, it is quite surprising when Salleh (2005) stated lower rate of *ujrah* regarding her finding at the four pledge institution she investigated in Perlis. This is contrast to the calculation of the loan plus *ujra* rate towards the end of the redemption period earlier before.[21] This finding most probably concluded within the similar products of *ar-rahn* and obviously, it is not the comparative rate to the financing products.

Mohamad (1995)[22] analyses the Pawnbrokers Act 1972 from the Islamic perspective by referring to sections that have conflicts with Islamic law. The study found that there are two sections in the act that contradict Islamic law, namely section 17 which allows the mortgage to take advantage of borrowing and section 23 (a) that allows the pledgee to have the pledge that are not redeemed if the loan not exceeding RM100. Similarly, Naim (2004)[23], concluded some practices adopted by the Islamic system

[19] Salleh, S. (2005). *Islamic Mortgage System: Practice and effectiveness of its operations in Perlis (Original text: Sistem Gadaian Islam: Pengamalan Dan Keberkesanan Operasinya Di Negeri Perlis).* Kuala Lumpur: University of Malaya.
[20] Mohamad, S. (2004). *The Implementation of Islamic Mortgage in Islamic Mortgage Institutions in Malaysia: Case Study in Terengganu Islamic Pledge Muassasah (Original text: Pelaksanaan Gadaian Islam Di Institusi-Institusi Gadaian Islam Di Malaysia.* Kuala Lumpur: University of Malaya.
[21] See table 1.
[22] Mohamad, S. (1995). Pawnbrokers Act 1972: An Analysis from the Islamic Perspective (Original text: Akta Pemegang Pajakgadai 1972: Suatu Analisa Dari Perspektif Islam) . *Jurnal Syariah, 3*(2), 277-284.
[23] Naim, A. M. (2004). Islamic Pawn Broking System (Original text: Sistem Gadaian Islam). *Islamiyyat, 26*(2), 39 – 57.

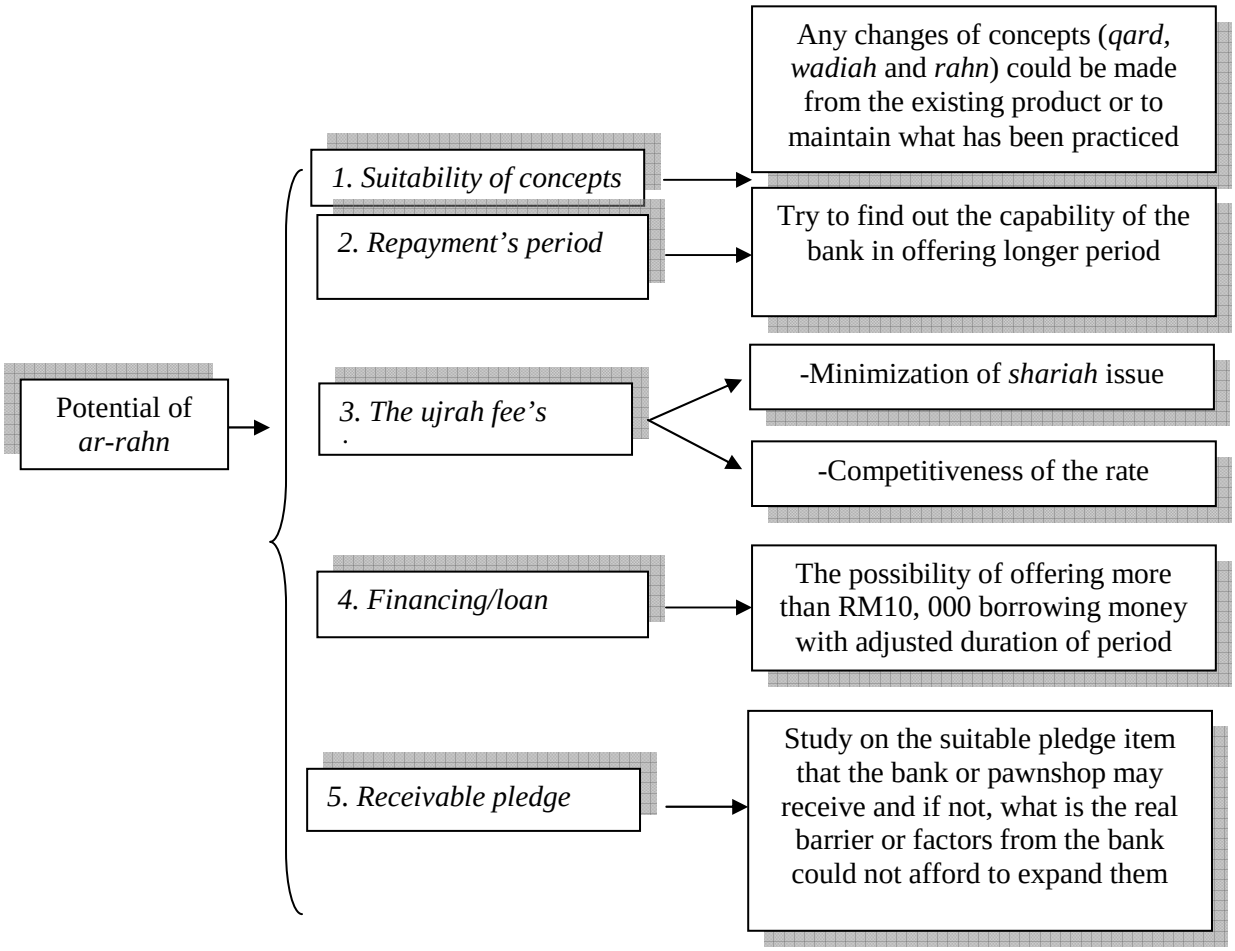
are “not truly in compliance” with the teaching of the Islamic law. He found *al-rahn* scheme still contains elements of usury in the transaction. He proposed of giving "good loan" which is backed by the pledged should be the responsibility of government and millionaire to prevent the folk continuously trapped in the financial system.

While upgrading *ar-rahn* scheme into a new innovation in the banking system, its current performance of efficiency should be a good reason of why it’s potential is extensively being explored. Selamah and Ghafar (2010)[24] have studied the efficiency of *ar-rahn* by measuring the secondary data for 2006 across several *ar-rahn* operators including Bank Rakyat, Permodalan Kelantan Berhad (PKB), Muasasah Gadaian Islam Terengganu (MGIT) and Cooperatives under Yayasan Pembangunan Ekonomi Islam Malaysia (YaPEIM). Even though they found the highest average efficiency score among categories of *ar-rahn* used is Bank Rakyat, they suggested *ar-rahn* outlets have to improve their efficiency because only 24% of 111 outlets operate at the efficient level. Previously in related article, Ghafar and Zakiah (1997)[25] have suggested the increasing amount for loan as a microenterprise credit in Malaysia as they were expected the amount of loan to increase over the 1990s resulted from the industrialization. Nevertheless, this idea should remain as a significant indicator for consideration at this day by the banks as the cost of living is continuously snowballing and reinforced by the continued upsurge in gold prices.

3. Research Method

This paper looked at the main domain and issues related to *ar-rahn* as practiced at the banks and pawnshops. There are five features of *ar-rahn* to be explored which are the suitability of concepts, repayment’s period, the *ujrah* fee issues, financing/loan amount and the receivable of the pledged item. The paper used the secondary data taken from the banks websites, brochures, Islamic jurisprudence and legal documents and previous works such as thesis and journals.

[24] Selamah Maamor and Abdul Ghafar Ismail. (2010). The Ar-Rahn Efficiency and Its Determinants. *Journal of Islamic Economics, Banking and Finance*, *6* (1).
[25] Abd. Ghafar Ismail and Nor Zakiah. (1997). Pawnshop as an Instrument of Microenterprise Credit in Malaysia. *International Journal of Social Economics, , 11*(24), 1343-1352.



4. Findings

Table 1: Comparative features of selective financing products and ar-rahn in Malaysia

Product	Maybank				BIMB			CIMB		Bank Rakyat	
	KOWAMAS Personal Financing	Maybank Islamic Personal Financing-i	ExeCash-i (Standard Package)	ExeCash-i (for GLC)	Personal financing-i (Non-package)	Personal Cash Line-i	Personal Financing-i	Cash Plus Financing-i	Pembiayaan peribadi sektor awam-i	Ar-rahn	Az-zahab
Concept incurred	*Bay Inah*				*Bay Tawarug*					*Wadiah + Qardul Hassan*	
Collaterals	*Nil*									*Yes*	
Financing amount	RM1k – RM100k	RM5k – RM100k	RM3k-RM50k	RM5k-RM100k	RM10k-RM150k	RM10k-RM200k	RM10k-RM200k	RM2k-RM100k	RM1l-RM200k	RM10k	RM100k
Profit rate & ujrah fee (p.a.)	4.99% - 5.9%	9%-11% (fixed rate)	8.88% - 12%	BFR+(2%-2.25%)	6%-7% (Flat rate)	BFR + (0%-2.5%)	3.25%-7% (fixed rate)	6.88%	3.98%-4.99%	12.85*	
Financing tenure	2 – 20 years	1-6 years	2-5 years	2-15 years	1-10 years or up to the retirement age, whichever is earlier	1-5 years	1-15 years	1-5 years	1-20 years	1 year**	

Source:www.maybankislamic.com.my,www.cimbbank.com.my,www.bankislam.com.my www.bankrakyat.com.my

The discussion of the explored features and their result are mainly based on the table 1 .

*Assumed that the customers were chosen the maximum amount of loan from the pawned item. If the amount of loan is below the maximum amount he could possibly engaged, the *ujrah* fee will be relatively higher as the *ujrah* is based on the value of *marhun*.

**Noted that the current duration of *ar-rahn* is 6 months, but can be extended for another 6 months (multiple extensions) subject to settlement of safe keeping fee for the past 6 months. This will imply the new *ujrah* fee for the new extension period.

The real rate of *ujrah* fee

The bank and pawnshop have undisclosed the real rate (in percentage) in their documents. This probably avoids the direct linkage of *ujrah* fee to the value of the loan. What are they do is to state the amount of *ujrah* in each RM100 of the pledge value. However, the customers should be revealed academically the real rate *of ujrah* fee so that they realize the higher rate of it. Thus, the calculations of deriving 12.85% are as follows:

Ujrah fee in 6 months
10,000/100x0.75 x 6
= RM450

Total ujrah fee in a year - (a new agreement been made for another 6 month of extension period)
450 x 2
= RM900 (assume that there no increasing or decreasing value of the pledge, if happens the *ujrah* fee may varies)

The rate of ujrah (in percentage)
900/7000 x 100 – (Financing up to 70% of the pawned gold value)
= 12.85%

1st feature: The suitability of contracts adopted in the product

In discussing *ar-rahnu* product, the main thing that needs to be addressed is the *qard* contract. Based on the evidence of al-Quran and Sunnah, *ar-rahnu* occurs when a person wishes to use money or goods but have to borrow or to buy it in a deferred time due to the absence or lack of money to deal with. Then, *ar-rahnu* contract is engaged as a guaranty for the borrowing money to be paid back after one has borrowed. It is clear, though it is named *ar-rahnu* product but the main contract is a debt contract and *ar-rahnu* functioned as a proponent of the debt contract. Therefore, the discussion on debt contracts should be seen first before contract *ar-rahnu* will go for signings.

According to Khir (2011)[26], it is difficult for a scheme or banking products to satisfy for both: the commercial aspect, namely the profit to the bank and at the same time to comply with the *shari'ah*. However, the implementation of *takyif fiqhi*[27] will be able to minimize issues related to *shari'ah*. There are four allowable composite contracts suggested by Khir (2011) namely the *takyif fiqhi* models are as follows:

1st model: Combination of *wadiah bi ajr, qard hasan* and *rahn al-wadiah*.
2nd model: Combination of *tawarruq* (through Commodity Murabahah) and *rahn*
3rd model*: Qard Hassan* with encouragement of giving *hibah*.
4th model: Combination of *rahn* and *qard hasan*

Among the four models that have been studied by him, only two models that is truly frees from the element of *riba, hilah* and *gharar*, which is the third and fourth model. But these third and fourth models could not be implemented in Islamic banking on its characteristics that are not able to generate profits. Thus, the products using these contracts were not practical to be offered[28].

Thus, the first and second models are suggested but have only one disadvantage in relation to the *shariah* aspect of the product, which is the element of suspicion of *riba*

[26] Khir, M. F. (2011). ***op.cit***., p. 151
[27] *Takyif fiqhi* can be defined as a juristic analysis of a transaction in order to find a place for it within the schema of Islamic law.
[28] ***Ibid***., p. 154

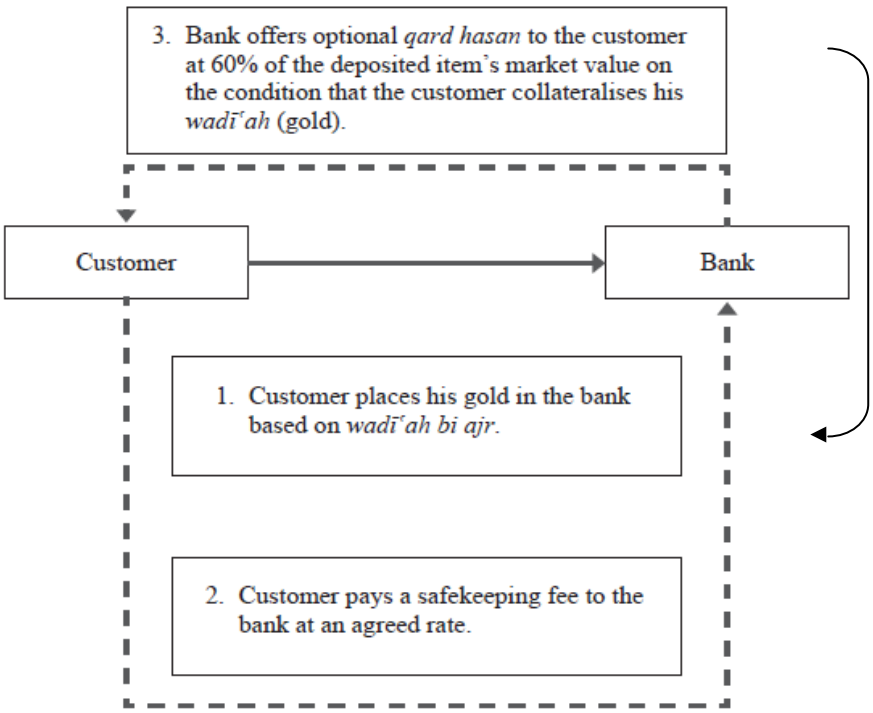
and *hiyal*. In first *takyif fiqhi* model, the whole contractual arrangement may constitute the element of *qard jarra manfa'ah*[29] while in second *takyif fiqhi* model; the contractual arrangement involves *tawarruq*, which is a form of *hiyal*-based contract.[30]

For the first model, *qard jarra manfaah* may happen when the bank will look at the value of *wadiah* item while offering a loan to the customer. Even the *wadiah* item is already stored during the engagement of *wadiah bi ajr* contract; the maximum loan given by the bank may connect to the value of the *wadiah* item stored by the bank during the first contract.

Meanwhile, a form of *hiyal*-based contract in the model 2 may happens when the bank is reselling the gold to the customer for a second time. This second time of reselling process may be questioned as the bank is not a jewelry shop; thus the sale of the gold to the bank is a trick to get some cash. This contract is more similar to *bay inah* than *tawaruq* where the bank has the intention to resell the gold to a similar customer who had been sold to them before. Figure 1 below is the process on how the bank may look at the value of the stored *wadiah* item.

[29] This term derived from the hadith *mursal* which means "*every loan that brings benefits thus not a good thing*". See Yamani, A. B. (1403 h). *al-Musannif* (2 ed., Vol. 8). Maktab al-Islami, p.145
[30] Khir (2011), ***op.cit***., p. 155

Figure 1: The process flow of the composite contract of wadiah bi ajr, qard hasan and rahn al-wadiah.



Source: Khir (2011)

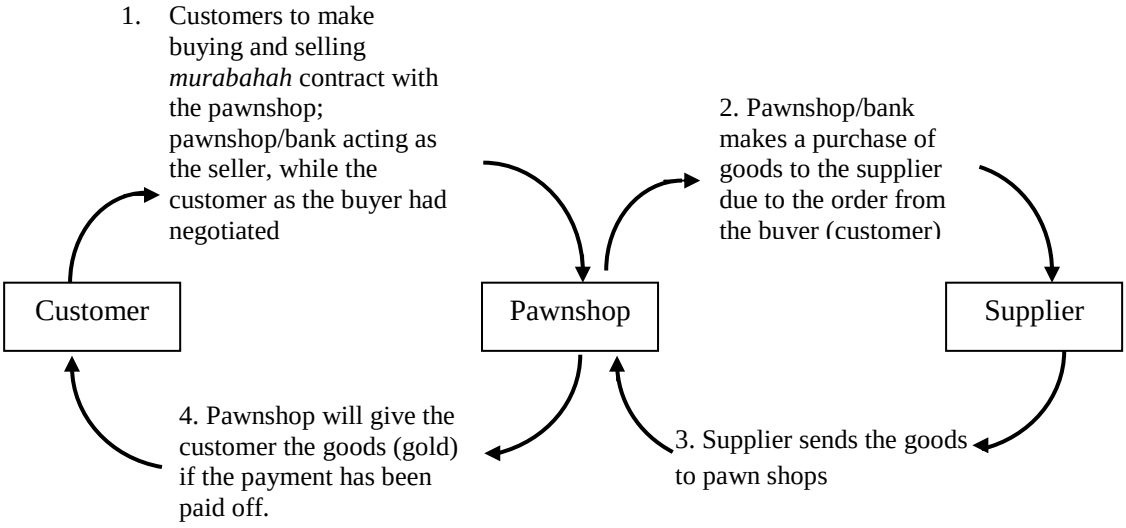
However, this *hiyal*-based contract may be avoided if the model suggested by Mukhlas (2010) could be further examined. The suggested model consists of the contracts of *murabahah* and *al-rahn.* The figure 2 below shows on how this model operates. The parties entered into a composite contract in the MULIA financing are:
First, the pawnshop as a buyer or financier of the goods purchased. Second, the customer as a buyer of goods in the MULIA commodity financing (gold) and third, the supplier or a party authorized by the pledgee to sell the goods. (In this case, the supplier is PT.Aneka tambang).

The pawnshop (the first party) is to finance the purchase of gold bar ordered by the customer or purchaser (second party). The purchasing is made to the supplier (third party). Purchase of goods or commodities by the customer (the first) is done with deferred payment system. In practice, the pawnshop buys the goods and sells them to their customers for principal amount plus a profit to be paid by the customer at a certain period. Then the commodity (gold bar) that is bought has made up as a guarantee (*marhun*) for the amortization of customer remaining debt to the pawnshop.

After all outstanding customer paid the gold bar; the documents will be submitted to the customer.

We can see the transaction could solve the *shari'ah* issue of what it cannot be done in the previous contract; however, the selling price of gold bar will be questioned if the price is above the market price. The above market price of selling gold bar seems unavoidable as the pawnbroker need to get some profit on it. Even the issue of *ujrah* fee will be resolve but the incident of *hiyal* and suspicious *riba* as what has been mentioned previously could be affected[31].

Figure 2: The process flow of the composite contract of Murabahah and al-rahn



Source: Mukhlas (2010)

2nd feature: The possibility of longer repayment's period

The current practice of *ar-rahn* requires customers to repay the loan and redeem the pawned item within 6 month and given the option of the extension for another 6 month. Based on the table 1, we believed that a 6 month period is not being able to serve a good substitute to the existing financing that mostly offered 5 years period and above. The longer period is essential as many people are willing to be given more time of repayments for their loan. This also could avoid the risk of default and

[31] As explained in page 5 and 6 of this paper.

encourage people to pay a loan steadily. In *ar-rahn* contract, another 6 month of extension period is given only when the *ujrah* fee for the first 6 month of period is been settled. This will lead to a double charge of *ujrah* fee as it is imposed for a second time in the sixth month extension period contract.

For instance, assume the value of *marhun* is RM10, 000 and the maximum amount of loan that can be offered by bank or pawnshop is only 70% from the total value of *marhun* which is RM7, 000. Thus, the *ujrah* fee can be calculated based on this formula[32]:

$$US = \frac{NM}{100} \times K \times T$$

Where:

NM = Marhun Value
K = Rate
T = Duration (month)

Ujrah fee = 10,000/100 x 0.75 x 6
= RM450

Assume that the pledgor does not yet to repay any amount in the first 6 month of period, thus the *ujrah* fee will be charge for a second time by a similar amount.

The *ujrah* fee after the period of extension
= 10,000/100 x 0.75 x 6 x 2
= RM900

In this case, a double charge of *ujrah* fee can be seen if one could not be able to repay the loan and redeem the pledge in a first 6 month but one could save a similar amount of money from being charged once again if he manages to settle the loan. This situation is likely not giving a good advantage to the pledgor as mostly they need

[32] Malaysia, Y. P. (t.t.). *Ar Rahnu-Based Micro Credit Programme.* Kuala Lumpur: YAPEIM

more time to repay the loan. This disadvantage situation is likely give the bank chances to get more money through the extension of time. This situation is unfair to the pledgor as the opportunity to redeem the pledge in 6 month seems tightening but at the same time the bank has deep concerned on the income generation. As a solution, the imposing of one time *ujrah* fee in a year will be a good alternative as the pledged item has already at their possession. At the same time, the bank probably could increase the financing amount as they giving up the higher rate as what other financing products have done[33].

3rd feature: The minimization of the *shariah* and economic issue of *ujrah* fee.

This work concentrates relevant issue from each *shari'ah* and economic perspective. In *shari'ah* perspective, the issue of linking *ujrah* fee to the value of the pledge is being examined as the current concept by the bank has led to the actual *riba*. Even though Khir (2011) suggested the composite contracts of *wadiah bi ujr*, *qard hasan* and *rahn al-wadiah* model and claimed they were removed from the direct linkage of the *ujrah* fee to the value of the pledge, there are two questions that become essential to be further examined. One of them is the use of the similar pledge in the two different contracts which are *wadiah bi ajr* and *rahn al-wadiah*. The use of similar *wadiah* item (gold) in two different contracts is still not enough in validating the removal of direct linkage of the *ujrah* fees and the pledge.

To see a clear picture, a process flow of these contracts is illustrated in figure 2. The similar item was identified in step 1 and 3 of the flow even their contract implications are different. In step 1, the customer is already places his gold based on *wadiah bi ajr* which then ended as a guaranty of the pledge by the bank. The payment of *ujrah* fee for the bank meaning that the bank has to safe keep the gold and it will be affecting the bank to guarantee the *wadiah* which is the gold. Then, in step 3, the similar gold that has been kept by bank is once again entering into the second contract which is *ar-rahn* contract that ended as a security for the loan. Unless the strong justification is being given, the issue of the removal of linking *ujrah* fee to the value of pledge is remaining unsolved. One could argue and get back the gold from the contract based

[33] Table 1 will give a brief picture on how the rate could tolerate to the amount of financing

on *wadiah bi ajr* after made full settlement of the *ujrah* fee just because of the reason *wadiah bi ajr* contract is separated with *the rahn al-wadiah* contracts. This is because the separation of contract is the only way to validate the removal of the linkage.

The second issue of *shari'ah* perspective is the absence of a clear justification of the *ujrah* fee rate charged by the bank and pawnshop. Is the rate of *ujrah* fee really based on the storage box? Or the other justifications such as weight of the pledge and the risk of losses are about to concern? If those justifications are included in determining the rate, then what kind of measuring standard are to be followed? Those questions are crucial to be reviewed and discoursed.

In term of economic issue, the rate of *ujrah* fee should be well-suited with the requirement that the banks had imposed. Based on the table 1, if the head to head comparison to the other financing product, *ar-rahn* is the only product that require the collateral and yet the rate is much higher than the others. The 12.85% a year with a strong back up of default payment obviously not a good competing rate. The solution of adjusting the rate could be made by increasing the maximum amount of loan. This probably could be done by offering various options of *ar-rahn* categories. For instance, *ar-rahn* based product may offer different categories of rate, loan amount and period for different purposes.

4th feature: The possibility of offering more than RM10, 000 borrowing money

The pawn broking act 1972 had clearly stated not more than RM10,000 only being allowed to be offered to the customers. This timeworn justification of maximum amount is obviously should be changed as the amount had determined 40 years ago. Based on the current gold prices and consumer goods, the need of the amendment for the amount of borrowing cash is significantly necessary. If one wishes to pledge three ounces of her jewelries today, he/she might not be able to get the loan from the product as the act restricted by the maximum amount of RM10,000.

Table 2: Change in percentage of gold prices in 5, 10 and 20 years

Year	Price (Dollar)/oz.	Percentage Change (+/-) in three set of period		
		5 years	10 years	20 years
1972	70	-		
1977	168	+140%		
1982	488.50	+190.7%	+597%	
1987	502.75	+2.9%		
1992	359.60	-26%	-26%	+413.7%
1997	367.8	0.2%		
2002	342.75	-6.8%	-4.6%	
2007	841	+145%		
2012 (until July)	1646.51	+95.7%	+380%	+357.7%
Average Percentage Change (+/-)		**+67.6%**	**+236.6%**	**+385.7%**

Source: http://www.kitco.com/charts/historicalgold.html

From the table 2, we can see the increasing prices of gold were soared in three different set of period. The average percentage of change for 5, 10 and 20 years' time have increased 67%, 236% and 385% respectively. This shows a growing percentage in the long run was tremendously gargantuan. The longer period engaged the bigger change in gold prices. This situation shows the bank and customers are mutually gained if the period will be extended up to 20 years. The customer will enjoy the access of big amount of loan and the bank will get a long commitment of income from the customers through monthly installment.

However, in the table 3, the average percentage of change in gold prices within a year has decreased 0.8%. This situation is not favorable to both parties due to the fluctuation of gold prices in each month. The customers are not able to enjoy more time in repayment for redemption. This situation does not encourage a customer to make a monthly payment to the loan provided by the bank. For the bank, a shorter period of loan will only give them a shorter commitment from the customers as well as the return.

Table 3: Change in percentage of gold prices in a year-time (2012)

Year	Month	Price (Dollar)/oz.	Percentage Change (+/-)
2011	Aug	1755	
	Sept	1771	+0.9%
	Oct	1665	-5.9%
	Nov	1738	+4.3%
	Dec	1652	-4.9%
2012	Jan	1656	+0.2%
	Feb	1742	+5.19%
	Mac	1673	-3.9%
	April	1650	-1.3%
	May	1585	-3.9%
	June	1596	+0.6%
	July	1592	-0.2%
Average percentage Change (+/-)			**-0.8%**

Source: http://www.onlygold.com/tutorialpages/picessince1972fs.htm and http://www.kitco.com/charts/historicalgold.html

4th feature: The receivable of pledge item.

Recently, the bank only receives gold jewelries as the pledge item as guaranty for the loan borrowed. Even the gold has its own intrinsic and strong value, when it comes to the form of bar or coin for instance, it is no longer accepted. This may scale down the people to engage *ar-rahn* product as they are not only comes from women community but also from the businessmen and investors. This is contrast of what Islam suggested about the pledge that can be received from any goods that has strong own value. Even though the plants, fruits, animals and other perishable goods are mentioned in Islamic jurisprudence, the goods that have not facing depreciation in the long run are given the priority. For time being, regardless of its form, any gold metal should be accepted in the contract as it carries a strong and stable value and demand.

5. Conclusion

The discussion of the potential of *ar-rahn* is one of the efforts of upgrading the existing products. The process is not to eliminate the existing product but rather to highlight a wider choice to consumers in engaging the mechanism of financing or

loan. The existing *ar-rahn* product will be better when its potential is developed to a certain extent until it becomes a good alternative product in the financial markets. This is only the beginning of a continuing effort that should be further reviewed in the future for the good of the parties involved.

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APPENDIX

Historical London Spot Gold Prices

Annual High & Low Gold Bullion Prices Since 1972

Year	Yearly High	Yearly Low	Year	Yearly High	Yearly Low
1972	$70.00	$44.00	1990	$423.75	$345.85
1973	$126.00	$64.00	1991	$403.00	$344.30
1974	$195.00	$117.00	1992	$359.60	$330.20
1975	$185.00	$135.00	1993	$406.70	$326.10
1976	$142.00	$102.00	1994	$397.50	$369.65
1977	$168.00	$127.00	1995	$396.95	$372.40
1978	$243.65	$165.70	1996	$416.25	$367.40
1979	$524.00	$216.55	1997	$367.80	$283.00
1980	$850.00	$474.00	1998	$314.60	$273.40
1981	$599.25	$391.25	1999	$323.50	$252.80
1982	$488.50	$296.75	2000	$325.50	$264.10
1983	$511.50	$374.25	2001	$291.45	$256.65
1984	$406.85	$303.25	2002	$342.75	$277.75
1985	$340.90	$284.25	2003	$417.25	$319.90
1986	$442.75	$326.00	2004	$454.20	$375.00
1987	$502.75	$390.00	2005	$536.50	$411.10
1988	$485.30	$389.05	2006	$725.00	$524.75
1989	$417.15	$358.50	2007	$841.10	$608.40
			2008	$1,011.25	$712.50
			2009	$1,212.50	$810.00
			2010	$1,421.00	$1,058.00
			2011	$1,895.00	$1,319.00

Source: http://www.onlygold.com/tutorialpages/picessince1972fs.htm

CONTRAST TO THE TRADITIONAL & ISLAMIC ETHICS WITH MODERN BANKING OF RUSSIA AND BRITAIN IN IRAN AT QAJAR PERIOD (1800-1900A.C)

Dr. Mohammad Amir Ahmadzade[1]

Abstract

The Nineteenth century was the beginning of World Trade. Meanwhile, Iran was in control of the Qajar rule. Iran's economy during this period was based on traditional farming and Traditional society with Islamic beliefs lead to a continuing tradition in Iran that in conflict with the era of global trade. On the other hand, political and geographical position of Iran in the Middle East, caused increase interference and competition between the Russian and Britain governments in Iran. One of the main disputes between these governments were economic competitiveness so that, they were trying to establish bank in Iran. on one side, This competition between two superpowers and political Weakness of Iran's rulers in other hand, lead to the formation of large economic concession in 19th century. So that, the traditional economy of Iran was bankrupted because it did not compete with European products and exchange model of money and traditional bankers (changers) of Iran had not fiscal power to compete with the Imperial Bank of Britain and Russian banks. Exchange method in the traditional economy of Iran was based on Islamic traditions such as One fifth (Khoms), Tribute (Zakat), Prohibition of usury(Mane reba) and etc. but Exchange method of modern banks belonge to Britain and Russia based on more profits and attract capital flows. This confrontation led to deprivation of Trust between people of Iran to modern banking and resistance of community groups to positive developments in modern banking.

Keywords: Iran, Traditional Economy, Changers, Modern Banking, Britain, Russia, Nineteenth Century

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1. Introduction

Bank has been the place for trading with money and credit, accepting deposits and lending, respectively. Bank from a Latin word meaning, the meaning behind the bench or counter the Italians keep the money paid to the exchange.

Bank, to the modern concept, was formed after the industrial revolution in Europe and the transfer of funds, issuing drafts(Barat), preserving capital of people to throw it in the way of economic growth and development, allocation of credit to the people and the Publishing notes(Mint).[2]Banks because of the economic sectors has various forms, including central banks, commercial and specialized government or private sector capital that will be created.

2. The Qajar Period (19th Century)

With the fall of the Safavids, which led to confusion and tribal wars, the boom began to decline in trade and exchange in Iran Territory; But after coming the Qajars to power in the Ninteenth century and establishment of central government and end tribal wars and Revival of security Under a single government, we can see that the trade flourished again. The British fleet in the Persian Gulf and Russia and the Ottoman wars in 1304/1877, and the abolition of duty through the Caucasus, Iran was due to trade routes and, under a single government increased to five or Sixtuple rather than the years before.[3] But, these enhance of trade relations did not mean that, Iran's trade progressed because Iran was the plaything of trade competition between two political powers of Great Britain and Russia.[4] Iran's traditional economy can not compete with modern political economy colonial sentiment in Russia, especially after the treaties of Golestan and Turkmanchay (1818-1828 A. C) which led to separation of the northern parts of the commercial zone of Iran and increased the influence into

[2] - Haj Sayyah, memories of Haj Sayyah(The horrors period), efforted by Hamid sayyah, corrected by Saifullah Golkar, Tehran, Ibn Sina, 1346, pp209-212

[3] - charls Issawi: economic history in Iran: Qaiar period1796-1913 A.C /1215-1332Hijrah,Translated by yaghob Ajand, Tehran, Gostareh publisher,PP125-128

[4] - Amin al Dawla, Mirza Ali Khan: Amin-Dawla's political memories, corrected by Hafez Farmanfarmaian, Tehran, Iran Book Co, pp134-135

Russia and Russian goods to 5% decline Tariff (The customs) , the goods were shipped to Iran,s Market. at this terrible condition, Great Britain also reduced the amount of political pressure Tariff of his country and its artifacts to fill the markets of Iran and the Iranian Transactions reached from 2500000 lira in 1215/1800A.C to Fourfold in 1331/1913.[5]Business growth, led to fifteen Crore Tomans of Iran,s Liquidity annually dismissed and sent out of Iran.[6] in spite of the success of the Qajar state in security and internal stability problems, but because the Europeans were quite weak, with commercial contracts with Western countries, the independence of Iran's trade was in danger.

Meanwhile, investors of these powers were active in various fields of commercial and participated in industrial and mining, finance and banking of Iran. Overall growth of universal trade in Iran, did not positive advantage for Iran economy because the's markets had the small capacity for business and any least of the elementary office markets, profits turn into losses. Some of Sarraf (Traditional changers) of Iran dominated on the money market with a backward system; at this period, Iranian bourse was highly fragmented and was not specialized; European companies, who want to profit more from a closer surveillance of their trade, were encountered with several problems in various fields such as transportation and conversion of the money from Iran. Also, Iranian merchants because of their traditional barriers had many obstacles with other countries which it was the result of the old exchange in Iran. For this reason, merchants, capitalists, Iranian and European companies and institutions realized the need to create a new financial institution, which named "bank".

For the first time, Europeans in the 1281/1864, the bank proposed by the Frenchman Jean Savalan, to Mirza Mahdi khan naserolmolk.[7]Then, Arlange Parisian institute, Won concession of banking establishment in 1283/1886, arose a bank in Iran. But, negotiations postponed because of the Iranian government had not had and refused sufficient guarantees to maintain bank deposits against the arbitrary actions of

[5] - Issawi,pp.198-203

[6] - Afzal ol Molk, History and geography of Mazandaran, pp.154-156

[7] - Timuri, Abraham, the idiotism era or history of monopoly concession in Iran, Tehran, Iqbal and Partners, 1332, pp176-179

rulers.[8]The bank thought it was common between capitalists and intellectuals of Qajar Iran: Mirza Malcolm Khan wrote a dissertation about the bank and Haj Mohammad Amin al-zarb (Head of mint) emphasized in the necessity and importance to establish a bank, in a letter to the Shah(king) at 1296/1878. But this proposal, were remained inconclusive by Opposing effects of the courtiers and princes, and eventually multi-capitalist Iranian followed banking. They decided to form with the participation of French investors and the Ottoman Bank, Bank of Iran and Afghanistan, for add in a bowl all of the funds that will flow between Iran and Europe, in 1302/1885. But it was not practical because the French did not make this investment. Finally, the British were able to establish Iran's first bank. This may lead to their success because they bad most trade relations with Iran and they wanted to facilitate bilateral trade.

3. New Oriental Bank (New Union Bank)

This bank was an English institution which had a center of London and its activity areas were in some Asian countries.[9] but, this bank did not stand more than two years and in 1305/1888 it sold furniture and its branches for the twenty thousand pound to the Imperial Bank and ended up to its works.

3.1 Imperial Bank

It was First State Bank of Iran which published and striked money. Based on patents in 13071888A.C, Establishment and management of this bank for sixty years were assigned to Baron Julius Reuter, a British citizen of German Jewish descent who had accepted Christianity. He gained enormous wealth, and, in 1289/1872, paid huge bribes to the courtiers of Shah, was achieved to earn points and monopolies. According to these concessions, it was entrusted to his charge the construction of railways, dams, operation of mines, forests, land, factories, banks established in Iran for seventy years. Tsarist Russia, opposed in these concession and supported of the protesting princes and priests and people to these points and thus, the king was forced

[8] - Isawi,pp539-543

[9] - Mostafa Fateh, money and banking, Tehran 1309, pp 78-81. George Nathaniel Curzon, Iran and the Iranian problem, translated by of Gh. Vahid Mazandarani, Tehran 1362, pp268-274

to cancel it in 1290/1873. Reuter for seventeen years complained to British government for their rights and accused the government of Iran to Lack of loyalty. Finally, with the exemption Rabino, Reuter representative in Iran, and the ongoing efforts of the British minister in Iran Sir Dramnd Wolf got and received points to establish the Imperial Bank, instead of canceled earlier concession. The patents in the first quarter, shah were awarded to Reuter and his partners to establish a public database called "Imperial Bank" for sixty years.[10]In the second quarter, according to the contract, the capital of this bank was intended eight crore Lira. In the third quarter, it was granted to the bank exclusive right for coincid bill backed by gold. This meant that, silver were replaced of gold practically. According to Chapter V, Bank was sponsored by government of Iran, and was exempt from any tax. According to Chapter VI, the bank was obliged to take into account special funds in its treasury and paid it to government of Iran and takes its payment inside or outside of Iran.[11] Under Chapter VII, the bank was obliged to pay 6% of annual net profit to the Iranian government and provided not less than four thousand lira. The chapters eleven and twelve declared the Iranian government was assigned utilization rate of all the mines, except gold and silver and jewels, to the Reuter and use of all land mines for the construction of the bank was declared free.[12] The government of Iran would receive 16% of the mining interests. The Iranian government was obliged to return the earlier bond rating to Reuter.[13] There are also bank accepted the observer from the Iranian government. In addition, patents mentioned in the amount of forty thousand pound loan to be paid to the Iranian government. Shah, during a trip to London in (1306/1889), signed appendix IV patent of bank and Reuter acquired the right to transfer any of the patents. Reuter after winning score in 1306/1889, founded a company composed of British capitalists, who were famous bankers, for the establishment of the Imperial Bank with a capital of four million pounds and its

[10] - Teimuri,Abraham, pp191-195

[11]- Firuz Kazemzadeh, Russia and Britain in Iran, translated by Manouchehr Amiri , Tehran, Pocket Books, 1354, p 344.

[12]- Morgan Shuster, Iranian repression, translated by Abolhassan Shushtari, Tehran, Safi Ali Shah,s publisher, 1344 p 347.

[13] - Geoffrey Jones, Banking and Empire in Iran , I, London 1986, pp216-219

president assumed to William Sykes from the Far East Company.[14] Imperial Bank, to ensure the profitability established its branches in Iran and its exchange centers were never more than 25 branches. Imperial Bank was in charge of the duties Central Bank of Iran, and gradually it had been accredited institution, a center of finance income between countries. This bank will be kept in special accounts the treasury funds and it played the major role in receipt of tax revenues and government spending in cities and abroad, government loans, and buy silver to mint coins and etc. Imperial bank was committed to debt payments to the Iranian government as the State bank of Iran but with increased power and history of bank lending as a tool for intervening in political affairs.

4. Financial and Political Role of Russia and its Bank in Iran

The Russia bank was established in 1308/1890, shortly after the Imperial Bank. Jacques Pvlyakov, the citizens of Russia, had offered establishment of it to the Shah. Shah, who had a keen interest to Pvlyakov, permitted to him to engage in the company of mortgage transactions and banking.[15] Under the provisions of patents, shah allowed to Jacques Pvlyakov, general councilor of Iran, and others. Based on first quarter it established debt Corporation to mortgage credit and a sales shop, with a validity of 75 years. According second point, company name was association of Iranian borrowings and Its purpose was lend against any kind of valuable property, other than immovable property, such as Europe and the establishment of the auction in Iran. At the Article III, Iran government should be responsible for the protection of the shop and the company's movable and immovable properties.[16] Pvlyakov sold part of the shares to the Russian and Belgian investors and institutions began to work with an initial capital of two crore and two hundred and fifty thousand manat equivalent to the estimated six hundred dollars in gold coin money.[17]

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[14]- Dennis Wright, Britain's role in Iran, translated by Faramarz faramarzi , Tehran 1361, P. 160

[15] - Marvin Antner:Russian-Iranian trade relations, translated by Ahmad Tavakoli, Tehran, foundation of endowments doctor Mahmoud Afshar, 1369. pp 91-97

[16] - Abdollah Mostofi, a description of my life, vol2, pp 52-53

[17] - Mohammad Ali Jamal Zadeh, treasure Shayegan,Berlin, kaveh,1335, p 38.

This foundation of institution at the beginning, did not any conflict with Iran and Britain financial Interests; because its Commercial purposes was limited and its sphere was small loans, jewelry and home goods and furniture business. Its main branch was located in Daralkhlafeh Tehran and other branches in the center was located in the area of Russian influence in the cities of Tabriz, Urmia, Julfa, Rasht, Anzali, the cities of Mazandaran province, Hamedan, Kermanshah, Qazvin, Isfahan, Mashhad, Mashhad, Quchan and Zabul.[18] acording Pvlyakov request, the Iranian government in 1309, to official declared the name of this institution, borrowing from the Bank changed into debt to the Russian government. In 1311/1892A.C, because of lack of profitability of Russian bank, its representative in Iran, suggestied to dissolve its activities; But the Russian government in all fields, including banks, had to compete with Great Britain, prevent of its close and intervened in the country's Ministry of Finance, and transferred all its shares to the Bank of Petersburg. Since then, Russian bank were borrowing to the Russian government and has been implement political objectives and economic objectives were overshadowed by its political goals. Whenever Russian intervention in Iran was more, the bank's capital will be increased.[19]For coordination between government policy and the Bank of Russia, the Russian Embassy as a Dependent Commerce in Tehran assumed the Bank responsibility and related consultations in the provinces were at the disposal of its assets until it becomes necessary. Although the borrowing bank began its work with the mortgage transaction, but, it, in practice, paid indifferent issues; including, insurance and transportation types rated at 1309 points in 1311 to make way Anzali Qazvin, Tehran, Hamedan road points created in 1314 and points to a road, Tabriz, Qazvin in 1319.[20]

Other objectives of the borrowing bank managers were the promotion of Russian goods and materials needed in Iran, from Russia to Iran. This bank increased the volume of trade between two countries, it deals with Iran in a way that complements

[18] - Mikhail Pavlovich and S. Ayransky, Iran's Constitutional Revolution and its social and economic roots, translated by Mohammad Bagher hooshyar, Tehran, Roodaki, 1329,p 31.

[19] - John Foran, brittle resistance (Russia and Britain in Iran), translated by Ahmad Tadayon, Tehran, expressive cultural services, fifth published, 1383, pp180-183.

[20] - National Bank of Iran(Fifty-year history of national Bank in Iranfrom 1307till 1357), Tehran 1357, p 45

the Russian economy may lead. Russian Bank, in fact, was conflicted with Tabriz and Mashhad keep a competitor who had traded with Russia and was also competed with foreign trade with Eastern European countries. But because the main purpose of the activity was political, not economic, did not lead to a danger for traditional bankers in these areas. The Russian Bank, gave loans with easy terms to statesmen, politicians, businessmen and prominent individuals, for achieving their political goals; This will grant loans for different purposes, including paying, with resilience to pressure debtors to known and cunning of the possibility, it provide critical intervention for government of Tsar's court and its centers. It scalated intervention of Russia representatives in the Iranian lives and prepared the materials to separate northern parts of Iran. It was not successful to the bank's policy because of their total capital was spent on mortgage deals and thirty million manat, and remained only three million in the bank account. It had different behavior against the Iranian government and the financial problems of government borrowing at different times when Talbot contract was canceled and the government fiscal deficit and economic crisis continued, Russian bank gave in 1318/1900, for a victory over rivals (Great Britain and the Imperial Bank), a loan of $ 000, 500, 22 manat, with profit 5% to seventy-five year period, customs revenues in exchange for the north, the Iranian government's confirmations.

Received successive loans from Russian banks, led to increased Russian continuity interventions to the private part of the Iranian government. Expansionist policies of the bank continued until after the collapse of Tsarist rule, pursuant to article 19 Convention in 1921 between Iran and the Soviet Union, the Russian bank was assigned to the Iranian nation. Economic measures were not successful because all branches of Russian bank in its capital and real estate became the property that the mortgage was made to capture and, consequently, his capital would decline and the constant conflict with the people and the lack of public acceptance. Russian government representatives had influenced on the king, courtiers, politicians and clergymen, through giving loans and were dominant On the Iranian government's policies.[21]They consist of numerous business centers in Iran such as Thomanyans

[21] - Hossein Mahboubi Ardekani, a new civilization on the Iranian institutions, Tehran, 1357, vol 2, pp. 108, 113, 125 127.

business center which was the first businesses of money exchange and banking business in Iran. Iran's trade growth, led to spread the Iranian reputable business activities. The Iranian traders had competed with Imperial bank and Russian business centers and some times, they could overcome on their Powerful competitors. But for reasons such as lack of government support, lack of codified rules of banking in Iran, lack of proper expertise and insight and scattering in investment banking and other institutions, had an important achievement and, after some partial and temporary success, but eventually were forced to retreat against the Imperial Bank.

5. The Coagulation Process of Customs Agreement With Russia

Iran's Customs Administration was from safavids period (15th century A.C) till year of 1317 AH /1899 as a contractor and was not applied or fixed any rules and regulations for customs duty. Usually, the person who wanted to act as contractor. Amin Dawla during his short Chancellery decided to organize and customer of many people to hire specialists from Europe. Therefore, the Belgian people as they are hired from a neutral country but, these three people came to Iran after the overthrow of Amin Dawla and the Russians' own valet who, like Amin Sultan.[22]This northern neighbor finding opportunities of the weak institutional Shah, and Amin Sultan impurity and ignorance of the masses for using of Belgians and others. Customs agreement between Iran and Russia dominated the ring completes the all-Russia on Iran. Russians already formed Brigade and bank borrowing, had been provided the executive power and the necessary capital to develop its influence in Iran, now deal with the economic dominance - Political discovered on Iran. Russia's trade with Iran took an upward trend since the contract because it was so arranged that it can provide benefits to Russians. Russians with their customs agreement became Iran as economical dependent country and it became bankrupt completely. Iran was become producing raw materials needed by the Russians. Instead, Iran was the importer and consumer goods and industrial production from Russia.

[22] - Mostowfi, pp143-151

6. Conclusion

Merchants and traders were assist the evolution of two species of Western societies during the era of urbanization,industrialization and agriculture: One way of promoting growth and trade, transportation, banking, New Industry, and other ways to change the longstanding relations of feudal power and the establishment of democracy or bourgeois democracy. However, the owners of capital had not identical role in the political and economic developments in all Western countries. In England and France, merchants and traders have played major role in determining the course of historical developments and move society towards industrial capitalism and democracy. Big business of Iran in a critical period of history had taken efforts to class their historic mission in the course of social change and community realize the semi-feudal and semi-Asian Persian era of capitalism and the "Urban - Industrial" to the new drive. But the efforts of groups inside Iran, influenced of Iran’s strategic positions have been incapable of playing an independent role.

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THE *RUHIYYAH* OF *QARD* AND ITS IMPLICATION FOR LOAN THEORY

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Abstract

The purpose of this paper is to discuss the spirit *(ruhiyyah) and* originality of *qard* from Islamic perspectives. This discussion will be able to re-visit the loan theory, the relationship between lender and borrower and the parameter for *fisabilillah*. This re-visit will lead to renew our discussion on the loan theory. This paper is conceptual in nature describing how *qard* is being derived from Quranic commentary and also from al-hadith, and defined by scholars. Then, this conceptual framework will be used to create the parameter for *fisabilillah* and needy person and link it to loan theory. Discussion in this paper attempts to discuss on matters pertaining *qard* such as Quranic commentary and al-hadith, the discussion about scholars view on *qard* and the contribution of *qard* that lead to loan theory. The paper initiates a new loan theory especially on building Islamic economics theory.

Keyword: *Qard, Fisabilillah*, Loan Theory, *Ruhiyyah*

1. INTRODUCTION

The origin of *Qard* could be traced from several verses in Al-Quran and several al-Hadith. The theoretical foundations from these sources, later, were expanded by many scholars such as Tabari, Ibnu Kathir, al-Suyuti, al-Qurtubi, al-Baidhowi and al-Jalalyn. The practices has been reported during prophet time, the reign of the eighteenth Abbasid Caliph Muqtadir (908 A.D. to 932 A.D.), in the period 300 AH to 333 AH that was ruled by four Abbasid Caliphs, Muqtadir, Qahir, Radi and Muttaqi and also in early fourth century A.H.[3]

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In conventional way, the similar model (known as benevolent loan) had been introduced in France since the early 14th century. In Netherlands, it was also introduced in the 14th century (G.L. 1963). The aim was intended as a gift of aid or money for the war and later it was intended to give an aid to other persons or an aid in place of a parliamentary subsidy(G.L,1963). However, due to the industrialization era in 17th century, it created people with business minded. Therefore, the facility, later leads to the owner of property (such gold and later known as fiat money) was rewarded with interest rate, as was introduced in Netherlands in 12th century.

However, the recent practice shows that *qard* has been used as commercial facility (with some return) in financial institutions. For example, in Malaysia, it has been practiced in business activities and became the business model as witnessed in the operations of Ar-Rahnu and Amanah Ikhtiar Malaysia. Other countries also introduce the same business model.

Originally the owner in *qard* transaction is allowed to lend the property. It raises the following related questions. What types of property that can be lent? There must also be reason(s) for lending. What are there? How could we say that lending must have the purpose? Since, the *qard* is meant for lending. Would it bring any monetary rewards? If not, what are the incentives for the owner? Hence, it would create another view on the loan theory.

The above question has motivated us to explain the loan theory and relationship between lender and borrower; especially in searching the parameters for *fisabilillah* and needy person.

The purpose of this paper is to discuss the spirit *(ruhiyyah) and* originality of *qard* from Islamic perspectives. This discussion will be able to re-visit the loan theory, the relationship between lender and borrower and the parameter for *fisabilillah*. This re-visit will lead to renew our discussion on the loan theory.

The remaining discussion of this paper will be divided into three sections. Section two will discuss *qard* from the original sources and view of several scholars. Section three

will produce the implication of *qard* on loan theory. The conclusion will be presented in section four.

2. WHAT DO THE ORIGINAL SOURCES AND SCHOLARS SAY ABOUT *QARD*?

In this section, we will discuss *qard* from the two original sources, i.e., al-quran and al-hadith. It will be followed by view from several scholars. The aim is to determine on how the three sources agree on the definition, validation and the objectives of *qard*.

2.1 From Al-Quran

Several studies, among others are Farooq (2008), Atia (n.d), Mirakhor and Iqbal (2007) refer to several verses in the Holy Quran when discussing about qard. They refer to the following verses, i.e., Chapter al-Baqarah: verse 245, Chapter al-Maidah: verse 12, Chapter Al-Hadid: verse 11 and 18, Chapter al-Taghabun: verse 17 and Chapter al-Muzammil: verse 20. However, in those studies, they refer the verses as to validate the approval of qard. In this section, we will use the interpretation of those verses in achieving the similar objective. In interpreting these verses, we will adopt the Quranic commentary[4] by al-Tabari, Ibnu Kathir and al-Suyuti who used the form of *al-tafsir bi al-ma'thur*[5] specifically using the method of *al-tahlili*.[6] We also add some Quranic commentary by al-Qurtubi, al-Baidhowi and al-Jalalyn that used the form of *tafsir bi al-ra'y*[7] and also in the *al-tahlili* method. We also add some quranic

[4] Al-zahabi, Muhammad Hussain, al-tafsir wa-almufassirun,vol 1, p 105-257

[5] *Tafsir bi al-Ma'tsur* is interpreted based on the Sahih collection that is interpreting the Qur'an with the Qur'an, the Sunnah with Qur'an because it serves as clarifying the Quran, with the word of Companions because they were most know the Quran, or the words of great tabi'in because they generally receive from his companions

[6] *Tahlili* means: This interpretation is done verse by verse and then sequentially letter by letter from beginning to end according to the order of the Qur'an. It explains vocabulary and wording, are required to clarify the meaning, the intended target and content of a sentence, namely the elements *i''jaz, balaghah* and the beauty of the arrangement of sentences, explain what can be taken from the text that is the law of *fiqh*, evidence *syar'i*, meaning in language, the norms of morality and so forth.

[7] *Tafsir bi al-ra'y*: This interpretation enlarges the role of ijtihad in comparison with the use *of tafsir bi al-Ma'tsur*. With the help of Arabic knowledge, *qiraah* knowledge, the knowledge of Al-Qur'an, hadith and Science of Hadith, *ushul fiqh* and other sciences, mufassir will be using ijtihad ability to explain the meaning of the text and expand it to support the development of knowledge.

commentary by *al-Zuhaily* in his book al-Munir that combined the form of *al-tafsir bi al-ma'thur* and *tafsir bi al-ra'y* using method of *al-tahlili* and *semi thematic*.[8] The discussion of each verse will be focused in two perspectives: reasons of revelation and various interpretations by mufassirrun.

(a) Chapter Al-Baqarah, verse 245.[9]

The reasons on why the verse 245 of al-baqarah was revealed, as noted from Said bin Mansur, Ibn Sa`d, al-Bazzar, Ibn Jarir, Ibn al-Munzir, Ibn Abi Hatim and al-Hakim al-Tirmizi, in several *al-usul*, and al-Tabrani, al-Baihaqi in discussing the topic of al-Iman, from Ibn Mas`ud, was due to the story of Abu al-Dahdah. When Allah say:

> *"Who is it that (will) grant Allah a goodly (sincere) loan so that He will repay him many times over? And (remember) it is Allah who decreases and increases (sustenance), and to Him you shall all return*."

Abu al-Dahdah al-Ansari said: O Messenger of Allah, does Allah want a loan from us? He replied: "Yes, O Abu Dahdah." He said, "Give me your hand, O Messenger of Allah: Then he held the hand of Prophet SAW and said: "I lend to the Lord my garden which there is six hundred palm trees, his wife and family. "Then Abu al-Dahdah went into his garden and he called: "O Umm al-Dahdah! She replied: "Yes, Abu al-Dahdah, said: "Since I have lent to Allah, so let us leave this garden.[10]

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[8] *Semi thematic* (method of *al-maudhu`i*) because he interprets the Qur'an from al-Fatihah letter by letter until an-Nas and put the themes in each study according to the contents of the verse, as in the interpretation of the letter al-Baqarah, verse one through five, he gave the theme attributes of believer and the reward of the righteous.

[9] As stated in the Quran, 2:245

[10] al-Suyuti, *Dar al-Manthur fi al-tafsir al-ma'thur*, vol.1, p.554. Original text in Arabic:

أخرج سعيد بن منصور وابن سعد والبزار وابن جرير وابن المنذر وابن أبي حاتم والحكيم الترمذي في نوادر الأصول والطبراني والبيهقي في شعب الإيمان عن ابن مسعود قال « لما نزلت { من ذا الذي يقرض الله قرضاً حسناً فيضاعفه له } قال أبو الدحداح الأنصاري : يا رسول الله وإن الله ليريد منا القرض؟ قال : نعم يا أبا الدحداح . قال : أرني يدك يا رسول الله ، فناوله يده قال : فإني أقرضت ربي حائطي وحائط له فيه ستمائة نخلة وأم الدحداح فيه وعيالها ، فجاء أبو الدحداح فناداها : يا أم الدحداح قالت : لبيك . قال : اخرجي فقد اقرضته ربي عز وجل

The act of Abu al-Dahdah was recognized by the Prophet pbuh who said great reward for Abu Dahdah in paradise when Abi al-Dahdah contributed his land as a charity in the path of Allah.[11]

In this verse, Ibnu Kathir commented, *qardhan hasana* means Allah encourages His servants to spend in His cause and do not be anxious because; Allah is the Sustainer Who increases or decreases the provisions to whomever He wills among His servants.[12] Again, Az-Zuhaily in his book, Tafsir al-Munir, interpreted this verse as Allah makes parable a donation like loans in order to urge servants to make donation in His path.[13]

While, Al-Tabari[14] said in the interpretation of this verse saying: Who is he that will lend unto Allah a good loan? Abu Ja`far said: I mean Allah said so: Whoever spent in the way of Allah, Allah will give the reward, shall appoint and weakens, strengthens the privations of jihad for the sake of Allah? This is a (*Qard al-Hasan*) good loan in which the servants give to Allah. And Allah said '*al-Qard'* or loan because the meaning of loan is to give the man his property to others, and Allah will give you same like you give others. And Allah promised to reward him very much of on the Day of Resurrection.

And *'Hasan'* mean is good. Due to what the giver give to others is recommended by Allah and Allah encouraged in obeying Allah's command and abstains from the evil 'syaitan'.[15]

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[11] Ibid.p.555
[12] Tafsir Ibn Kathir,Volume 1, p 684 – 685
[13] Az-Zuhaily, Tafsir al-Munir, Vol 2
[14] al-Tabari, *Jami` al-Bayan fi Takwil al-Quran*,vol.2, p.607
[15] Ibid, p.607. Original text in Arabic:

القول في تأويل قوله : { مَنْ ذَا الَّذِي يُقْرِضُ اللَّهَ قَرْضًا حَسَنًا فَيُضَاعِفَهُ لَهُ أَضْعَافًا كَثِيرَةً }

قال أبو جعفر: يعني تعالى ذكره بذلك: من هذا الذي ينفق في سبيل الله، فيعين مضعفا، (1) أو يقوي ذا فاقة أراد الجهاد في سبيل الله، ويعطي منهم مقترا؟ وذلك هو القرض الحسن الذي يقرض العبد ربه.

وإنما سماه الله تعالى ذكره"قرضا"، لأن معنى"القرض" إعطاء الرجل غيره ماله مملكا له، ليقضيه مثله إذا اقتضاه. فلما كان إعطاء من أعطى أهل الحاجة والفاقة في سبيل الله، إنما يعطيهم ما يعطيهم من ذلك ابتغاء ما وعده الله عليه من جزيل الثواب عنده يوم القيامة، سماه"قرضا"، إذ كان معنى"القرض" في لغة العرب ما وصفنا.

وإنما جعله تعالى ذكره"حسنا"، لأن المعطي يعطي ذلك عن ندب الله إياه وحثه له عليه، احتسابا منه. فهو لله طاعة، وللشياطين معصية.

(b) Chapter al-Maidah: verse 12.[16]

Allah has mentioned: Meaning: "And lend to Allah a good loan" meaning by spending in His cause, seeking to please Him.[17] *Qarḍ al-ḥasan* appears in al-Maidah, verse 12 where it comes after prayer, paying zakah, and belief in the messengers.

(c) Chapter al-Hadid: 11.[18]

From At-tabari, he interprets *Qard al-Hasan* as anyone who makes spending in the cause of Allah in this world, to achieve the blessing from Allah. And that is *qard al-Hasan.* And Allah will reward more on what you have give (loan) to Him, such as spending in the way of Allah. Allah will reward one with seven hundred.[19]

From al-Baidhowi, "Who is he that will lend Allah a good loan, mean that who spends his money in the process hope of compensate, it is like someone who lend and spending the money sincerely, and give the best property and his best sides" .[20]

From Tafsir al-Jalalayn, "Who is it that will lend God, by expending his wealth in the way of God, a goodly loan, [goodly] by virtue of his expending it for God's sake, so that He may multiply it (for him, from tenfold up to more than seven hundredfold - as stated in chapter al-Baqarah [Q. 2:261], and [so that] there may be for him, in addition to the multiplied [reward], a generous reward, coupled with satisfaction and prosperity".[21]

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[16] As stated in the Quran, 5:12

[17] Ibnu Kathir, vol.3, page 127-128.

[18] As stated in the Quran, 57:11

[19] al-Tabari, *Jami` al-Bayan fi Takwil al-Quran*, vol.11, p.675. Original text in Arabic:

القول في تأويل قوله تعالى : { مَنْ ذَا الَّذِي يُقْرِضُ اللَّهَ قَرْضًا حَسَنًا فَيُضَاعِفَهُ لَهُ وَلَهُ أَجْرٌ كَرِيمٌ }

يقول تعالى ذكره: من هذا الذي ينفق في سبيل الله في الدنيا، محتسبا في نفقته، مبتغيًا ما عند الله، وذلك هو القرض الحسن، يقول: فيضاعف له ربه قرضه ذلك الذي أقرضه، بإنفاقه في سبيله، فيجعل له بالواحدة سبع مئة.

[20] al-Baidhowi, *Anwar al-Tanzil wa Asrar al-takwil*,vol 2, p.468. Original text in Arabic:

{ مَّن ذَا الذى يُقْرِضُ الله قَرْضًا حَسَنًا } أي من الذي ينفق ماله في سبيله رجاء أن يعوضه ، فإنه كمن يقرضه وحسن الإنفاق بالإخلاص فيه وتحري أكرم المال وأفضل الجهات له

[21] Tafsir al-Jalalyn, vol.6, p 11.

(d) Chapter al-Hadid: 18.[22]

From Tafsir al-Jalalyn, the verse mean “Indeed men who give voluntary alms and women who give voluntary alms and [those of them] who have lent God a goodly loan ‘it will be multiplied namely, their loan [will multiplied], for them and they will have a generous reward”.[23]

(e) Chapter al-Taghabun: 17.[24]

From al-Jalalyn, he said that if you lend God a good loan, by giving voluntary alms out of the goodness of [your] hearts, He will multiply it for you, from tenfold up to seven hundredfold or more for each one - this [loan] being the giving of voluntary alms out of the goodness of the heart - and He will forgive you, whatever He will, and God is Appreciative, rewarding of obedience, Forbearing, in refraining from [always] punishing disobedience.[25]

(f) Chapter al-Muzammil: 20.[26]

From al-Baidhowi, {And lent Allah a good loan} wants up in all other expenditures in the ways of good things, or by performing Zakat in the best way, and seeking the promise of reward.[27]

2.2 From Al-Hadith

[22] As stated in the Quran, 57:18

[23] Ibid.p.16

[24] As stated in the Quran, 64:17

[25] Ibid, vol.6, p.106

[26] As stated in the Quran, 73:20

[27] Tafsir al-Baidhowi,vol2, p539-540

Based on the *Al-Mu`jam al-Mufahras lil alfaz al-hadith al-nabawiah `an al-kutub al-sittah wa `an musnad al-darami, wa muwatta' wa musnad ahmad bin hanbal,*[28] (The Encyclopedia of hadith Nabawiah with reference to six books and musnad al-darami, book of muwatta and musnad Ahmad bin Hanbal), the word *qarḍ* appears several times, without any connotations that are traditionally attributed to *qarḍ* as *qarḍ ḥasan*.

Hadith on *Qard* (with reference to *Kutub al-Sittah*), has been classified into several subtitles. The subtitles are as follows. About *Qard*[29], the intention to pay and avoid for being in debt[30], repayment of debts[31], repayment of debts handsomely[32], demanding of debts handsomely[33], delayed the payment[34], period of delay/deferred[35], put condition on *al-Qard*[36], the reward for giving loan[37], the right of creditor[38], intercession for the reduction of debts [39], Prohibition on giving loan to person who waste the property[40] and *al-Kafalah* in debt [41] and threats of a debt[42].
In conclusion, from Ḥadīth, *qarḍ* is referred to as *qarḍ*, without addition of word *'ḥasan'*. The authority in Sahih Muslim, Sunan Abu Dawud, Sunan al-Nasai, Sunan

[28] Al-Mu`jam al-Mufahras lilalfaz al-hadith al-nabawiah `an al-kutub al-sittah wa `an musnad al-darami, wa muwatta' wa musnad ahmad bin hanbal, vol.5, p.363-364
[29] Sahih al-Bukhari, Vol.3, Hadith no.570 (Buy something on credit), 571(mortgage).
[30] Ibid,Hadith no. 572, 573, 574, 582 (seek refuge from being in debt), Al-Kutub al-Sittah, Sunan al-Nasai, Book of transaction. Hadith no.4690, 4691. p.2390
[31] Ibid,Hadith no.580 (pay less if creditor accept), 581 (repay without weighing or measuring if the creditor agrees)
[32] Ibid Hadith no 575, 577, 578, 579 (Buy a camel on credit and pay with older one is better), Al-Kutub al-Sittah, Sahih Bukhari, Book of al-Wakalah..Hadith no. 2306.p. 180 , Al-Kutub al-Sittah, Sahih Muslim, Book of al-Musaqah..Hadith no. 4111, p.956., Al-Kutub al-Sittah, Jami` al-Tirmizi, Book of al-Ahkam, Hadith no. 1316,1317.p.1784, Al-Kutub al-Sittah, Sunan Ibnu Majah, Book of charity.Hadith no. 2423,2424 p.2622.
[33] Ibid Hadith no 576.
[34] Ibid, Hadith no 585 (delay payment by wealthy person is unjustice), 583 ,Al-Kutub al-Sittah, Sunan al-Nasai, Book of transaction. Hadith no. 4692, 4693, 4694, p.2390
[35] Ibid Hadith from jabir, page 345. (does not perceive as procrastination since have maslahat)
[36] Al-Kutub al-Sittah, Sahih Bukhari, Book of condition. Hadith no. 2734(fixed a period), 2735, (condition that opposite with kitabullah),2736, p.219.
[37] Al-Kutub al-Sittah, Sunan al-Nasai, Book of transaction..Hadith no. 4687. p.2390,Al-Kutub al-Sittah, Sunan Ibnu Majah, Book of tijarah..Hadith no2289. p.2613 (*barakah* for lending money),Al-Kutub al-Sittah, Sunan Ibnu Majah, Book of charity..Hadith no. 2430, 2431, 2342. p.2622.
[38] Sahih al-Bukhari, Vol.3, 586 (right of creditor to speak), 587,588 (The case of debtor bankruptcy), 592 (guardian of the property), Al-Kutub al-Sittah, Sahih Bukhari, Book of al-Wakalah. Hadith no. 2306.p.180 (right to ask the payment)
[39] Ibid, Hadith no 589
[40] Ibid, Hadith no 590, 591
[41] Al-Kutub al-Sittah, Sahih Bukhari, Book of al-kafalah..Hadith no. 2290, 2291, 2292, 2293, 2294.p.178
[42]Sahih al-Bukhari, Vol.3, Hadith no 583 and 584(funeral prayer for debt person).Al-Kutub al-Sittah, Sunan al-Nasai, Book of transaction.Hadith no. 4688, 4689. p.2390

Ibn Majah, Sunan al-Tirmidhi, Musnad Ahmad bin Hanbal and Sunan al-Darimi does not have separate chapter on *qarḍ* except in al-Bukhari.

In some of the collections, some minor and brief segments on *qarḍ* are included in *Book of Buyūʿ* (business transactions), *Book of Ṣadaqah* (alms/charity), *Book of Musafir (travelling,), Book of Musaqah, Book of Imarah, Book of al-Aiman, Book of Manasik, Book of al-tib and book of Kafalah.* All the above hadith give explanation on how scholars interpret *al-qard* itself.

Therefore, from the discussion of *qard* in Al-Quran and Al-Hadith, we could conclude that: *first*, *Qard al-Hasan* from the view of *mufassirun* in interpreting Quranic verses means to do sacrifice by spending in the path of Allah. At the same time, Allah will give reward to the believers by doing that. While, there is nothing in Ḥadith pertaining about *qarḍ* that a *qarḍ* must be understood as *qarḍ al-ḥasan.*

Second, according to the definition by mufassirun views, tell us that *qard al-hasan* refers to the symbolic transaction between Allah and the believers. And the word *qard al-hasan* is referring to the contribution in the path of Allah by giving or spending money or property. This can also be related to the hadith that giving loan would be rewarded more than *sadaqah* which is eighteen and *sadaqah* is ten rewards.[43] As *sadaqah* is literally means give something in order to seeking Allah's pleasure. However, the significant term is, Allah promised to the believers when spending in the path of Allah, Allah will reward it more on what they have spent. Meaning that, for example when a believer give loan to other (in order to help others) Allah will reward him.

2.3 SCHOLAR VIEW ON *QARD*

Among the definition given by scholars can be extracted is as follows: (i) Hanafi scholar defined as "when one party gives to the other to be returned in its own kind"[44]; (ii) Maliki scholar defined *al-qard* as "payment of valuables for repayment

[43] Sunan Ibnu Majah, Book of charity, hadith no 2431.

[44] Ibn. Abidin, Muhamad Amin, *Rad al-Muhta `ala al-Dur al-Mukhtar sharh Tanwir al-Absar,* tahqiq: Sheikh `Adil Ahmad `Abdul Maujud & Ali Muhammad Mu`awwad, vol.7, p:388

not different in kind";[45] (iii) Shafie' scholar defined *al-qard* as "transferring the ownership of something to others and will return back as it original";[46] and (iv) Hanbali scholar defined *al-qard* as "the payment of money to someone who will benefit by it and return its equivalent".[47]

In general, the definition of the scholars give the same meaning, that is, in providing part of the property to the borrower or debtor which will be returned to the lender, the property or article or similar items. All these definitions are close to each other, and each one of them shows that loan in the Shariah is a property contract and not a consensual one. Therefore, to validate the contract, it is necessary to deliver to the borrower the property which he borrowed. [48]

The practice of the Prophet and his companions, shown that, *al-qard* in Islam is free from elements of usury and oppression. *Al-qard* means there are no elements of riba or interest.

Looking at the meaning of *al-qard*, in terms of language, Qurtubi says that the *qard* can occur not only to property, but also on one honor. For example, a person who has been backbitting by others and never takes any action to those slanders, this was associated with a hadith narrated by Ibn Umar r.a.[49] Meaning: *Lend price of your soul to the day of your poor, which is you did not take any action and penalties to those who slandered you, until the day of Judgement and you shall receive the reward.*

While, this opinion is oppose with Abu Hanifah and Malik, because one honour is in Allah's right. The word *al-qard* according to Mu'jam al-Wasit means: Property given to others and returned to him. While the word *al-qard al-hasan* defined as loans

[45] Al-Dusuqi, Muhammad bin Ahmad bin `Arafah al-Dusuqi, *Hashiah al-Dusuqi,* takhrij: Muhammad `Abdullah Shahin, vol.4, p. 359
[46] al-Jamal, Sulaiman bin `Umar al-`Ujaili al-Misri, Hashih al-Jamal `ala sharh al-minhaj, p.48: al-Ramli, Shamsuddin Muhammad bin Abi al-Abbas Ahmad bin Hamzah Ibn Shihabuddin al-Ramli, Nihayah al-Muhtaj ila sharh al-Minhaj, vol.4, p.219.
[47] Al-Sa`di, `Alaudin Abi al-Hasan `Ali bin Sulaiman bin Ahmad al-Mardawi, al-Insaf fi ma'rifati al-rajih min khilaf 'ala mazhab Imam Ahmad bin Hanbal, vol..109, p.5,; al-Buhuti, Mansur bin Yunus bin Idris, Kashaf al-Qina', Tahqiq: Hilal Musailihi Mustafa Hilal,vol.3, p.312
[48] Ala'eddin, Kharofa, The Loan Contract in Islamic Shariah and Man Made Law, Roman, French, Egyptian: A Comparative Study, p52.
[49] Al-Qurtubi, *al-Jami`u al-Ahkam al-Quran,* vol.3, p158

without interest or profit.[50]Muhammad Umar Chapra[51] defines *al-qard* and *al-Hasan* as a loan to be returned when due without any benefit promised, whether from business profits or losses.

3. IMPLICATIONS ON LOAN THEORY

The *qard* is meant for lending. As discussed in section 2, it would bring reward and love of God (via fisabilillah) to the owner because the action is done in the cause of God. However, action will only happen, if owner knows the philosophy of both reward and fisabilillah. Therefore, the understanding of the ethical philosophy and metaphysical philosophies are crucial in explaining the loan theory from Islamic perspective. Therefore, we will explain the ethical and metaphysical philosophies of *qard*. Then, a new view on reward theory and fisabilillah will be forwarded in this section. Does it fit with the conventional loan theory? How does this reward theory differ from Islamic perspective? If the difference exists, it might lead towards a new theory of reward and a new view on fisabilillah in economics.The philosophical aspects would cover the ethical and metaphysical philosophy. While the division of philosophy covers the practical and theoretical foundations.

3.1 Philosopical Foundations in Relation to Reward

(i) Ethical Philosophy

The conventional economic theories normally concern with the ways in which the production, distribution and consumption of goods and services are organised through the interaction of money (or in kind) and the market mechanism. The rational choice theorists can be used to understand interactions in which such resources as time; information, approval, and prestige are involved. According to the contemporary rational choice approach (as suggested by Lavric and Flere (2011)) people engage in religion predominantly because they expect to maximise their perceived rewards/costs ratio.

[50] Anis, Ibrahim, *al-Mu`jam al-Wasit*, p 727.
[51] Chapra, Muhammad Umar, *Towards a just monetary System*, p.68

In rational choice theories, individuals are seen as motivated by the wants or goals that express their 'preferences'. They behave within specific manner, given constraints and on the basis of the information that they have about the conditions under which they are acting. The relationship between preferences and constraints can be seen in the purely technical terms of the relationship of a means to an end. As it is not possible for individuals to achieve all of the various things that they want, they must also make choices in relation to both their goals and the means for attaining these goals.

Rational choice theories hold that individuals must expect the outcomes of alternative courses of action and calculate that which will be best for them. Rational individuals choose the alternative that is likely to give them the greatest satisfaction (Heath 1976: 3; Carling 1992: 27; Coleman 1973).

Qard is an action. By giving *qard,* the lender has two choices whether the loan he gives is based on benevolent loan or monetary rewards. While the outcome is either reward from Allah (which is unseen and postponed), or monetary reward. However, the choices will be based on the satisfaction he will get. In Islam, how this reward will give satisfaction to him is subject to principles of ethical philosophy by al-Ghazzali which is the end; Knowledge of God; Love of God; and The Vision of God.

(a) The End

All individual activity is directed towards some end. By knowing that this world only for temporarily period, one should know the everlasting happiness is towards the next world. Thus, the good deed in this world will ensure the achievement of greatest happiness. By lending property to someone, it will lead happiness of our sahabah (who are in need) and our happiness in term of reward we will get later. The Alchemy of Happiness or *as-Sa'ada al Haqiqia* by Imam al-Ghazali, clarified that happiness is necessarily linked with the knowledge of God.

(b) Knowledge of God

Perfect of knowledge is only possessed by Allah. Knowledge about qard might lead us to loving Allah.... Suffering in the next world will be experienced by the individual who has excessive love for this world (having more wealth without helping others), for example loving the mal.

"O believers! Indeed many are the (Jewish) rabbis and the Christian (monks) who defraud men of their possessions and hinder (people) from Allah?s Path (the religion of Islam). And (remember) those who hoard up gold and silver and do not spend it in the Path of Allah - proclaim to them a painful punishment."[52]

(c) Love of God

Love of God is the supreme end of individual, in this world.

"Verily, your Wali (Protector or Helper) is Allah, His Messenger, and the believers, - those who perform As-Salat (Iqamat-as-Salat), and give Zakat, and they bow down (submit themselves with obedience to Allah in prayer)."[53]

The proof that we love Allah is by following what has been laid down in al-Quran.

(d) The Vision of God

The phrase "the face of Allah" (for example Chapter 6:52; chapter 13:22, which occurs frequently in al-Quran was interpreted as the sight or vision of God. i.e the highest end of an individual.

"And that which you give in gift (to others), in order that it may increase (your wealth by expecting to get a better one in return) from other people's property, has no

[52] QS.9:34
[53] QS.5:55

increase with Allah, but that which you give in Zakat seeking Allah's Countenance then those, they shall have manifold increase."[54]

Thus, anyone who believe and love Allah truly, will sincerely lend his property to someone, without any negative feelings. For example feeling doubt about the period of payment, fear on the risk and etc. The alchemy of happiness by al-Ghazzali, may be briefly described as turning away from the world to God, and its constituents are four; i)The knowledge of self ii)The knowledge of God iii)The knowledge of this world as it really is and iv)The knowledge of the next world as it really is. However, different stage of people's faith will affect different acceptance on lending. Therefore one's knowledge on *qard* and God reflect the readiness to lend something they own to others. Therefore, philosophically, individual must have the principles in dealing with *qard*.

(ii) Metaphysical Philosophy of Reward

In metaphysics[55], Ibn Sina (AD 980) makes a distinction between essence and existence, existence is an 'absolute existence' *(al-wujud al-matlaq)* or existence so far as it exists. While, essence considers only the nature of things and it should be considered apart from their mental and physical realization. This difference applies to all things except God.

In understanding the link between reward and metaphysical philosophy, this study concentrates on the human soul. For Ibn Sina, the soul is intangible and that it must be immortal.The soul, in his view, is an agent with choice in this world between good and evil, which in turn leads to reward or punishment.

In addition, Al-attas (2003) described that, man as human being in this worldly existence is endowed with a dual nature, he is both body (*badan*) and soul (*nafs*) and at once a physical and a spiritual being. It is a mysterious composite of soul and body, a third entity which is his very self. The human soul is created yet immortal,

[54] QS.30:39

[55] Metaphysics is generally accepted as a branch of philosophy, concerned with the nature of ultimate reality. In the Islamic sense, metaphysics which includes of course its original concern, theology, is the most important because it influences the Muslim conception of the universe, human psychology, epistemology, epistemology, ethics and even logic.

conscious of itself, the locus of intelligibles and equipped with a faculty variously called the soul (*ruh*), self (*nafs*), heart (*qalb*) and intellect (‘*aql*). Since the self is intimately interacting with the dual aspects of body and the soul, it is therefore described as the animal soul (*al–nafs al–hayawaniyyah*) on the one hand, and on the other, as the rational soul (*al–nafs al–natiqah*).

In contrast to the Greek philosophers such as Socrates and Plato, and the Medieval Christian scholars, the Islamic emphasis on the spiritual reality of man. It does not mean that his body which is the source of animal powers as an obstacle to man’s spiritual development. The body has significant contribution for man’s spiritual development for it is through the bodily faculties that the soul can acquire particular information and data concerning the world of sense and sensible experience. The soul, through its various faculties will then develop these sense data into general principles, ideas and beliefs. Further the soul, through its faculties of imagination and estimation, can make distinction between types and differentiate of their various attributes and abstract their general and particular meanings from material connections and relations. In this way it can attain to the knowledge of the individual sensible and their nonsensible meanings such as love and hate (Al-Attas, 2003). Thus, the soul that is unseen and immortality can also make comparison between single universals by denial and affirmation of relations and ratios. The result that determine by soul is also unseen such as reward and punishment since soul itself unseen.

In order to believe that the reward is unseen, one must believe in the matter of non-existence thing (*ghaib*) as a matter of prerequisite. Since Ibnu Sina and al-Farabi also differentiate between existence and essence.

From ethical philosophy and metaphysical philosophy of *qard*, we found that from Islamic perspective, reward thus affect motivation to do something, especially if the reward is toward the end which is the Day of Judgement (hereafter) and although it is unseen, it still affect one’s belief because of the reward come from God. Giving *qard* to others in term of reward will affect one’s action to give *qard* sincerely. While, requesting *Qard* from others is permissible, and considered morally good because it does not take others property. However, it becomes bad and turn to punishment when one refuses to pay or giving back the property. Thus, one’s action lead to either

reward or punishment and every action is determined by the soul.Thus, to gain reward, is by doing good that determined by rational soul *(al–nafs al–natiqah*) and it is result of the choice in this world.

3.2 Practical Aspect of Reward Theory

Among the reasons of lending is because to relieve and assist a person who is under pressure and adversity. In fact a *hadith* shows, the Prophet (pbuh) himself indicates that a loan seeker would not ask for a loan unless necessity and financial despair. Ibn Qudama argues that giving loans is considered "desirable" in the *shariah*, because lending implies provision of relief to one's Muslim brother, fulfilment of his need and extension of help and support (Kahf & Khan, n.d.). Islam against those who love poverty as Islam against a certain group of Theosophy (*tasauf*), who adapt astray opinion about poverty. Difference thing about ascetic (*zuhud*) because it does not mean they praise and love poverty, but the struggle for *zuhu*d itself is require someone to have the luxury world and then leave it. Ascetic person is who have luxury world, but it put the world in the grip of his hands, not in his heart. Islam beliefs that wealth is award bestowed from Allah, thus man need to appreciate it by doing good things as Allah prescribed in his revelation.

Islam also encourages the believers to accumulate wealth. The verse from chapter Nuh, verse 10-12, Allah stated that the property and pleasure in this world is reward to the believers. Several *hadith* reported about poverty as a catastrophe that would invite danger to individuals, society, belief and faith, body and spirit, thought and culture, families and society as a whole. There are some affects of poverty to *aqidah* (faith), ethics (moral and character) and ibadah (worship). A *hadith* narrated from Bukhari and Muslim stated about a man who make a donation to a man who actually a thief and also a woman (a prostitute), and certainly, the charity has been detained that man from stealing and the woman from becoming prostitutes. (3)Poverty may also affect one's worship to Allah. For example, if someone wants to get married, but he does not owe money, he may be involved in adultery if he not keeps his passion. In 24:33, Allah said, mean, *"And let those who find not the financial means for marriage keep themselves chaste, until Allah enriches them of His Bounty."*

By giving *qard* to others, one has been promised about a rich and double reward by Allah and simultaneously he also help needy people who have financial despair. Ethical philosophy stressed by al-Ghazzali is aimed towards the end, knowledge of God, love of God and the vision of God. To link all those theory with *qard*, we will look at *Aqidah* (faith), *Akhlaq* (ethics) and *Ibadah* (worship) dimensions.

In *Aqidah* dimension, one's who believe in Allah promise that he will be given reward in Hereafter by lending to others, then he lend money or any property to others. The implication from that, he will be rewarded by Allah and then reduce his sin before and this will strengthen his faith and abstain from being 'poor' in term of faith.

In *Akhlaq* dimension (ethics), the lender who sincerely give the money without any negative feeling or actions, will be rewarded and at the same time reduce his sin. This will reflect his ethics because of, the purify heart (*qalb*) will affect to one's moral and character. Prophet said, "Truly in the body there is a morsel of flesh which, if it be whole, all the body is whole and which, if it be diseased, all of it is diseased. Truly it is the heart."

In *Ibadah* (worship), it is consider the relationship with Allah and also with other human beings. This world is a preparatory ground for the next, and in this world human has to achieve his perfection in order to realize the mission of his existence. However, he cannot achieve perfection except through his interaction with society. For example, the relationship towards a friend and this relationship mean friendship formed for the sake of truth in the path of Allah. Lending money or property to friend in order to help him from any difficulties with intention of blessing from Allah will be rewarded by Allah and this will avoid the lender from negative behavior such as selfish, stingy and etc. The quality of his worship also will be better than before and the friendship or brotherhood will be blessed by Allah. The prophet said, "The two brothers are like two hands which was each other."

In conclusion, as discussed in 4.1, the choices either to give *qard* based on benevolent loan or monetary benefit then it turn to spending in the path of Allah (*fisabilillah*) after they realize about the reward will affect his faith, ethics and worship to Allah.

3.3 Implication on *Fisabilillah*

(i) Philosopical Aspect of *Fisabilillah*

In the early discussion, stated in 2.1, the word *qard* in several verses discussed earlier found that giving loan or lending is considered sacrifice by spending in the path of Allah or the contribution in the path of Allah by giving or spending money or property.

Generally, *fisabilillah* is defined as an act in the cause of Allah. Act or behave in the sake of Allah is due to love to Allah. Love expresses itself in the conduct of man. The tongue, the eyes, the lips and all bodily organs express it. The man who loves Allah is desirous of union with Allah. Therefore, a lover of Allah loves death, for it is a means of achieving the cherished end.[56] As the property is belong to Allah, then each property we utilized are directed and return to Allah. Giving *qard* is considered act in the cause of Allah. One who lends money to someone is due to love of Allah because he knows that the property is belonging to Allah and Allah will reward him while he assists the others who need the money. Philosophically, love to Allah will encourage the act of giving *qard.*

Implication for *fisabilillah* is regarding the parameter on how to determine the act in the cause of Allah. It is show that among the parameter is (i) the act which is command by Allah, (ii) any *dakwah* activities (iii) any act with intend to get closer to Allah; (iv)any act with regards to public interest. The parameters also are in line with the current view on conceptual definition of *fisabilillah*.[57]

ii) Practical Aspects of *Fisabilillah*

This part will look at two perspectives. i) The Lender Perspective and ii) the Borrower Perspective

[56] Umaruddin, Ethical Philosopy of al-Ghazzali, p180

[57] Tahir, Hailani Muji, Paper presented on 9th June 2009, Penafsiran dan Pelaksanaan Agihan Zakat Fisabilillah Mengikut Keperluan Semasa di Malaysia, Seminar Pengagihan Zakat di bawah Sinf Fisabillillah.

(i) The Lender Perspective.

Someone who gives *qard* to other is considered spending in the way of Allah *(Fisabilillah*) as explained before. Thus, Muslim especially who capable to lend others property should be striving to act the good deed in order to get reward from Allah (2:148 and 5:48) or because of loving Allah. When they lend to others, they also lend to who are in need, who are also in the path of Allah.

Some of attributes and ethics of the lender has been stated in several *hadith*. Among them are *hadith* about demanding of debts handsomely, the right of creditor, intercession for the reduction of debts and the prohibitions on giving loan to person who waste the property.

(ii) The Borrower Perspective

Whoever include in *fisabilillah* surely have good ethics because they involve in preaching Islamic *dakwah* and in order to get closer to Allah. Muslims should be striving to achieve *falah* which includes rewards in the Hereafter by avoid bad habit such as dishonesty, reluctant or delay to pay the loan, misused the money and others. Several cases still happen as reported by Ahmed (2000) that the moral hazard problem arising from dishonesty in reporting the actual figures of profit by the entrepreneur.[58]

4. CONCLUSION

In the beginning we asked the following question: What is new in loan theory from Islamic perspective? Loan is a contract between lender and borrower. The items borrowed can be anything, unless it is valuable as discussed in 2.3. In Islamic perspective, loan must be returned without any promised benefit, unless it is given by the borrower as a gift to lender without pre-determined conditions. In Islam, giving loan to someone is called *qard al-hasan*, which is giving to others and to be returned

[58] Iqbal, Munawar & Llewellyn David T.,(2001).Islamic Banking And Finance, New Perspectives On Profit-Sharing And Risk, p43

without any interest. Allah has stated in the Quran that means whoever give loan to others, Allah will reward him in the hereafter. While, the mufassirun commented that the word *qard al-hasan* means spending in the path of Allah. Thus, the act of the lender who assist someone who are in need, is claimed as spending in the way of Allah.

The *qard* is meant for lending. The relationship between lender and borrower between conventional and Islamic view can be distinguished by looking into its philosophy. The Islamic view which based on the Quran and *hadith* is totally different from conventional view.

Rational choice theories hold that individuals must expect the outcomes of alternative action and determine which will be best for them and the alternative is depend on which will give greatest satisfaction. By giving *qard*, the lender has two choices whether the loan he gives is based on benevolent loan or monetary rewards. In Islam, the choices either to give *qard* based on benevolent loan or monetary benefit turn into spending in the path of Allah (*fisabilillah*) after they realize about the reward will affect his faith, ethics and worship to Allah.

In conventional perspective, the lender will be rewarded by incentive especially with interest. Islam prohibits any benefits from the act of lending, because it includes in *riba*. However, by giving *qard* (loan), the lender has been promised by great reward in hereafter as explained in several verses in the Quran. The reward by giving loan in Islam is non-monetary and it is unseen. Thus, it is crucial to understand the philosophical of reward and *fisabillillah*. As in Islamic principles, Muslims must belief in the non-existence matter (*ghaib*) such as paradise, hell, angels and etc. Islamic philosophers such as Ibnu Sina and al-Farabi have described the different between existence and essence.

Therefore this paper has explored, from ethical philosophy and metaphysical philosophy of *qard*, we found that from Islamic perspective, love to Allah will encourage the act of giving *qard*. Reward thus affects motivation to do something, especially if the reward is toward the end which is the Day of Judgement (hereafter) and although it is unseen, it still affect one's belief. Metaphysically, the human soul

emphasized to gain reward, is by doing good that determined by rational soul *(al–nafs al–natiqah*) and it is result of the choice in this world. From the verses, this study found (i) the act which is command by Allah, (ii) any *dakwah* activities (iii) any act with intend to get closer to Allah and (iv) any act with regards to public interest become the parameters *for fisabilillah*.

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FRACTIONAL RESERVE BANKING IN THE LIGHT OF MAQASID AL-SHARIAH

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Abstract

Documented writings show that all commercial banks operate fractional reserve banking (FRB) system; where money (debt) is created out of nothing with neither backing nor control, which contributes to the expansion of money in circulation and eventual loss of public purchasing power due to inflation. In fact research has shown that the system is fraudulent, dishonest and unfair because it leads to high indebtedness and illegitimate transfer of wealth from the poor to the rich. More pathetic, it destabilizes the equilibrium between real and financial economies; with the former over weights the latter, causing global financial crises. These features not only violate *shariah* but also negate the *maqasid al-shariah*. This challenges the operations of Islamic Banking and Financial Institutions (IBFIs), who ought to comply with *shariah*. The aim of this paper is to examine the position of FRB in the attainment of *maqasid al-shariah*. The study employs idiographic qualitative approach and conducts interviews with Shariah scholars and lecturers teaching Islamic banking and finance in Malaysia to understand the aforementioned arguments. The paper to argue and discusses its findings on the basis of Quran, *Sunnah* and *ijmah*. The study explains the implications of these findings and recommends some ways forward.

Keywords: Fractional Reserve banking, *maqasid al- shariah, and* idiographic approach.

1.0 INTRODUCTION

One of the common statutory practice in banking is fractional reserve banking (FRB) system where the central banks of most nations issues certain reserve requirement ratio(RRR) to all commercial banks to guide their ability to create money via loan

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extensions and project financing [1]. Prior to Bretton Woods' era of 1944, all banks create money based on the available gold in their vaults; thereby creating a balance between money and currency. But after the Vietnam War and in 1971, the Federal Reserve closed the gold window; banks are not required to back the printing of currency with gold but with United States of American Dollar (USD) which is also a fiat currency, thus currency backed by another currency[2]. This gave birth to the fiat currency system in the world and from that moment, it becomes compulsory for all nations to use the fiat currency backed by USD and central banks of every nation issue RRR to guide the money creation in the commercial banks. This gave the FRB global legitimacy and become part of the banking practice requirement across the world. The emergence of Islamic banking system in the 1970s proclaim to practice banking in line with shariah but until today, the impasse of Islamizing banking system has become a serious challenge to Islamic scholars and Muslims bankers especially in terms of fractional banking practice. The aim of this paper is to examine the FRB in the shariah and particularly investigate the position of FRB in the attainment of *maqasid al-shariah*. The paper is divided in to four sections with this introduction as the first section. The second section reviews the brief history of banking, FRB and *maqasid al-shariah*, while the third section explains the method used to the objective of the paper. Finally, section four discusses the findings and conclusion of the research

2.0 LITERATURE REVIEW

Brief History Of Banking

To understand FRB, we need a brief history of commercial banking. The goldsmiths were the early bankers and form the beginning of global baking [3]. The society including the merchants then trusted the goldsmith and deposits their gold (commodity money) for safe keep. In return, the goldsmith issue a receipt to represent equal quantity of the gold deposited and charge some fees for each deposit. Thus the receipts serve as a promissory note as well as symbolic money [4] which the merchants/ public can claim back their deposited gold at any time they want. As public trust with goldsmith continues, merchants and public transact businesses with the symbolic money given by the goldsmith without going back to the goldsmith. This

is because the merchants and public believed that any symbolic note they hold is backed by same amount of gold and is redeemable on demand. On the other hand, the rest members of the society demand for some loans from goldsmith at an interest. As the goldsmith have no enough gold of their own to loan out and cannot loan out the gold deposited by the merchants because the latter may come anytime to demand for the gold, the former begin to think what to do to source for extra gold for loans.

As time goes on, the goldsmith came up idea of printing more symbolic money or promissory notes similar to the existing one but has no any gold backing it. The additional promissory notes are then issued to people as loans on interest. Put differently, 'Goldsmith Bank issued two different kinds of promissory notes (money) - PN & PN' but they did not distinguish between them, and few people realized it. The same identical promissory notes were issued to represent both symbolic money and credit money' and in n the whole, the goldsmith business principally become more of lending than the safe keeping business because the former business is more profitable than the latter business [2].

Fractional Reserve Banking

Fractional Reserve Banking (FRB) is statutory banking practice which all commercial banks create money on the basis of customer deposits out of nothing; without any backing just by simple debit and credit entries in the customers' accounts [6]. The system allows banks to create money as much as ten times greater than the actual cash deposit of customers. In fact, one very startling issue about FRB is that money raised to finance projects or loaned to customers is not from the customers' deposit, it created through computer entries (debit and credit) [9]. Thus, with FRB system banks can as much money as possible out of thin air through the principle of reserve ratio issued by every central bank which always increase the money in circulation resulting to loss of purchasing power due to inflation.FRB has been with us since the days of goldsmiths of England, and indeed the banking system that governs the working of the present-day monetary system. In most countries, all commercial banks including Islamic Banks operate under this Fractional Reserve banking framework [1].

Despite several efforts to defend the system by Federal Reserve as money multiplier in the economy, various scholars, analysts, politicians and researchers criticize the

system for various socio-economic implications. For example, [7 & 8] conceptualizes the ownership effect of FRB in the light of Islamic law. The argument concluded that the system is not permissible in Islam and Islamic banks should not be practice under the FRB framework if they are to achieve the objectives of Islamic law. This is because in FRB, public wealth is eaten unjustly and without peoples' consent; a practice which both Quran and Sunnah prohibit and warn Muslims to desist from eating the wealth of other unjustly; for example, Q4:29 Allah says: **O you who have believed, do not consume one another's wealth unjustly but only [in lawful] business by mutual consent. And do not kill yourselves [or one another]. Indeed, Allah is to you ever Merciful**. Similarly, the Messenger of Allah peace be upon him in the farewell pilgrimage***: "Your blood, your wealth and your honor are sacred to you as this day of yours in this country".*** Furthermore, in another hadithul qudsi reported by Abu Dharr Ghaffari may Allah be pleased with him, the Messenger of Allah peace be upon him as he narrated it from his Lord, he said**: "O My servants, I have forbidden oppression for Myself and have made it forbidden amongst you do not oppress one another".**

Others [10] term it as an economic parasitism that disrupts welfare and economic stability as well as cause of cycles of economic recessions and inflation. FRB is dishonest and unsustainable and is destruction to businesses, fraudulent, and fragile that is vulnerable to collapse [11]. Similarly [16] argues that the US treasury, which leans on FRB, is the cause of the present monetary disturbance due to currency hoarding, debt based system and use of fiat money. [19] Confirms the presence of FRB in the Islamic banks of Pakistan. [20] says, FRB affect the redistribution of income mechanism from poor to the rich causing instability, cheating and full of usury. [18] believes that FRB does not allow the attainment of objectives of Islamic law (*MaS*) by Islamic banks due to its socio-economic implication that occludes the possibility of achieving *maqasid al-shariah*. Finally, [5] argues that FRB system has some distributive effects on ownership of assets leading to poverty loss of faith. In conclusion, FRB system is unjust, dishonest and fraudulent system. Therefore, it is pertinent to Islamic financial institutions to avoid such framework and work toward more *shariah* compliant formidable system for the benefits of all and sundry.

***Maqasid al-shariah, MaS* (Objectives of Islamic Law)**

Many jurists (Malikite Abu Ishaq al-Shatibi, the Shafite al-'Izz ibn 'Abd aI-Salam, and the Hanbalite Ibn Qayyim al-Jawiziyyah) explain the objectives of Islamic law (*Shariah)* to safeguard the humans, remove harm and provide benefits (*maslaha*) to the *ummah* in all business transactions (*muamalat*) [18]. Particularly Imam Al-Ghazzali explains the aim of *Shariah* is to promote the well-being of all mankind, which lies in safeguarding their faith (*dīn*), their human self (*nafs*), their intellect (‘*aql*), their posterity (*nasl*) and their wealth (*māl*). Whatever ensures the safeguard of these five serves public interest and is desirable,” [14]. The issue with fractional reserve banking practice is that it is dishonest, fraudulent and unfair [6] because it leads to reduction of public purchasing poor and illegitimate transfer of wealth from the poor to the rich [12]. Thus fractional reserve banking does not only violate *shariah* but also obstruct the attainment of *maqasid al-shariah* and unfortunately all Islamic banks practice FRB [15]. This violates *shariah* because FRB is a zero sum game that benefits bankers at the detriment of the *ummah* and it is *haram* as it has some elements of *Riba* [7].

3.0 RESEARCH METHOD

This study employs idiographic qualitative approach in order to have an in-depth understanding and interpretation of complex human phenomena and define the social reality within holistic contextual [15]. The idea of nomothetic and idiographic knowledge in research was first introduced by a German philosopher Wilhelm Wildenband in 1894 and Stern(1911) and much later Allport (1960,1962 &1966), so Windelband and Stem were two of the main predecessors to Allport [21], idiographic and nomothetic research approaches. Both authors used the word "nomothetic" to characterize the search for general laws, and "idiographic" to indicate a concern for what is specific to the individual case [22].These authors further distinguished nomothetic from idiographic approaches as the former uses ‘dimension approach’ (abstracting and formulating variables as general and from outside) while the latter uses ‘morphogenic approach’ (abstracting and formulating variables from within and in particular).an idiographic approach focuses on the individual as a whole which enable direct and intense mutual relationship that provides clearer understanding of the issues the researchers are investigating [20].This approach seeks to know not only what people do but also why people do what they do with aim of understanding

people' thoughts, and value judgement. The approach does not limit knowledge to phenomena and external perspectives rather to internal, purposeful and tacit patterns [20]. Another benefit of this approach is its flexibility and interpretive ability of the research according what the findings showed by the data collected considering both majority and minority opinion of the respondents [23]. It is a scientific research strategy fully capable of establishing the causal relationships among variables as [23] state that

> "Idiographic approach represents a true scientific undertaking, as independent variables are manipulated in the context of carefully measured and repeatedly assessed dependent variables. This is in contrast to the alternative nomothetic experimental strategy, in which the researcher looks to assemble relatively large groups of individual organisms and, in the most straightforward application, examines the average response of the group to the introduction of some manipulation compared with the response to well-construed control conditions:, p.3.

The study conducts face-to-face interview with some *shariah* scholars of Islamic banks and lecturers teaching Islamic banking and finance in Malaysia. For shariah scholars, the research interviewed at least one shariah committee member of all Islamic Banks in Malaysia in addition to one member whor represented the shariah advisory committee at Bank Negara (Central bank of Malaysia) level. The research also interviewed some lecturers teaching Islamic Banking and finance from International Islamic University Malaysia (IIUM), Universiti Kebangsaan Malaysia (UKM), Universiti Teknologi Mara (UiTM) Shah Alam and International Shariah Research Academy Malaysia (ISRA), all in Malaysia. Idiographic approach is more efficient in giving complete and in-depth understanding of individuals or groups of individuals about a phenomenon that can spark further research and detail comprehension of the underlying concepts [17].

4.0 FINDINGS

The respondents admitted that IBFIs practices are only different in principles but similar in practices with the conventional banks. Most respondents believe the current practices of IBFIs is not yet meeting the *maqasid al-shariah* in terms of *muamalat*

because they say is still too early to expect that. While few of them are of the opinion that IBFIs are not charity organizations therefore need to maximize shareholders' wealth; that *maqasid al-shariah* in *muamalat* can only be achieved if the whole system is Islamic. In ascertaining the *Islamicity* of Islamic financial products, they are guided by Bank Negara *Shariah* Guidelines (BNM-SGF) in addition to other *shariah* sources from Quran, *Hadith* and *Ijmah*. Most of them admitted that the Islamic financial product; *Bay Bathaman Ajil* (BBA) is not very compliant to *shariah* and need further *shariah* clarifications.

Similarly many of my respondents agree that IBFIs use fiat currency due to legal tender rules and not because they meet the *shariah* requirement of serving as money. Many of them agree with the currency and bank credit as money and all Islamic banks use the terms in the same way and consider money, currency and bank credit to be money.

Many *shariah* advisors of Islamic banks are not very familiar with technical practices of the banks such as fractional reserve banking and money creation. Most of them believed that banks finance projects from the shareholders' fund and recapitalization. However they all agree that IBFIs use the statutory reserve ratio when it comes to financing projects and create money to finance such project with agreed profit margins. On the way forward, some of these respondents say three major issues need to be improve; the current regulations IBFIs are inadequate, no manpower and poor public awareness.

5.0 CONCLUSIONS

This paper examines the position of FRB system in Islam and interviews some *shariah* scholars of Islamic banks and some lecturers. The findings of this paper confirm that all commercial banks practice FRB as required by most banking laws. The paper concludes that FRB is fraudulent, dishonest, and unfair thus violates *shariah*. It argues that FRB fails to protect the faith, intellect and public prosperity of the *ummah* which are all the demands of *maqasid al-shariah* as the system benefits only the banks while the customers bear most of the consequences of money creation. FRB is a zero sum game where wealth in the economy is redistributed from masses to the bankers through illegitimate transfer of ownership of asset, thus the *ummah* looses

assets and the same loss gives banks gain; zero sum game indeed. The paper also conclude that banking is about leading whether with interest or profit, banks create money out of nothing and treat debt as an asset which violate the principles of Islam. In fact Islamic banks operating under FRB are very similar to conventional banks which makes it difficult for the former to avoid Riba and unable to meet the *maqasid al-shariah* which implies that Islamic banks are not Islamic especially in practice; so long as they continue to operate under FRB. Muslim bankers must keep to *maqasid al-shariah* as guiding principle in *muamalat* and fear Allah and avoid misrepresentations of facts regarding FRB and fiat currency to *shariah* scholars who approve such misrepresentations as *shariah* compliant while in the actual sense they are not. *Shariah* scholars should also fear Allah and avoid stamping banking practices that they are not very clear upon, instead they should seek for clear understanding of all banking and finance technicalities (FRB, fiat currency and spanning theory) so that they can properly give right decisions on the issue of *shariah* compliance. We must acknowledge the current effort of these noble and learned *shariah* scholars for their invaluable efforts to ascertain *Islamicity* of financial products. Muslims should understand that it difficult if not impossible to combine banking and Islam, because the two terms are not compatible as banking is about leading and lending is debt and debt is an asset but Islam does not treat debt as an asset and lending must be free of Riba. Thus, Muslims must rethink about the combination of Isla and banking to form Islamic banking.

The paper recommends that training and retraining of *shariah* Advisors of Islamic banks regarding the technical concepts in banking and finance should be highly and urgently emphasized by the concerned authorities in order to broaden their knowledge in finance in addition to their Islamic expertise. More so the teaching modules of institutions teaching Islamic banking and finance should be further enhance with understanding of economy from Quran, *Sunnah* and *Ijmah* in addition o the current contents that are very similar to conventional economic philosophy. Muslims should also emphasize more on the knowledge of muamalat because Islam requires Muslims to understand *ibadat* and *muamalat* equally. Further research is required in other countries and even in Malaysia to enquire from more shariah experts who understands both Islam and finance. There is also need for alternative system for the Muslim *ummah* in line with principles of Islam.

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ANALYSIS OF LARGE SHAREHOLDER OWNERSHIP OF ISLAMIC BANKS IN MALAYSIA

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Abstract

Investors with large ownership or large shareholders play an important function in the governance of a corporation. Large shareholders have the ability to monitor management and could influence the strategic decisions of the corporation. Different types of large shareholders are also found to have different ability in exercising control or monitoring the management. As such, the objective of this paper is to review relevant literature relating to large shareholder ownership. In addition, this paper also provides analyses the large shareholder ownership of Islamic banks in Malaysia by focusing the shareholding and types of large shareholder in the Islamic banks for the year 2011. Analysis is also done on the level of the ownership concentration. This paper provides evidence on the ownership structure of Islamic banks in Malaysia and could initiate future research on the role of large shareholders, especially in Islamic banks.

Keywords: Ownership structure, large shareholders, Islamic banks, Malaysia

1.0 INTRODUCTION

Prior literature such as by Claessens, Djankov, Fan and Lang (20002), Faccio and Lang (2001) and La Porta, Lopez-De-Silanes and Shleifer (1999) have noted that most companies in European countries and East Asian countries have high ownership concentration. A single large shareholder or a shareholder group are also observed to predominantly control these companies. Hence, evidence of large shareholders ownership in countries located outside the United States (U.S.) and United Kingdom (U.K.) are against Berle and Means (1932) concept of separation between ownership and control. Shareholders with substantial holdings or large shareholders could influence agency conflicts in a company as they could play an essential role in

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monitoring the management. Large shareholders also could influence companies' decisions such as corporate policies. The role of large shareholders, however, is not well developed in the ownership literature (Holderness, 2003).

There are two objectives of this paper. The first objective is to review relevant literature relating to large shareholder ownership. The second objective of this paper is to analyse the large shareholder ownership in Malaysia, particularly large shareholders in Islamic banks. Malaysia offers an attractive institutional setting in examining ownership issue. Corporate ownership structure in Malaysia is characterized as concentrated in nature and large shareholders are in control. Tam and Tan (2007) find that the large shareholder in Malaysia approximately owns 43 percent of companies' shareholding. While Nathasa Mazna (2010) observes that on average, the largest and the second largest shareholder holds 40 percent and 11 percent of companies' paid-up capital, respectively. In addition, the large shareholder in Malaysia can be categorized into several groups, namely family, institutional shareholder and the government. It is observed that 74 percent of listed companies in Malaysia are owned by a family group (Nathasa Mazna Ramli, 2011). However, prior ownership literature in Malaysia mainly focuses on non-financial public listed companies and thus, the findings might not be comparable with banks and finance companies. Considering the significant role of large shareholders, it is important that a specific analysis is done based on a sample of banks and finance companies.

The remainder of this paper is as follows. The next section provides background of Islamic banks in Malaysia. Section 3 presents a review of prior literature relating to roles and function of large shareholders. Section 4 discusses the data, the methodology and variables employed in this study. Section 5 presents the results and the discussion of the analysis. Section 5 contains a summary of the findings and conclusion.

2.0 BACKGROUND OF ISLAMIC BANKS IN MALAYSIA

Malaysia is known as one of the countries that put their effort to support the Islamic banking and financial system. The idea of the establishment is to fulfil the demand of

Muslims clients who need for the own financial system based Shariah. Malaysian Government took the approach of dual financial system; whereby conventional and Islamic banking and, financial system are operating in parallel under the supervision of Central Bank, Malaysia (BNM). [2] The formation of the Bank Islam Malaysia Berhad (BIMB) in 1984 is viewed as a significant milestone towards the establishment of the system in Malaysia.

Since the establishment of the Islamic banking is to serve the Muslims' needs, the objective of the Islamic banks should be in line with the Shariah. The Islamic banks are expected to serve the public interest, in addition to increasing their shareholders' wealth. The banks should adhere to Islamic principles of prohibition of interest, gambling, uncertainty and, alcohol and pork. Differently from the conventional banks, their deposit, financing and investment activities should avoid all the impermissible activities. As well, the Islamic contracts are used to develop and structure the Islamic banking products. Among Islamic contracts that are currently used by Islamic banks in Malaysia are *wadiah yad dhamanah*, *mudarabah*, *qard*, *tawarruq*, *wakalah*, *ijarah*, *bai' dayn*, *istisna'*, *bai' bithaman ajil*, *murabahah*, *ar-rahn*, *hiwalah*, *kafalah*, *ujr and musharakah* (Malaysia International Islamic Financial Centre 2012). [3]

To strengthen the Islamic banking industry, the government permit the banks that involved in the industry either to become the fully Islamic banks or a conventional banks that have a division offering the Islamic banking products (regularly known as Islamic window banks or participating banks). Up till now, there are 21 Islamic banks (local and international Islamic banks)[4] and 15 participating banks in Islamic Banking System (Malaysia International Islamic Financial Centre 2012).

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[2] However, the Pilgrims and Management Fund Board (Lembaga Tabung Haji/LUTH) in 1969 is considered as the earliest Islamic financial institutions in Malaysia. It was setting up under the different act.

[3] The *mudharabah* and *musyarakah* contracts which are based partnership contracts and preferable by most of scholars are less concentrate by Islamic banks. This practice entailed the arguments on the purpose of the Islamic banks (Abdul Manan et.al. 2011).

[4] Most of these Islamic banks (except for certain banks such BIMB, Bank Muamalat Malaysia and Kuwait Finance House (Malaysia) Berhad) were initially developed as the Islamic banking division of

There are several acts that regulate the Islamic banking industry, related to their operation and corporate governance. The Islamic Banking Act 1983 is the first act related to Islamic banks and regulate the fully fledge Islamic banks. In addition, the Banking and Financial Institution Act 1989 that serve the conventional banks also regulates the conventional banks with Islamic banking division. These two of the acts regulate these banking institutions to have their own Shariah Committee. Based on the structure stated in these acts, the Committee has a direct relationship with the Board of Directors to oversee the Islamic banking operation. These regulations and additional features on corporate governance structure ideally are directed to ensure these banks to fulfil the objectives.

3.0 LITERATURE REVIEW: FUNCTION OF LARGE SHAREHOLDERS IN THE GOVERNANCE OF COMPANY

Jensen and Meckling (1976) highlights the agency theory which established the agency relationship between principals and the agent. The said relationship is based on a contract where the principal(s) appoint the agent '*to perform some service on their behalf which involve delegating some decision making authority to the agent*' (Jensen and Meckling, 1976, p. 310). A company can be seen as a nexus of contracts between shareholders (as resource holders) and managers. Due to these contractual relationships, there exists a separation between the ownership and management (control) of a company.

Agency problems will occurs when managers has none or minimal holdings of shares in a company. The company's assets may be used by managers for their own benefit without suffering consequences from this value destruction. Examples of private benefit are such as perquisite consumption, empire building and other value destroying investment behaviour. One of the costs that are borne by shareholders in minimising the conflicts of interest between shareholders' ownership and managers are monitoring costs. This cost id associate with overseeing managers' behaviour. They, however, only receive the benefit of monitoring based on their percentage holding. Shareholders who own very few shares in a dispersed company would not

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conventional banks, before restructuring to fully Islamic banks (as the subsidiary of the parent conventional banks).

have a sufficient incentive to monitor whether management is acting in their interests or not. Grossman and Hart (1980) states this situation would lead to free-rider problems. Large shareholder who do not manage the company, would minimize agency conflicts since they have more incentive to monitor the management (Shleifer & Vishny, 1997).

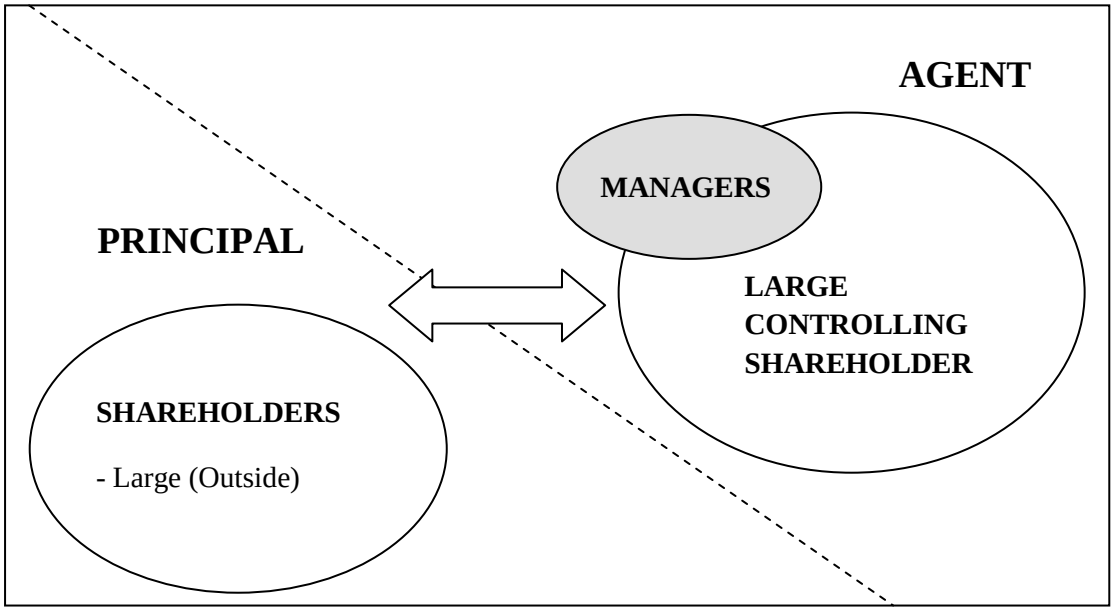
Outside large shareholders have more incentive to maximize the value of shares that they own. Large shareholders are also able to collect information and monitor managers. Shleifer and Vishny (1986) highlight that large shareholders could pressure a company's management or even use a proxy fight or takeover to oust incumbent managers. The free-rider problems mention by Grossman and Hart (1980) can be overcome by large shareholders' monitoring onto the management. Agency conflicts can be reduce by the existence of large shareholders in a company, as they have a strong incentive to maximize the company's wealth and also to have influence over the company so that their interests are respected (Shleifer & Vishny, 1997).

The discussion so far largely focuses on the agency perspective that is inherent in the Anglo-Saxon system. Corporate ownership structures in the U.S. and the U.K. are typically described as dispersed and shareholders have little direct control over management. These traits are consistent with the separation of ownership from control concept (Berle & Means, 1932) and agency theory (Jensen & Meckling, 1976). However, recent studies by Claessens et al. (2000), Faccio et al. (2001) and La Porta et al. (1999) observe that many publicly listed companies in other parts of the world have concentration of ownership, with single large shareholders predominantly controlling the companies.

The ownership structure of most companies outside the Anglo-Saxon system is illustrated in Figure 1. Large shareholders exist in concentrated ownership corporations. The large shareholders tend to be controlling owners who could influence and control managers. The control can be exercised either through their voting rights or their representative on companies' Board of Directors. Indeed, most controlling shareholders are part of a company's management (Claessens et al., 2000;Wiwattanakantang, 2001; Yeh, Lee, & Woidtke, 2001). The managers, who are also part of the controlling shareholders, are likely to focus on the interest of

controlling shareholders instead of maximizing the outside shareholders' value. Indeed, Faccio et al. (2001) highlight that the salient agency conflicts in Western European and East Asian corporations take on the form of expropriation of minority shareholders by controlling shareholders.

Figure 1: Agency relationship in large concentrated ownership companies



A great corporate governance concern, then, is how to protect minority shareholders from the expropriation[5] by the controlling shareholder, as the interests of large shareholders in such corporations might not match the interests of minority shareholders. The effective control of a company enables controlling shareholders to make decisions regarding how to run the company and decisions regarding its corporate policies.Having controlling ownership also involves other additional costs, especially underinvestment costs (Claessens, Djankov, Fan, & Lang, 2002; Truong & Heaney, 2007). As the large shareholders hold undiversified investment portfolios, the company's risk-taking may become limited, and this may lead to possible distortion in capital budgeting decisions.

[5] Shleifer and Vishny (1997) define expropriation as the extraction of private benefits of control by large shareholders that are not shared by minority shareholders. Claessens et al. (1999) describe expropriation as the process of someone using his control powers to maximize their own welfare and redistribute wealth from others.

There is several ways to utilize this controlling mechanism as highlighted by Hart (1995), Shleifer & Vishny (1997). These include: (i) voting control; Takeover and Proxy fight (direct controls) and, (ii) advice, negotiation, campaigning, shareholder proposal and dialogue (shareholder activism and engagement).

Table 1: Controlling mechanisms in selected Asian countries

Country	Own = 20% control (%)	Pyramid with ultimate owners	Cross-holdings	Controlling owner alone	Management
Hong Kong	19.71	25.1	9.3	69.1	53.4
Indonesia	19.17	66.9	1.3	53.4	84.6
Japan	20.00	36.4	11.6	87.2	37.2
Korea	20.00	42.6	9.4	76.7	80.7
Malaysia	19.14	39.3	14.9	40.4	85.0
The Philippines	18.71	40.2	7.1	35.8	42.3
Singapore	20.00	55.0	15.7	37.6	69.9
Taiwan	19.61	49.0	8.6	43.3	79.8
Thailand	19.82	12.7	0.8	0.8	67.5
East Asian nine					

Source: Claessens, Djankov, Lang (2000, p. 92)

The discussions so far have assumed that the controlling shareholder is of the same group. However, another significant aspect of ownership structure beside the concentrated of ownership is its composition. The category of the large shareholders relates to two questions, namely (1) who they are, and (2) who among them belong to the controlling group(s). These categories are important as far as corporate governance is concerned. The differences in the identities of the controlling shareholder would likely have an impact on a company's corporate policies and operations. The identities and the characteristics of large shareholders differ in various types of markets. Usually, large shareholders in the U.S./U.K. are portfolio investors, while, in Europe, the largest shareholders consist of families, Governments or corporate shareholders (Becht & Mayer, 2001). Claessens et al. (1999) also shows that family groups and the Government substantially control corporations in Asia. Instead of the maximization of shareholders' value, other types of large shareholders might have different objectives when investing in a certain company (Thomsen & Pedersen, 2000).

The family-owned businesses are found to be the dominant form of business in the world. La Porta et al. (1999) conclude that family control is the main pattern of ultimate control in their sample of 27 wealthy countries. Claessens et al. (2000) perform an investigation in nine East Asian countries (including Malaysia). They observe that more than half of the listed companies in East Asia are controlled by families or individuals. In addition, Capulong et al. (2000) find that nominee companies owned 46 percent of Malaysian listed companies, which are indirectly owned by families. According to Faccio and Lang (2002), 57.2 percent of listed companies in Western Europe belong to family groups.

Family-owned companies can be associated with intense agency conflicts. Typically, families have a dual role in a company, which are as shareholders and managers. The close controls in family-owned companies would result in no separation between large shareholders and managers, which consequently increases the risk of expropriation from minority shareholders (Khan, 1999). However, the close controls in this type of companies could also eliminate traditional agency costs, as discussed by Jensen and Meckling (1976). Wiwattanakantang (2001) also supports the conclusion that the expropriation problem is more severe when the controlling owners, such as a family group, are also on management boards. There is evidence that the existence of a family group as a controlling shareholder may expropriate a company's wealth for their own private benefit (Claessens et al., 2002; Lins, 2003; Villalonga & Amit, 2006).

In contrast to other types of large shareholders, a family group acts on its own behalf, instead of being agents for other principals. Managers in family-owned companies tend to encounter cognitive conflicts in separating professional relationships from family relationships, and this impedes cooperation and effective decision-making (Kellermanns & Eddleston, 2007). In addition, family members may stay in control of the company although they are no longer competent to run it (Burkart, Panunzi , & Shleifer, 2003). Morck, Strangeland and Yeung (2000) present evidence that heir-controlled companies perform worse compared to other companies.

However, other studies indicate that family ownership does have benefits when they stay in control of public companies. Fama and Jensen (1983) suggest that family-

owned companies have the greatest incentive to monitor managers and control agency conflicts. As family members are expected to be managers, they have the incentive and ability for efficient direct monitoring (Gugler, 2003). Families would have better information regarding the business compared to other types of investors. This information provides advantages to the family group in monitoring the companies effectively. Hence, due to lower agency conflicts in these types of companies, family-owned companies perform better compared to non-family owned companies (Maury, 2006; Villalonga & Amit, 2006). Unlike other types of shareholders, families have their money invested in companies that they control. Thus, they have a strong incentive to maximize the company's wealth. Families are also keen to ensure the company's survival because they would want their offspring to inherit the firm (Anderson, Mansi, & Reeb, 2003).

Institutional investors are another type of shareholder who usually have large holdings. The literature on finance recognizes that institutional shareholders play a significant function as external monitors in the share market (Agrawal & Mandelker, 1990). Institutional shareholders are fiduciary bodies and Barnard (1990) categorizes these shareholders into public pension funds, corporate pension funds, union pension funds, retail mutual funds, banks and thrifts, insurance and annuity companies and private foundations. Institutional shareholders have large amounts of funds invested in companies, therefore, giving them the potential to substantially influence companies.

Grinstein and Michaely (2005) highlight the difference between institutional shareholders and individual shareholders. First, institutional shareholders can invest on a larger scale in a company because they manage large pools of funds. Therefore, they have more incentive to monitor the companies that they have invested in. Institutional shareholder ownership can influence managers' incentives (Bushee, 1998; Pound, 1988), by monitoring their behaviour, thus, minimizing the likelihood that managers would misuse companies' corporate resources. Bushee (1998) states that institutional shareholders monitor companies by participating in a company's governance activities or by gathering information and correcting the pricing impact due to managerial decisions. Even though monitoring activities are costly, institutional shareholders have the incentive to monitor managers since they usually

hold companies for a long period (Bushee, 1998). Indeed, certain institutional shareholders appoint their own representatives on Boards of Directors of companies which they invested in (Abdul Rahman, 2006).

Secondly, Grinstein and Michaely (2005) state that institutional shareholders are more informed than individual shareholders because they have the resources to gather information and occasionally have access to corporate information that are not privy to individual shareholders. Finally, they highlighted that the tax liabilities of institutional shareholders differ from individual shareholders, as some institutional shareholders are tax-exempted.

The role of institutional shareholders in listed companies has expanded over the past years. Previously, when institutional shareholders have not been satisfied with the management or companies' shares performance, they will leave the companies by reducing their holdings in the share market (Joher, Ali, & Nazrul, 2006). However, institutional shareholders have changed their behaviour from being passive investors to active monitors (Coffee, 1991). Coffee (1991) recommends that changes are due to the fact that increased activities are less costly since the ownership of institutional shareholders is more significant. Furthermore, liquidating their holdings would be expensive for institutional shareholders because they have to face substantial discounts on their selling actions (Coffee, 1991).

Recent studies also report that Governments own and control a substantial percentage holding of publicly listed companies in many countries around the world (Claessens et al., 1999; La Porta et al., 1999; Truong and Heaney, 2007). Many studies argue that the presence of Government as a large shareholder has a negative impact on companies. There are several reasons for this situation, and it can lead to more intense agency problems in Government-owned companies. First, Government-owned companies may respond to signals from the Government to enhance national welfare or other non-profit considerations, which may not be related to a goal of value maximization (Vernon, 1979).

Second, due to the preference of political influence, a Government may appoint less experienced managers or staff (Boycko, Shleifer, & Vishny, 1996; Megginson, Nash,

& Randenborgh, 1994). Empirical evidence also shows that Government-owned companies are more vulnerable to political interventions (Clarke, Cull, & Shirley, 2005; Stijn Claessens, 1997) and allocate funds for political advantage (Sapienza, 2004).

Third, Gugler (2003) views that agency problems in Government-owned companies are more severe than in private companies. Gugler contends that the ultimate owners of Government-owned companies are the citizens. The citizens have fewer incentives to monitor companies, as they do not control them directly. Therefore, they elect representatives (politicians) to monitor such companies on their behalf. However, these representatives do not actively monitor the companies, as they are also not strongly monitored by their principal, i.e. the citizens. These situations may lead to more severe agency conflicts, which Gugler (2003) describes as double principal-agent problems.

The behaviour of foreign shareholders is expected to differ from other types of shareholders discussed above. Bena and Hanousek (2006) state that, compared to domestic shareholder owners, foreign shareholders have better business, managerial and corporate governance expertise. This would eventually minimize any agency problems emerging in companies in which foreign shareholders invest. However, this also depends somewhat on who the foreign shareholders are, and whether the foreign shareholders are institutions or corporate shareholders. As an institutional investor, the foreign shareholder might be a good monitor, nevertheless, it may be less familiar with local corporate, employment, and other laws relevant to the operations of companies that they owns. Therefore, agency conflicts and asymmetric information between management and foreign institutional investors would be different from the conflicts between management and domestic institutional investors. As a corporate shareholder, foreign shareholders might have good knowledge of technology and expertise, thus could asses the effectiveness of companies and prevent managers from misappropriating the profit. In addition, large corporate shareholders are likely investing for control (parent ownership) purposes, so they are likely to be more involved and knowledgeable shareholders.

4.0 DATA AND METHODOLOGY

In achieving the second objective of this paper, the study focuses on licensed Islamic banks that are listed on Bank Negara Malaysia Website (www.bnm.gov.my). The data uses in the analysis consists of 15 Islamic banks as at financial year ended 2011. The basic ownership information is collected from the BankScope database produces by Bureau van Dijk Electronic Publishing. Apart of the databases, the study uses the respective bank's annual reports to confirm the reliability of the data gathered from the BankScope database and thus, further improve the data accuracy.

This study focuses on the largest shareholding, as the largest shareholding is a unique type of shareholder. This due to the fact that the largest shareholding can be associated with costs and benefits, especially the underinvestment costs (Claessens et al., 2002; Truong & Heaney, 2007). Indeed, the role of the largest shareholder in a corporation is not well developed in the ownership literature (Holderness, 2003). The immediate largest shareholding and its types are obtained from the BankScope database for each bank. The largest shareholder is defined as the largest shareholder who owns directly and indirectly (total) holding of ordinary shares of the bank. According to BankScope, indirect ownership by the largest shareholder refers to as the shareholding by the largest shareholder through intermediate entities. Furthermore, the largest shareholder is identified as a shareholder of the bank who holds at least 5 percent of the bank's total shares.[6] The study also focuses into ultimate largest shareholder. Ultimate largest shareholder is defined as a shareholder who owns directly and indirectly the voting rights of a company and the holding is more than 20 percent, consistent with La Porta et al. (1999)

The largest shareholder is then categorized into 4 groups, namely (1) inside largest shareholder, (2) Institutional shareholder, (3) the government and (4) foreign. Inside large shareholder is defines as a shareholder who is associated with the company including directors, employees or families. Institutional shareholder includes insurance companies, pension funds, banking institutions and fund managers, while the government refers to the federal government, state agencies and other government

[6] The Bursa Malaysia Listing Requirement defines a substantial shareholder as one having equal or more than 5 percent of the aggregate nominal amounts of all the voting shares in the company.

entities. Foreign relates to foreign individual or foreign company. Following Truong (2007), the study also uses Bureau van Dijk Electronic Publishing (BvD) independence indicators for ownership measurement. These indicators reveal variations in the level of ownership concentration. Details of the indicators are shown in Table 2.

Table 2: Definition of Independence Indicators

Indicator	Definition
A	Assign to companies where no recorded shareholder has an ownership percentage exceeding 24.99%. The sub categories of A+, A and A- refer to the level of certainty associated with this allocation. Essentially, it is assumed that the more specifically identified the shareholding the greater the chance that the 24.99% hurdle reflects the actual maximum individual ownership level. If the company has 6 or more identified shareholders whose ownership percentage is known then A+ is allocated to the company. If the company has 4 or 5 identified shareholders whose ownership percentage is known then A is allocated to the company. If the company has 1 to 3 identified shareholders whose ownership percentage is known then A- is allocated to the company. In this study, A+, A and A- are ranked as A.
B	Assign to companies where no recorded shareholder has share ownership exceeding 49.99% but having one or more shareholders with an ownership percentage of at least 24.99%. The sub categories of B+, B and B- refer to the level of certainty associated with this allocation. If the company has 6 or more identified shareholders whose ownership percentage is known then B+ is allocated to the company. If the company has 4 or 5 identified shareholders whose ownership percentage is known then B is allocated to the company. If the company has 1 to 3 identified shareholders whose ownership percentage is known then B- is allocated to the company. In this study, B+, B and B- are ranked as B.
C	This is allocated to companies with a recorded shareholder who has share ownership exceeding 49.99%. This is also allocated to companies that are classified as having an ultimate owner.
D	This allocated to companies with a recorded shareholder (excluding the three above) with a direct ownership over 50%

Source: BankScope and Truong (2007)

5.0 RESULTS

The immediate largest shareholder ownership of the Islamic banks based on its direct and indirect holdings are presented in Table 3. The table also shows the type of the largest shareholder and the BvD independences indicator. It is observed that mainly of Islamic banks in Malaysia are unlisted entities and hence, the largest shareholder owns 100 percent of the share capital. The only exception is Bank Islam Malaysia Berhad and Bank Muamalat Berhad. However, the two listed Islamic banks in Malaysia are majority owns by its respective largest shareholder. In terms of concentration of ownership, based on BvD independence indicators, all Islamic Banks are group under D indicator, except AmIslamic Bank Berhad. From Table 3, it can also be observed that all banks are owned by another financial institution. This is expectable as majority of the Islamic banks in Malaysia are subsidiaries of another banks. Bank Islam Malaysia Berhad is substantially owns by the government via its funds. While Bank Muamalat Berhad's largest shareholder is an industrial company, DRB-Hicom Berhad.

Table 3: The Immediate Largest Shareholder of Islamic Banks in Malaysia

No.	Bank Name	BvD Indep. Indic.	Immediate Largest Shareholder	Type	Shareholding (%)
1	Affin Islamic Bank Berhad	D	AFFIN BANK	Bank	100.00
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	D	AL RAJHI BANKING & INVESTMENT CORPORATION-AL RAJHI BANK	Bank	100.00
3	Alliance Islamic Bank Berhad	D	ALLIANCE BANK MALAYSIA BERHAD	Bank	100.00
4	AmIslamic Bank Berhad	C	AMMB HOLDINGS BERHAD	Bank	100.00
5	Bank Islam Malaysia Berhad	D	GOVERNMENT OF MALAYSIA via its fund	Public authority, State, Government	71.11
6	Bank Muamalat Malaysia Berhad	D	DRB-HICOM BERHAD	Industrial company	70.00
7	CIMB Islamic Bank Berhad	D	CIMB BANK BERHAD	Bank	100.00
8	Hong Leong Islamic Bank Berhad	D	HONG LEONG BANK BERHAD	Bank	100.00
9	HSBC Amanah Malaysia Berhad	D	HSBC BANK MALAYSIA BERHAD	Bank	100.00
10	Kuwait Finance House (Malaysia) Berhad	D	KUWAIT FINANCE HOUSE	Bank	100.00
11	Maybank Islamic Berhad	D	MALAYAN BANKING BERHAD - MAYBANK	Bank	100.00
12	OCBC Al-Amin Bank Berhad	D	OCBC BANK (MALAYSIA) BERHAD	Bank	100.00
13	Public Islamic Bank Berhad	D	PUBLIC BANK BERHAD	Bank	100.00
14	RHB Islamic Bank Berhad	D	RHB BANK BERHAD	Bank	100.00
15	Standard Chartered Saadiq Berhad	D	STANDARD CHARTERED BANK MALAYSIA BERHAD	Bank	100.00

This study further extracts the ultimate largest shareholder of the Islamic banks in Malaysia. Table 4 shows that several Islamic banks are ultimately owns by the government. It should be highlighted that Affin Islamic Bank Berhad ultimate largest shareholder is also one of the largest institutional investor in Malaysia. Further look on Maybank Islamic Bank Berhad also indicates that it is owns by the government. However, thorough observation of its immediate largest shareholder shows that the bank is also ultimately own by a large domestic institutional investor.

Two banks, namely Bank Muamalat Malaysia Berhad and Hong Leong Islamic Bank Berhad are ultimately owns by industrial companies. However, due to limited resources and time, this study unable to determine whether or not these industrial companies ultimately owns by a family-group. From Table 4, this study observes that a conventional bank that operates in Malaysia also significantly owns Islamic banks. Interestingly, six Islamic banks in Malaysia are owned by a foreigner.

Table 4: The Ultimate Largest Shareholder of Islamic Banks in Malaysia

No.	Bank Name	Ultimate Largest Shareholder	Types	Shareholding (%)
1	Affin Islamic Bank Berhad	LEMBAGA TABUNG ANGKATAN TENTERA	Public authority, State, Government	n.a
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	AL RAJHI BANKING & INVESTMENT CORPORATION-AL RAJHI BANK	Bank	100.00
3	Alliance Islamic Bank Berhad	ALLIANCE FINANCIAL GROUP BERHAD	Bank	100.00
4	AmIslamic Bank Berhad	AMMB HOLDINGS BERHAD	Bank	100.00
5	Bank Islam Malaysia Berhad	GOVERNMENT OF MALAYSIA via its funds	Public authority, State, Government	71.11
6	Bank Muamalat Malaysia Berhad	ETIKA STRATEGI SDN BHD	Industrial company	n.a.
7	CIMB Islamic Bank Berhad	CIMB GROUP HOLDINGS BERHAD	Bank	n.a.
8	Hong Leong Islamic Bank Berhad	HONG LEONG COMPANY (MALAYSIA) BHD	Industrial company	64.58
9	HSBC Amanah Malaysia Berhad	HSBC HOLDINGS PLC	Bank	100.00
10	Kuwait Finance House (Malaysia) Berhad	KUWAIT FINANCE HOUSE	Bank	100.00
11	Maybank Islamic Berhad	GOVERNMENT OF MALAYSIA via its funds	Public authority, State, Government	64.32
12	OCBC Al-Amin Bank Berhad	OVERSEA-CHINESE BANKING CORPORATION LIMITED OCBC	Bank	100.00
13	Public Islamic Bank Berhad	PUBLIC BANK BERHAD	Bank	100.00
14	RHB Islamic Bank Berhad	RHB CAPITAL BERHAD	Bank	100.00
15	Standard Chartered Saadiq Berhad	STANDARD CHARTERED PLC	Bank	n.a

6.0 CONCLUSION

This paper critically reviews the literature relating to large shareholder ownership and analyse the largest shareholding and type of owner of Islamic banks in Malaysia. It is observed that the ultimately largest shareholders of the Islamic banks are the government and another bank. This contrast with the findings based on non-financial companies. The findings raise an interesting question for the topic of further discussion, does the largest shareholder interest align with the interest of other shareholders and stakeholders? This question is important particularly towards the interest relating to the Shariah principle and Islamic operation. As large shareholders, they have the power to monitor the Islamic banks, particular towards the compliance of Shariah issues. However, the objective of the ultimate owner might solely towards profit maximization, while compliance towards Shariah Governance only becomes a 'tick of the box' activity. Nevertheless, large shareholder such as institutional shareholder could monitor the Islamic banks and indirectly could strengthen the Islamic capital market.

Future research should focus on scrutinizing further the largest shareholder, particularly when the shareholders are industrial companies or banks. Research also could be done on the influence of large shareholders on Islamic banks corporate policies. It is also interest to research further the function of large shareholders, particularly institutional investors' role in Islamic framework in enhancing Islamic capital market.

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THE IMPACT OF BOARD OF DIRECTOS STRUCTURE ON BANK PERFORMANCE BY ISLAMIC BANKS OF THE GULF COOPERATION COUNCIL

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Abstract

The objective of this paper is to investigate the impact of board structure on bank performance within Islamic banks in Gulf Cooperation Council (GCC) countries for the year 2008. The board structure contains board size, board of directors' composition, the separation's role of CEO and chairman, chairman composition, as well as the existence of the audit committee. The findings of the study find the separation of CEO and chairman's role and the existence of the audit committee to be positive significantly associated with both proxies of the bank's performance. Conversely, bank size, board's composition and independence of the chairman are consistent with previous studies that did not report any important relationship between these board characteristics and bank's performance. These findings suggest the need to set more constraints on corporate governance mechanisms in terms of board size, board's composition and chairman's independence among Islamic banks of GCC countries in order to improve the banks' governance requirements that are existed.

Keywords: Board of Directors' Attributes; Bank Performance; Islamic Banking; Corporate Governance

1. Introduction

One of the most important factors that supports the stability of local economy is a well-functioning financial system. Previous studies suggest that the financial intermediation's efficiency influences economic development of a country (Levin, 1998; Rajan and Zingales, 1998). On the other hand, insolvencies of a bank can cause in regular crises that have negative effects on the economy as a general with losses increase from 10 to 20% of GDP in the most cases and sometimes exceeds 55% of GDP (Caprio and Klingebiel, 2003). Furthermore, according to Golin (2001), banks

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need earnings to protect solvency, to survive, and develop in an adequate environment.

In GCC countries, the banking industry is considered as one of the main components of the financial system. Strong and continuous profits support the banking system's stability. There is evidence that great profitability rises the financial performance of commercial banks (Fraster and Fraster, 1991). The banking sector in GCC countries has some features. 1) it is based on oil. 2) it focuses more on the real estate, construction and consumer loans. 3) it dominates by government and protects from foriegn competition. The banking industry in GCC countries is one of the largest industries in the economy.

According to Jensen and Meckling (1976), board of directors works as a monitor for the performance and activities of top management and to ensure that the management act in maximizing the owners' wealth. Based on this perspective, the board of directors has a vital function to play in reducing agency problems that rose between the owners and management (Fama, 1980; Jensen, 1993). Furthermore, board of directors also has essential function in designing and executing policies within the company and supporting its relationship with external environment (Ruigrok, Peck and Keller, 2006). With respect to their multifunctional duties, it appears that board of directors tends to influence the performance of a firm by maximizing shareholders' wealth.

There is evidence that industry is a very important factor that could influence corporate governance model, and particularly in a more organized industry such as banking (Demsetz and Lehn, 1985; Thomsen and Pedersen, 1997). The importance of banks is due to the nature of the sector which has strict rules and regulations unlike non-banking industry, and unique structure of the board of directors that represent the shareholders' interest. Most of the previous studies merely focus on non-banks organizations (Adams and Ferreira, 2007; Aljifri and Moustafa, 2007; Arosa, Iturralde and Maseda, 2010; O'Connell and Cramer, 2010; Boone, Field, Karpoff and Raheja, 2007; Coles, Daniel and Naveen, 2008; Harris and Raviv, 2008; Lehn, Patero and Zhao, 2009; Linck, Netter and Yang, 2008).

In the literature of finance and banking industry, there are sparse researches that have investigated the impact of board of directors' characteristics on firm's performance (Adusei, 2011; Belkhir, 2009; Juras and Hinson, 2008; Rachdi and Ben Ameur, 2011). To the best of the authors' knowledge, this is the first empirical research that examines the impact of board of directors' attributes, namely board's size, board's independence, the separation between chairman and CEO role and chairman's position, as well as the existence of the audit committee on the performance of the bank. The present research attempts to fill the gap in literature by using data from the annual reports of the Islamic banking sector in GCC countries. The main objective of this study is to add the extant research in the area of the corporate governance mechanisms in threefold. First, the study investigates the question of whether the negative impact of board size on company performance that found in previous research is apparent in the Islamic banking. Second, it explores whether the high proportion of non-executive directors in the context of Islamic banks in Arabic Gulf reign has the same effect on the performance as found in other sectors, since the Islamic banks operate under similar comparative environment as the conventional banking industry. Third, it also explores whether the great number of boards has more influenced on bank's performance, and whether the impact is consistent with previous studies. Fourth, it investigates whether the chairman of the banks (as a non-executive director) has the power to affect on the bank's performance, and whether this effect is similar as observed in many other studies. Finally, it examines whether the existence of the audit committee has positive influencing on bank performance as found in earlier researches.

The remainder of this paper is organized as follows. The next section provides brief explanation in terms of Islamic banking industry, institutional characteristics, ownership structure and corporate governance, reviews previous studies on bank's performance and and develops the study's hypotheses. The third section explains the variables employed, the research model, the sample and data collection. The main results are highlighted in the fourth section. The last section provides a summary of the importance results and the limitations of this study as well as the possible avenues for further research.

2. Literature Review

2.1 Islamic Banking Industry

The emerging of the Islamic banking system was established in the 1970s based on the principle of interest-free loan. Since all transactions and activities of Islamic banks are derived from the *Shariah* rules and principles, the fixed return on the capital and operations are forbidden. The whole types of investments' dealings are allowed by the *Shariah* if it is in the form of the profit and loss sharing, which is the main principle covering all kinds of financial transactions.

Islamic banks are required to operate under the main *Shariah* principles: the profit sharing and free-interest loans. They give money to provide services to the society and generate productive wealth by investment in different sectors to develop the national economy, which is the primary objective of the establishment of those banks.

In the last three decades, Islamic banking sector has emerged as one of the fastest-growing industries in terms of numbers and size with an annual growth rate of 12-15% or higher (Rogers, 2004; Zaher and Hassan, 2001). At the end of 2008, there were more than 300 Islamic banks operating in over 70 countries throughout the world with a capital size in excess of US$ 500 billion (Khan and Bhatti, 2008). Consequently, the Islamic banks have extended and diversified their activities all over the world and received broad acceptance by both Muslims and non-Muslims countries (Iqbal and Molyneux, 2005).

According to Sufian (2007), the most growth and dominance of Islamic banking industry are in the Gulf Cooperation Council countries. By the end of 2002, the total assets of the Islamic banks in GCC were $226 billion, which represents 87% of the whole assets of the Islamic financial system (Olson and Zoubi, 2008). Recently, the Islamic banking industry has witnessed great development and raising the demand for *Shariah*-compliant products and services. It posses 16.6% of the total assets of the banking sector of the GCC countries in 2010 (Kuwait Finance House Research Ltd).

2.2 Institutional Characteristics of Banking Sector in GCC Countries

Banking industry derives the economy in GCC countries, and banks possess most of the financial assets, which are controlling by private sector. According to Al-Hassan,

Khamis and Oulidi (2010), the credit accounted of private sector rises from 27.8 percent of GDP in 1995 to 46 percent in 2006. Recently, Islamic banks have been considered as an important source of financial intermediation in the GCC countries, which managing around 24 percent of the total assets of the banking sector (Al-Hassan *et al*., 2010). In GCC countries, credit ratios for Kuwait, UAE, and Bahrain ranging between 50 to 60 percent, whereas the ratios for Saudi Arabia, Oman, and Qatar are between 30 to 40 per cent (Crowley, 2008).

Government in GCC countries manages the financial sector in order to reduce external risks. Further, the GCC countries have an open economic system, and capital moves freely. The great numbers of banks with many branches are existed in the GCC countries. Big and rich families are owned the majority of these banks, whereas the specialist banks are owned by the government. In order to decrease the competition level in the banking sector and keep profits high, the GCC countries set conditions for entering to their markets in terms of reducing the gains of foreign investments, the transfer of technological innovations, and the decreasing of efficiency (Al-Khouri, 2011).

Recently, the authorities of GCC countries have set guidelines and standards at the minimum level of requirements for banks applying to open new branches, including licensing, capital and capital reserve, monitoring and inspection of licensed foreign banks, bank closures, minimal capital retention requirements and a minimum age of 10 years old for a bank (Jabsheh, 2002). These steps are existed by GCC countries in order to raise competition and to decrease the possibility of bank's collapse. Furthermore, banks in GCC countries have started to open branches outside the region, especially in Malaysia, Pakistan and Turkey.

2.3 The Ownership Structure of Banking Sector

The banking industry in GCC countries is greatly locally owned, which explains the conditions and barriers to establish foreign banks. All GCC countries except Bahrain, put restrictions on foreign ownership, which did not exceed 49 percent in Kuwait and Qatar, 40 percent in UAE and Saudi Arabia, and 35 percent in Oman. However, foreign banks in GCC countries are limited, and majority is existed as individual branches. In contrast, the existence of foreign banks in Bahrain and UAE are

significant, which have 57 and 21 percent of total assets, while in other GCC countries are 12 percent in Oman, 10 percent in Kuwait and Qatar, 2 percent in Saudi Arabia (Al-Hassan *et al*., 2010).

In GCC countries, the domestic banking industry is public sector ownership, but it is varied significantly, for example, more than 52 percent in the UAE, 35 percent in Saudi Arabia, 30 percent in Oman, and 13 percent in Kuwait (Al-Hassan *et al*., 2010). More important, half of the total assets of the domestic banking sector in the UAE is almost possessed by the public sector, and a great amount (41.5 percent) is owned by the government.

2.4 Corporate Governance in Islamic Banks

Corporate governance is a "set of relationships between a company's management, its board, its shareholders and other stakeholders" (Chapra and Ahmed, 2002, p. 13). These relationships identify the corporate culture and structure through setting the objectives of the organization and determining the means of attaining those goals and controlling performance. The importance of corporate governance is to prevent the conflict of interest within management, board of directors, shareholders and other stakeholders with protect all interests of stakeholders. The role of management to govern is to agree responsibility for the whole life of institution through taking accounts all of groups that affect its viability, competence and moral nature (Selznick, 1992). The legitimacy of company's power and firm's responsibility are the main governance issues to whom and for what the company is accountable, and by what requirements it is to be governed and by whom (Worthy and Neuschel, 1983). Corporate governance comprises the controls and procedures which are existed to make sure that management works in the shareholders' interest, to reduce the expectation that management behaves in its self-interest and takes behaviour that deviate from maximizing the firm's value. Welker (1995) argued that the separation between the ownership and management reduces the agency problem since agency theory gives a framework for connecting performance to corporate governance.

From an Islamic perspective, Islamic banks act under a diverse framework of corporate governance that include *Shariah* supervisory board and board of directors. The members of directors' board must have the reputation of moral integrity and

technically qualified in the banking business to play this role effectively. They must also have additional abilities to enable them to understand and aware of the *Shariah* principles and rules as well as the Islamic teachings related to business and finance. One of the board's crucial functions is to specify clearly the strategic objectives and guiding principles of the bank, codes of conduct of senior management, and standards of appropriate behaviour towards the staff (Chapra and Ahmed, 2002).

The board of directors' structure seems to be a significant mechanism that could impact firm performance, and the directors' board is considered an important factor of corporate governance (Bhagat and Bolton, 2008). The board of directors may guide to higher monitoring, and as a result to maximize the company value and the extent to which the board will influence the performance may also rely on the attributes of this corporate governance indicator. Hence, the characteristics of the board (board size, board composition and separation role between CEO and chairman) can be viewed as mechanisms of corporate governance.

2.5 Studies Related to Bank's Performance

According to Fama (1980), the board of directors has the responsibility to monitor and supervise the management and the firm's activities. The attributes of the independence of directors, role duality and size of the board seem to influence the effectiveness of the board in controlling the managers (Jensen, 1993), and therefore, the performance of a firm. However, in the context of financial and banking industry, the research on the effect of board of directors' structure on the performance of a company has attracted more attention in the last decade (see, for example, Adusei, 2011; Belkhir, 2009; Juras and Hinson, 2008; Rachdi and Ben Ameur, 2011).

One of the earlier empirical studies on the effect of board of directors' structure on the performance is conducted by Juras and Hinson (2008). They examined the impact of independence of board of directors, stock ownership and size of the board on different measures of accounting performance based on agency theory. The data were collected from the Sheshunuff database and the SEC EDGAR database as well as financial statements of companies for the period from 1999 to 2003 for 1440 cases. The results showed that net interest margin has no significant relationship with all corporate governance variables except stock ownership. In addition, the findings also revealed

that more outside directors on the board and great levels of stock ownership gives more returns on average assets (ROAA), but size of the board has no any association. Furthermore, the results indicated that there is a relationship between the high proportion of independent directors and high levels of stock ownership with return on average equity (ROAE). However, size of the board has no impact on ROAE.

In the same vein, Belkhir (2009) investigated the influence of manager and board ownership, blockholder ownership, the proportion of outside directors, CEO-chairman duality and size of board of directors on firm's performance. The sample of the study was the 260 banks and Savings-and-Loan Holding Companies. The data for the year 2002 were selected from four different sources: Research Insight, CRSP database, the annual proxy statements filed with the SEC and annual reports 10-K in SEC. The results of OLS regression indicated that higher insider and blockholder ownership lead to weak performance. The findings also found interrelations between corporate ownership and board's structure in banking companies.

In a more recent research, Adusei (2011) explored the impact of characteristics of board of directors comprising size and composition of the board on performance of the bank. The data collected from the annual reports and websites of 17 banks operating in Ghana during 2005 to 2009. The results showed that an increase in the number of board of directors leads to poor performance. Moreover, the independence of boards has insignificant negative relationship with profitability of the bank but significantly positive relationship with efficiency of the bank.

Consistent with the above studies, Rachdi and Ben Ameur (2011) examined the association between structure of board of directors and performance and risk taking. The data were obtained from Tunisian Stock Exchange for 11 larger commercial banks through 1997 to 2006. The results showed that an increase in size of the board leads to less performance with lower risk taking. They found that the high proportion of board's independence has a negative influence on performance with no significant impact on the risk taking. Furthermore, a low CEO ownership led to poor performance.

Research on the effect of corporate governance mechanisms on firm performance is scarce generally in Meadle East, and particular in GCC countries. Arouri, Hossain and Muttakin (2011) investigated the impact of ownership structure and board characteristics on bank performance of GCC countries. Data were collected from annual reports or publications by stock exchanges of GCC countries excluding Kuwait for 27 banks for the year 2008. The results showed that the foreign ownership has positive and significant relationship with the bank's performance. In contrast, concentrated ownership has a negative and significant effect on performance, while institutional ownership does not report any significant association. Other corporate governance mechanisms in terms of CEO duality and board size seem to be insignificant correlated with performance.

Regarding the existence of the audit committee, it is expected to have a positive impact on company performance (McMullen, 1996), although of that, scant empirical studies have been conducted in this area. Yasser, Entebang and Abu Mansor (2012) examined the effect of board size, board composition, CEO/chairman duality and audit committee on corporate performance, for a sample of 30 Pakistani listed companies during 2008 and 2009. The findings showed a positive and significant association between board size, board composition and audit committee with both measure of firm performance (ROE and PM).

In a sample of Korean firms listed on the Korea Stock Exchange, Black and Kim (2007) investigated the relationship between board structure and corporate value from 1998 to 2004. The results indicated that board independence and audit committee have to be effected the firm value.

In summary, it can be concluded that the findings from previous studies are inconclusive. This is due to the difference in sample size, industry, culture, country economy, time and measures of the company performance.

2.6 Background of Theory and Development of Hypotheses

2.6.1 Board Size and Bank Performance

Theoretically, an increase in the number of board of directors improves the ability of boards for monitoring. This is in line with Klein (2002) and Andres and Vallelado (2008), who stated that the board with more members will be preferred than the one with fewer members. The possible reason behind this is that a larger size of the board has more effectiveness roles for controlling than smaller one. Therefore, this advantage of greater board size may disappear against additional costs of weaker and low-sufficient decisions making (Jensen, 1993). On the other hand, some researchers highlighted that a small board size is more favored and more effective in monitoring than larger one (Fama and Jensen, 1983; Lipton and Lorsch, 1992; Yermack, 1996).

In the last twenty years, researchers gave more concerns for the association between size of the board and performance of the company. For instance, Yermack (1996) reported a negative correlation between board's size and corporate value, measured by Tobin's Q, as well as return on assets and return on sales. These results are supported by Conyon and Peck (1998) who also found an inverse impact on return on equity. Consistent with the above studies, de Andres, Azofra and Lopez (2005) documented a negative effect of board's size on corporate value. However, Dalton, Daily, Johnson and Ellstrand (1999) in the meta-analysis stated a positive association between size of the board and performance of the company. In line with this study, Haniffa and Hudaib (2006) showed a significant relationship with measures of accounting performance.

In the context of banking industry, Juras and Hinson (2008) found no relationship between the board's size and bank's performance measured by return on assets and return on equity. In contrast, Belkhir (2009) reported that the small number of the board leads to increase performance of the bank. This result is consistent with a recent finding of Adusei (2011) who indicated that a decrease in the size of the board resulted in an improvement in the bank's performance. Furthermore, these results are supported by Rachdi and Ameur (2011) who found the relationship between the small size of the board and performance of the bank.

In general, the findings of the above studies are in line with the view that the incremental costs of weaker communication and making decisions are more than the benefits of larger size of the board (Jensen, 1993).

It is expected that the number of directors on the board does not affect the performance of Islamic banks. This is based on the teachings of *Shariah* that each Muslim is responsible to perform his/her work in the best way. So, it should be no differences in the level of performance between the banks that have small or large size of directors' board. Therefore, based the Islamic viewpoint, the researchers expect that the board size has no impact on bank performance.

H_{1a}: Board size has no direction influence on bank performance as measured by ROA.
H_{1b}: Board size has no direction influence on bank performance as measured by ROE.

2.6.2 Board Composition and Bank Performance

Agency theory suggests that the greater percentage of independent directors is associated with the performance of the company (Stiles and Taylor, 2001). In the same vein, Laing and Li (1999), the existence of outside directors leads to decrease agency costs, and therefore, increase financial performance. Because of the important function of non-executive directors on the board, UK firms tended to increase the number of independent directors (Hampel, 1998; Higgs, 2003). The possible reasons are that: 1) Outside directors have good skills and experiences (Kor and Misangyi, 2008); 2) they are less informed than insiders, but they are more able to effective monitoring on the board of directors, and consequently, enhance firm's performance (Linck *et al.*, 2008); 3) they can face the un-desired decisions of CEO (Rachdi and Ameur, 2011). This perspective is supported by de Andres *et al.* (2005) who found a significant relationship between the high non-executive directors on the board and performance of the company. Furthermore, recent work of Juras and Hinson (2008) report that the great proportion of outside directors has an association with all measures of bank performance.

In contrast with agency theory, the stewardship theory stated that the independence of the board of directors has an inverse impact on firm performance. From this perspective, the main role of board of directors is advising and counseling top

management rather than monitoring its activities (Anderson, Mansi and Reeb, 2004). Further, Indeed, Donaldson and Davis (1994) stated that "managers are good stewards of the corporation and diligently work to attain high levels of corporate profit and shareholder returns" (p. 159).

From an Islamic perspective, the members of directors' board must have the reputation of moral integrity and technically qualified in the banking business to play this role effectively. They must also have additional abilities to enable them to understand and aware of the *Shariah* principles and rules, and the Islamic teachings related to business and finance.

There are many functions for the board of directors to meet full effective control over the transactions of the bank. One of the board's crucial functions is to specify clearly the strategic objectives and guiding principles of the bank, codes of conduct for senior management, and standards of appropriate behaviour toward the staff (Chapra and Ahmed, 2002). Therefore, the board is to be able to carry out this function successfully when corporations have the strong internal control system, fitting accounting procedures, efficient risk management, effective internal and external audit and all necessary checks and balances, which are included rules, regulations and procedures. The board should also ensure that all appointments, especially to CEO position, are according to merit without any preference and nepotism. For more effective and power monitor and control of the management, non-executive directors have to be independent of the executive management (Gubitta and Gianecchini, 2002), and free from any dealing or other relationships with company that could compromise their autonomy. Non-executive directors can play this critical role through monitoring the managers opportunistic and preference actions (Fama and Jensen, 1983; Leftwich, Watts and Zimmerman, 1981; Leung and Horwitz, 2004).

Based on both agency and stewardship theories the results of relationship between the independence of board of directors and bank's performance have been mixed. For instance, Juras and Hinson (2008) found a positive and significant association between the board composition and performance of the bank. O'Connell and Cramer (2010) document similar results for Irish firms. On the other hand, Belkhir (2009) did not report any impact of proportion of outside directors on bank's performance.

However, recently, Adusei (2011) showed that board impendence was insignificant and negatively associated with performance of the bank. In the same vein, Rachdi and Ameur (2011) found that the existence of the independent directors influenced negatively on bank's performance. Hence, based on the above discussion, the following hypotheses were developed:

H_{2a}: There is a negative relationship between the proportion of board of directors on the board and bank performance as measured by ROA.

H_{2b}: There is a negative relationship between the proportion of board of directors on the board and bank performance as measured by ROE.

2.6.3 The Separation of CEO and Chairman's role

Another aspect to examine independence of the board is the "dominant personality" phenomenon (Chapra and Ahmed, 2002; Forker, 1992). According to Belkhir (2009), the separation of the role between CEO and chairman leads to decrease agency costs and improve performance of a company. This is because the combination of CEO and chairperson function makes the power within a firm in the hand of one person. This gives the CEO to manage the flow of information to other members of directors' board, and the board will be under the managers' control, which prevent him/herfrom discharging his/her tasks effectively such as hiring, rewarding executive officers of top management and making important decisions (Belkhir, 2009). Jensen (1993) recommends firms to separate between the role of CEO and chairman of the board. Segregation of the two roles gives the necessary checks and balances of the power and authority on management behavior (Blackburn, 1994; Chapra and Ahmed, 2002).

From an Islamic perspective, there is an obvious separation of accountabilities of the top management of Islamic banks through the separation between the CEO and chairman, who performs two distinct functions. This will lead to one of the most important constraints on the management of Islamic banks that is the key making decisions should not be held by one person (Chapra and Ahmed, 2002). According to Chapra and Ahmed (2002), the management will be able to achieve its effective role completely when it has all the three essential virtues namely honesty, frugality and preparedness, which are clearly stated in the Qur'an and the *Sunnah*.

In contrast with the above viewpoint, the presence of duality role facilitates CEO to manage the functions of the board such as meetings, agenda discussion as well as choosing the board's members (Al-Arussi *et al*., 2009). Duality role also allows the CEO to regulate the company in achieving its goals and enhances leadership in a firm (Dahya, Lonie and Power, 1996). From a stewardship theory, there is no problem if the two functions are combined.

There is evidence that the role of CEO and chairman held by two different persons lead to lower costs and higher return on assets in the banks (Pi and Timme, 1993). Hence, the following hypotheses were developed:

H_{3a}: There is a positive association between the separation of CEO and chairman function and performance of the bank as measured by ROA.

H_{3b}: There is a positive association between the separation of CEO and chairman function and performance of the bank as measured by ROE.

2.6.4 Chairman Independence

According to Beasley (1996), the separation and independence from management may support the ability to maximize shareholders value through independent judgement. More importantly, independent director such as chairman can give a good quality and protection of corporate judgement (Ferris, Jagannathan and Pritchard 2003).

Chairman independence became one of the significant corporate governance mechanisms due to improve oversight and monitoring functions of the board by supervising and controlling the CEO function (Abbott, Parker and Peter, 2004; Fama and Jensen, Haniffa and Cooke, 2002), and consequently, improve the performance of a firm. Besides, the chairman's independence can enhance corporate governance quality (Coulton, James and Taylor, 2003).

Chau *et al*. (2006) cited in Habbash, Salama and Dixon (2010) stated that non-independent chairman led to a concentration of the power of decision making, which may lead to poor performance as a result of the weakness as in controlling and monitoring the board. Therefore, researchers have investigated the independent role of chairman and CEO in the management approach (Willard, Krueger and Feeser, 1992),

which may influence the company's prospective success (Daily and Dalton 1993). From an Islamic perspective, Islamic banks should have a clear separation of duties at the top management of the bank to ensure independence and stability of power and authority between the CEO and Chairman, since they perform two distinct functions in an Islamic bank (Chapra and Ahmed, 2002).

Beth (2003) found that the independence of the director has no effect on company performance. This finding is inconsistent with the agency theory which state that chairman as non-executive director in the company can play a great independent role in improving the performance because of its accountabilities at the top of the firm and its influential power. Therefore, it is expected that the independence of chairman can lead to improve performance.

H_{4a}: Chairman independence has a positive impact on the bank's performance as measured by ROA.

H_{4b}: Chairman independence has a positive impact on the bank's performance as measured by ROE.

2.6.5 The Existence of the Audit Committee

Audit committee plays an important role through reviewing the internal and external auditor reporting, and to assist a flow of information across the board of directors, which reducing the conflicts between the management and auditors (Cohen, Krishnamoorthy and Wright, 2002; Gibbins, Salterio and Webb, 2001; McMullen and Raghundan, 1996). In the case of the Islamic banks, the main role of an audit's committee is to achieve the essential objectives of the bank by enhancing greater transparency and disclosure in the annual reports, and enhancing the public's confidence of the banks by ensuring that all their transactions are conformity with the *Shariah* principles.

The essential role of an audit committee is to make sure the financial accounting and control system work well (Collier, 1993). Audit committee acts as monitoring mechanisms and its presence enhances reliable the external financial reporting (Bradbury, 1990; McMullen and Raghunandan, 1996). To improve the extent of relevance and reliability of the annual report, the board of directors usually delegate accountability for supervising the financial reporting to the audit committee

(Davidson, Goodwin-Stewart and Kent, 2005; DeZoort, 1997; Wolnizer, 1995). According to AAOIFI (2005), the major functions of an audit committee for the Islamic financial institutions are: Firstly, the audit committee preserves the integrity of the annual report process by reviewing all transactions of an organization and ensuring that the annual report is completeness, fairness and accuracy. Secondly, the committee protects the different groups of shareholders, investors and other stakeholders. Thirdly, to enhance the assurance on reliability of information in the annual report before to pass to the board of directors. Therefore, the audit committee acts as an effective monitoring mechanism to reduce the agency cost, and as a result corporate performance (Forker, 1992).

There is evidence that research on the association between the audit committee and overall corporate performance is scant. Klein (1998) found a correlation between the existence of the audit committee and different measure of accounting and market performance. Similar findings reported in the UK by Vafaes and Theodorou (1998) and Weir, Laing, and McKnight (2003). Accordingly, consistent with these researches and the responsibilities of the audit committee, it is exoected that the existence of an audit committee improves corporate performanc.

H_{5a}: The existence of an audit committee has a positive impact on the bank's performance as measured by ROA.
H_{5b}: The existence of an audit committee has a positive impact on the bank's performance as measured by ROE.

3 Research Design

The main objective of this paper is to investigate the type of the association between performance of the Islamic bank and board size, board composition, separation role between CEO and Chairman as well as Chairman's independence in the Islamic banks of GCC countries. Consistent with prior studies, the current study measures board size by the total number of directors on the board, and the board composition measured by the percentage of non-executive directors to the whole directors. Further, the separation role between CEO and chairman was measured by zero/one (1 if the

function held by two different persons and zero otherwise), the independence of Chairman was measured by the separation of the role between executive and non-executive director, and the existence of an audit committee was measured by zero/one (1 if there is an audit committee and 0 otherwise). Table 1 shows the variables of corporate governance are namely as BOARDSIZE, BCOMP, CEO, CHAIR and AC respectively. This study used bank size to control the relationship between all the four independent variables and bank performance, as used in previous studies (Adusei, 2011; Arouri *et al*., 2011).

Table 1: Definition of the variables

Variables	Definition
BOARDSIZE = Board size	The total number of directors on the board
BCOMP = Board composition	The proportion of non-executive directors sitting on the board
CEO = The status of chief executive	Measured as a dumy variable where if the CEO is also the chairman is coded as '0' and '1' if otherwise
CHAIR = Chairman independence	Measured as a dumy variable where if the chairman is a non-executive director is coded as '1' and '0' if otherwise
AC	Measured as a dumy variable '1' if there is an audit committee and '0' if otherwise
BSZIE	Log total assets
ROA = Return on assets	Profit before tax and *Zakah* over total assets
ROE = Return on equity	Profit before tax and *Zakah* over total equity

Two important of financial ratios (ROE and ROA) are used to measure bank performance. Table 1 is included the definition of each measure of performance. The two ratios of ROE and ROA are considered as the best measures for performance of the bank (Sinkey, 2002). These two ratios also are used widely in previous studies (Kosmidou, 2008; Siddiqui, 2008; Sufian and Habibullah, 2009; Williams, 2003).

3.1 Empirical Model

The specific empirical model used in this study to test all three of independent variables as mentioned earlier is explained in the following equation:

$y = \beta_0 + \beta_1 BOARDSIZE + \beta_2 BCOMP + \beta_3 CEO + \beta_4 CHAIR + \beta_5 AC + \beta_6 BANKSIZE + £$

Where:

y is represented by ROE or ROA, while the independent variables are BOARDSIZE (board of directors' size, BCOMP (proportion of non-executive directors), CEO (the separation role of CEO and chairman), CHAIR (the independence of chairman) and AC (audit committee) controlling by BSIZE and. The current study utilized ordinary least square to estimate the model.

The study used multivariate regression to examine the hypotheses. Further, it tested the assumptions of linearity, normality, homoscedasticity and multicollinearity. The study also tested the assumptions of multicollinearity by using the Pearson correlation matrix. In addition, it tests the other assumptions by conducting the analysis of standard deviation of dependent variables against residuals, standard deviation, skewness and kurtosis test and White test. The Normal scores were used to transform the data.

3.2 Data and Sample

The study used cross-sectional data from the annual reports of Islamic banks in GCC countries for the year 2008. The sample includes 54 banks comprising 22 banks from Bahrain, 17 banks from Kuwait, four banks from Qatar, four banks from Saudi Arabia and six banks from UAE. The fiscal year of 2008 was chosen for this research as most of the banks had already uploaded their annual reports in their websites.

Nevertheless, the sample size for conducting multivariate regression should preferably be one to ten (Roscoe, 1975), or five (Coakes, 2005; Green, 1991) for each variable tested.

4 Empirical Results

4.1 Descriptive Statistics

Table 2 reports the descriptive statistics of the dependent and independent variables used in the study. The mean ROA for all Islamic banks is about 2.86%, while the mean ROE is approximately 11.75%. These findings show that for each $100 turnover

of the sampled banks, $1.83 and 11.92 (median) were the return earned respectively. Both the ratios of ROA and ROE are better than 0.068 and 0.012 that found in the study of Rachdi and Ben Ameur (2011).

The mean board size is 8.3 (9) directors for the whole sample. This result is in line with previous empirical study that suggested a board composed of around 8 or 9 directors is perfect from the perspective of control. The mean board size for Islamic banks is higher than 4 in the study of Belkhir (2009), and it is consistent with the research of Yasser *et al*. (2011) for Pakistani firms.

Table 2: Descriptive statistics

Variables	Minimum	Maximum	Mean	Std.Dev.	Median	Skewness	Kurtosis
ROA	-30.06	22.87	2.8640	6.7567	1.83	-1.432	11.897
ROE	-39.87	76.19	11.7529	16.7874	11.92	.316	4.682
BOARDSIZE	4.00	13.00	8.3019	1.9766	9	.058	-.369
BCOMP	1.00	10.00	6.6415	2.1492	7	-.649	.298
CEO	.00	1.00	.9245	.2667	1	-3.309	9.297
CHAIR	.00	1.00	.8302	.3791	1	-1.810	1.326
AC	.00	1.00	.8113	.395	1	-1.638	.709
BSIZE	3416683	43957250303	4533695860.	8422424250.	1747868043	3.538	13.369

Concerning BCOMP element, the percentage of non-executive directors sitting on the board is approximately 7. This finding is similar with the result of Yasser *et al.* (2011)'s study for the Pakistani firms. The findings also show that 92% of the sampled banks have a separate role of the CEO and Chairman, whereas only 7% of the banks set the two functions in the hand of one person. This result is quite similar to the study of Yasser *et al.* (2011) who reported 93% of Pakistani firms have different persons of CEO and Chairman. Furthermore, this result is greater than 50% that found in the study of Belkhir (2009). Most banks (81%) have audit committees, and this proportion is lower than (91%) that found in the study of Yasser *et al*. (2011). The mean BSIZE for all Islamic banks is about $4.53 billion, which is higher than 1.93 and 1.00 billion in the study of Rachdi and Ben Ameur (2011) and Belkhir (2009) respectively.

4.2 The Pearson Correlation Matrix

Table 3 presents the correlation between the variables. The table shows that ROA is correlated positively with board size and is significant at the 0.10 level. Similar findings are also revealed for the separation of CEO and chairman as well as the audit committee at the 0.01 level. Further, ROA had insignificant and positive correlation with the independence of chairman but has negative correlation with board composition and bank size.

Table 3: Pearson correlation matrix for Both ROA and ROE

Variables	ROA	ROE	BOARDSIZE	BCOMP	CEO	CHAIR	AC	BSIZE
ROA	1							
ROE	.518***	1						
BOARDSIZE	.255*	.015	1					
BCOMP	-.175	-.133	-.144	1				
CEO	.315**	.300**	.190	-.069	1			
CHAIR	.060	.041	.070	-.115	.632***	1		
AC	.391***	.318**	.296**	-.259	.227	.039	1	
BSIZE	-.109	.038	.269	.017	-.124	-.275**	.178	1

***, ** and * Correlation is significant at the 0.01, 0.05 and 0.10 level respectively.

Furthermore, Table 3 shows that ROE is correlated positively and significantly with the separation of CEO and chairman and the audit committee at the 0.05 level. ROE also has insignificant positive correlation with board size, chairman independence and bank size, but has negative correlation with board composition.

4.3 Regression Results and Discussion

Table 4 and 5 show that the variance inflation factor is lower than two (2), which suggest that there is no multicollinearity problem in both models (Haniffa and Cooke, 2005; Naser, Al-Hussaini, Al-Kwari, & Nuseibeh, 2006).

Table 4: The relationship between ROA and board of directors structure

Model	β	t	Sig.	Tolerance	VIF
(Constant)		-1.881	.066		
BOARDSIZE	.175	1.286	.205	.833	1.200
BCOMP	-.080	-.618	.539	.912	1.096
CEO	.338	2.016	.050	.548	1.826
CHAIR	-.251	-1.495	.142	.549	1.822
AC	.293	2.108	.040	.801	1.249
BSIZE	-.234	-1.712	.094	.827	1.209

Table 5: The relationship between ROE and board of directors structure

Model	β	t	Sig.	Tolerance	VIF
(Constant)		-.593	.556		
BOARDSIZE	-.136	-.941	.352	.833	1.200
BCOMP	-.081	-.590	.558	.912	1.096
CEO	.403	2.264	.028	.548	1.826
CHAIR	-.218	-1.223	.228	.549	1.822
AC	.250	1.700	.096	.801	1.249
BSIZE	.021	.147	.884	.827	1.209

The results show that there is no relationship between ROA and board size, implying that board size does not affect bank's performance. Hypothesis one (H_{1a}) is thus supported. The same finding was found for ROE but in the opposite direction. These results may be explained from the Islamic viewpoint that there is no reason why a bank with more directors on the board can achieve higher profitability than a bank with lower number of members. Therefore, hypothesis one (H_{1b}) is also supported. This finding is consistent with the studies of Arouri *et al*. (2011) and Belkhir (2009), who does not report any association between board size and bank performance.

The independence of the board has a negative and insignificant associated with an Islamic bank performance for both measures of ROA and ROE. Hence, hypothesis two (H_{2a} and H_{2b}) is supported. This result is in line with previous studies (Adusei, 2011; Belkhir, 2009; Rachdi and Ben Ameur, 2011). Furthermore, this finding goes straight with the perspective of stewardship theory that supposed the board of directors' independence has the negative effect on company performance. This implies that the independence of board of directors within Islamic banks leads to poor performance and vice versa. This is because majority on non-executive directors were selected based on their contacts, not of their experience and expertise, and they may not support independent oversight and the decreasing the agency conflicts.

The findings show a positive and significant relationship between the separation of CEO and chairman and bank performance measured by both ROA and ROE at the 0.05 level. Therefore, hypothesis three (H_{3a} and H_{3b}) is supported. This result is consistent with the Islamic viewpoint that emphasizes the roles of CEO and chairman within Islamic banks must be hold by two different persons in order to reduce agency costs and improve performance of the bank (Belkhir, 2009).

The chairman independence has a negative and insignificant association with bank's performance as measured by ROA and ROE. Hence, hypothesis four (H4a and H4b) is rejected. This reflects that a non-executive Chairman among Islamic banks does not have more power to influence the performance, and he may select based on its relations. This result is in contrast with agency theory whcich state that the independence of chairman could improve the performance of a firm. Further, the finding is consistent with the study of Beth (2003) who documented no relationship between chairman independence and company performance. The existence of the audit committee has positive and significant influence on bank's performance as measured by ROA and ROE at 0.05 and 0.10 level respectively. Hence, hypothesis five (H5a and H5b) is accepted. This implies that the presence of an audit committee as a monitoring mechanism reduces ageny costs (Forker, 1992 ; Ho and Wong, 2001), and therefore, improving bank performance. This result is consistent with prior research (Klein, 2002; Anderson *et al*., 2004).

Concerning control variable, no significant association was found between the bank size and performance of the bank measured by ROA and ROE. This implies that an Islamic bank could grow without the need to achieve revenues, and due to the characteristics of GCC banks, which is based on the diversification of the assets in order to improve the profitability (Arouri *et al*., 2011). This finding is in line with studies of Adusei (2011) and Arouri *et al*. (2011).

5 Conclusion

Without doubt, there are many studies that have investigated the association between company performance and the structure of corporate governance in different industries (but not in Islamic banking sector), and yet the results are mixed. The main objective of the current study is to examine the effect of bank performance, as measured by ROA and ROE, on four characteristics of board of directors (board size, board composition, separation roles of CEO and chairman and chairman independence), as well as the existence of the audit committee. A sample size of 53 Islamic banks from GCC countries was employed for the year 2008. The study found that board size has no influence on the bank's performance, and this result is in

contrast with agency theory. The same finding was found for board composition but in the opposite direction. The important result is that the separation of the roles of CEO and chairman and the presence of the audit committee have positively and significantly affect performance of the bank. In contrast, the independence of chairman has negative and insignificant influence on bank's performance, and the finding is inconsistent with the agency theory.

These reults suggest the need to improve the extant of bank governance by sitting new constraints on corporate governance mechanisms in terms of the independence of board of directors and chairman. GCC regulators may require Islamic banks to invest more on the audit committee in order to protect investors and retain confidence in the economy. Investors may use the results to understand the situation of corporate governance within Islamic banks better.

The study has some limitations. First, it used only two proxies to measure performance of the bank (ROA and ROE). As such, future research may employ another measurement such as Tabin's Q. Second, the data is obtained from the annual reports; further research may use other sources of information such as Ipos, press released, etc. Third, it used just one-year data. Future research may use longitudinal data. Fourth, it employed a small sample size and few corporate governance variables. Future research may increase the sample size and include other variables such as ownership structure. Despite these limitations, this study has provided the avenues for more empirical research on governance mechanisms in Islamic banking industry.

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AL BAI' BITHAMAN AJIL VERSUS CONVENTIONAL HOUSE FINANCING: PROFITABILITY AND EFFICIENCY FACTORS

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Abstract

Currently, there are many research studies being done on various aspects of Islamic financing. A number of them are based on the comparisons of Islamic banking and conventional banking. However, only a few are on comparative studies of Al Bai' Bithaman Ajil (BBA) and housing loans (house financing). Therefore, as an alternative product to conventional housing loan, the BBA house financing need not only is enhanced but also stand at par in order to remain competitive. This paper examines the factors contributing to the profitability and efficiency of Islamic and conventional banks in term of BBA and house financing. In the study, the data was based on six Islamic banks and ten conventional banks which were taken from the International Institute of Islamic Business and Finance (IIIBF) from 2006 to 2010.In order to assess the factors of performance for the Malaysian conventional banks and Islamic banks regression analysis was used. Form the results obtained in the study, it showed that asset utilization has a negative effect on these banks. Whereas, efficiency has a positive effect on Islamic banks in BBA, but negative impact on conventional house financing. Furthermore, our research indicates that the return on asset is negatively related to Islamic banks in BBA, while conventional banks in House financing have positive associations. Islamic banks can further develop its economic scope so as to increase profitability and enhance efficiency in order to be competitive in the banking industry.

Keywords: Islamic Banks, Conventional Banks, *Al* Bai' Bithaman Ajil, House Financing.

1. INTRODUCTION

Islamic banks are based on specific nature and qualities which make them special from other conventional banks. Furthermore, there is also the specific relationship

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between Islamic banks and its customers whereby they have achieved success on economic and social levels. In addition, an Islamic bank does not use interest for its transaction. Apart from that, it does not allow businesses that deal with industries like pork, pornography, gambling and other such thing which acceding to Shariah law is Haram. Here, the term Shariah is regarded as approved for underlying transactions and economic activities, based on contracts that acceptable with Shariah laws. It must also agree to financial products and services that add value in all financial transaction and operation.

There are a number of research studies that have been carried out regarding comparative financial analysis between Islamic banks and conventional banks. Among many of the researchers, Kadir et al. (2003) have been able to determine the differences between Islamic bank and conventional bank based on return on asset, asset utilization, and operating efficiency ratio. One could these as a good example for analysis .We can also see that some matters are not found in conventional banking as they do not in Islamic banks. For instance, interest rate risk is not covered in Islamic banking since interest rate is Haram in their operations. However, for conventional banks interest rate is very important in its operation. In the case of some Islamic bank, they will deduct all expenditures from their profit while others will share their profit with their depositors as return on their deposit.

Therefore, the main objective of the study is to investigate the financial performance of BBA and housing loan between the years 2006 to 2010 Apart from that, this study aims to achieve the following objectives:

To compare the financial performance between BA BBA and house loan based on return on asset (ROA), Asset Utilization (AU), Operating Efficiency ratio (OER), loan profit ratio (LPR) and equity margin (EM) and to provide a descriptive statistic, regression analysis and hypothesis of (BBA) and housing loan. Furthermore, this study will make a comparison of Islamic banks in Malaysia. In this paper an analysis of financial statement of the banks was used. We have also indicated the differences and similarities between BBA and hosing loan. In this paper, the methodology that has been used for the data analysis included the impact hypothesis for each variables

and applying the regression analysis. For this project six Islamic banks and eleven conventional banks has been used between the years 2006 and 2010.

The purpose of this study is to examine the relationships between *BBA* and mainstream housing loan, by comparing them and finding which factors has either more or less affect their financial performance. Another purpose of this study is to use some financial ratios to measure a company's financial performance.

2. LITERATURE REVIEW

2.1 Impact of Profitability on Islamic and Conventional Banks

In relation to the study on the impact of Profitability on Islamic and Conventional Banks, we have referred to a study done by Tafri.et al. (2009). He studied on the impact of profitability of banks based on return on equity (ROE) and return on asset (ROA).In this paper, we have considered the relationship between financial risk and profitability of the conventional and Islamic banks in Malaysia. They were studied between the years1996 and 2005. Most of the data were obtained from income statements and balance sheets of 14 Islamic banks in eight Middle Eastern countries. For this paper, the analysis used included 18 regression equations in order to compare the impact variables based on the conventional banks and Islamic banks. The method which was used in this paper included correlation coefficients of the variables and normal distribution. The paper was based in on variables such as return on asset (ROE), return on asset (ROA) and net interest /income margin (NIM). Whereas in this paper, for Independent variables we used risk factors involving liquidity, credit and interest rate. From the result it does show, that it does not have an impact on liquidity risk. However, for the credit risk, the total asset has a negative impact on profitability. In addition, for the conventional banks, interest rate risk has a positive and significant effect on return on asset (ROA) rather than a negative return on equity (ROE). Regardless of the interest rate risks, there is no significant impact on the profitability of the Islamic bank.

In his research, Bashir (2003) has described the impact of the profitability on Islamic banks. This study was based on Islamic banks in eight Middle Eastern countries

namely, Egypt, Bahrain, Jordan, Kuwait, Qatar, Sudan, Turkey and United Arab Emirates- between year 1993 and 1998. In this paper, the data methods used were the White, the coefficients and Heteroskedastic.The variables used in this paper, include such financial data as before tax profit (BTP/TA), net income divided by total assets (ROA), and net income to total equity (ROE). In terms of Bank characteristics, for this paper it has been indicated as equity over total asset, loans to total asset, non-interest earning to total asset, total liabilities to total asset, short term funds to total asset. The explanatory variables used include control variables like financial structure variables, taxation variables, and macroeconomic indicators. As a result, it shows that Islamic banks profitability has a positive prelateship in terms of capital and loan ratios .Moreover, the result also show that equity to total asset ratio is larger than loan to asset. For taxes, the result have a negative relationship in Islamic banks, has positive relationship in terms of loan to total asset and profit margins'. Furthermore, there is a positive correlation in the measures that foreign owned banks do in order to provide the capital. In addition, result in macroeconomic shows high inflation and high GDP that have a positive relationship to the banks' performance.

Through his research, Akhtar, et al. (2011) has been able to determine the profitability of conventional banks in Pakistan. He also examined the profitability of commercial banks and analyses their profitability between years 2006 to 2009. A total of 22 banks are used composed of 20 in the private sectors and 2 public sectors. This paper used multi-variant regression model for testing the significant of variables on profitability of conventional banks. Among the variables used in this paper are Return on Assets (ROA), Return on Equity (ROE), Bank's Size, Gearing Ratio, NPLs Ratio, Asset Management, Operating Efficiency, and Capital Adequacy. Furthermore, the operating efficiency and capital adequacy ratios have a negative relationship, but have an insignificant relationship in terms of return on equity (ROE). The result shows that correlation coefficient has a positive relationship out of the operating efficiency asset management and in term of banks. There is a positive relationship with regards to profitability and statistically in terms of coefficient; it has a significant relationship with the return on assets (ROA). The result has indicated the profitability measure of the bank's performance in terms of return on asset and return on equity. In addition, return on asset was used to measure bank's profitability and has an insignificant

relationship and return on equity was also used to measure the profitability of commercial banks.

2.2 Impact of Efficiency Ratios on Islamic and Conventional Banks

Tarawneh (2006) in his study evaluated the impact of asset management, operational efficiency. He tried to find out based on the bank size, the financial performance, of the banks performance of the commercial banks in Oman. A total of five Omani commercial banks with more than 260 branches were financially analyzed, and for the period between 1999 to 2003 by identifying the differences in performance of commercial banks in Oman. In this paper, the method that was used for the analysis, include descriptive financial analysis, correlation, analysis of variance (ANOVA), and simple regression by comparing the ratios for each year. By using those methods, he tried to describe the impact of independent variables on dependent variable Furthermore, in this paper the measured variables are dependent ROA and Interest income. The independent variable for this paper include: Operational Efficiency, Asset Utilization and Asset size. The result showed that impact of the financial performance of the banks was strong and positive in the operational efficiency. Moreover, as result in correlation analysis shows that there is a positive relationship involved by comparison ROA, interest income size, and by operational efficiency, asset management, bank size in the banks. Furthermore, results of variance (ANOVA) show that there is a positive relationship measured by ROA and interest income. Statistically, the measure that came up by concluding that the banks with higher predictors of total asset, credit, deposit or shareholder equity, does not mean that it is always performance that are better done in profitability.

ElGindi and Salevurakis et al. (2009) analyzed the impact of profitability, liquidity and asset quality between the performances of Islamic banks and conventional banks in Malaysia. The paper analysed a total of 8 banks in Malaysia. They are Standard Chartered Bank Malaysia Berhad, Overseas Chinese Banking Corporation Limited (OCBC) Malaysia Berhad, HSBC Bank Malaysia Berhad, Affin Bank Berhad, Citibank Berhad, AmBank Group, Maybank, and Hong Leong Bank. In this paper, the data has been used for each of these banks from year 1999 to 2006. The methodology used in this paper used two hypotheses relating to the equality of variances test (F-

test) and equality of means test (Z-test) .The variables chosen in this paper include profitability, financing activities, nonperforming financing ratio, liquidity, rates of return, and capital adequacy. Under portfolio, which is also included in this paper, such as return on asset (ROA), return on equity (ROE), and return on deposit (ROD)? Furthermore, through liquidity ratio, which were taken in this paper such as cash deposits radios (CDR) and loan deposits ratio (LDR). In addition, the last ratios used in this paper were the asset quality ratios and a nonperformance loans (NPL) ratios. As the result show in term of profitability, Islamic banks' ROA, ROE and ROD were much larger than that of the conventional banks. However, in terms of liquid ratios the results showed that conventional banks have much more higher ratios as compared to Islamic banks. Furthermore, Islamic banks have a greater ability to turn deposits into net earnings. As to the result of NPL its ratio for conventional banks is higher than Islamic banks. Also in terms of measure, Islamic banks were higher in CDR but lower in LDR.

According to Rosly and Bakar (2003), their study found that Islamic banks have higher ROA ratio, as used by conventional banks which does not imply efficiency. Moreover, in connection with Islamic bank on interest margin ratio product or credit finance, it is less likely to be better than conventional banks on efficiency term. In terms of measure, one compares the profitability performance of selected Islamic bank and the mainstream operating in sixteen commercial banks and eight finance companies. The data has been selected for the year 1996 to 1999. They used the methodology for comparison of profitability on Islamic banks and mainstream banks by providing the descriptive statistics, the t-test, and p-value performance of profitability. These are used as variables namely return on asset (ROA), return on deposit (ROD), asset utilization (AU), operating efficiency ratio (OER) and investment/interest margin. For selection, ROA is a better choice over ROE. The ROA indicates efficiency position in terms of the bank management make use of assets into net earnings .Basically, ROA should be higher than ROD. Moreover, a management is able to make decision to turn deposit into net earnings. Furthermore, there is no guarantee that Islamic deposit is on profit and it has positive relationship between banks earning and ROD. In conventional banks it is based on interest income plus non-interest income. For Islamic banks, it is the total operating income consisting of investment income and fee income. As result, to conclude by their results, it shows

that in conventional banks AU and interest /investment insignificantly higher than for Islamic banks. In Islamic banks the result shows that the ROA, PM, NOM and OER have significant higher result than for conventional banks as based on this paper. In addition Islamic banks have more power to give deposit in term of higher dividend rate than interest bearing deposits. Conventional banks loans are based on variable interest rates.

2.3 Bai Bithaman Ajil (BBA) in Islamic Bank's and house finance in Conventional Banks

Aris, et al (2011) described the impact of house finance and *Bai' Bithamin Ajil* (BBA). In Malaysia BBA was first introduced by Bank Islam Malaysia Behad (BIMB). This was as an alternative product to the conventional housing loan, so as to make the BBA house financing need to be enhanced and stand at par to remain competitive.

In the conventional system, housing loan is simply giving a loan to the customer charged to the customer over the period of payment. Islamic house financing is an alternative financial product to substitute conventional interest-based house financing modes. In Islamic banking, house finance used sale and buy method for the product through Islamic principles of Bai bithaman Ajil and Musharakah Mutanaqisah (diminishing partnership). In addition, an Islamic bank provides to its customer an opportunity to own a house. As mentioned earlier, Bai' Bithaman Ajil means a (deferred payment sale) generally, it is a mode of Islamic financing used for property, and vehicle transactions. Using this type of contract based on the precepts that one acquires a given asset in terms of deferring the payment of the asset in a specific period of time by deferred installment. Accordingly, as for the purchase for example in this paper, are bought by the bank and then sold to customer at an agreed price. This agreed price between them will include the bank's mark-up profit which is fixed over a period time for the loan. In Malaysia, the BBA's deferred payment is based on the Shari'ah concept .As such, the BBA home financing can be said to be almost similar to that of the conventional financing except for the fact that the customer is likely to end up with higher financing costs in case of early redemption or defaults.

Amin and Chong (2007) examined the effect of Islamic home financing in Malaysia. Their study is based on two methods of home financing, such as Islamic home financing and conventional home loan. Variables that were used in this paper include such as Base Lending RatesIn (BLR), Inflation, and underlying principle base on BBA. Islamic banks, interest rates those are forbidden and unlawful to be practiced. Furthermore, Islamic banks employ *hibah* rate or profit sharing ratio when providing profit to depositors of the banks. The *hibah mean* rate is based on Islamic banks' financial performance. However, conventional banks based theirs on interest rate that is whether the banks gain profit or not, but in Islamic banks they share with both parties. As analyzed in this paper, Islamic home finance offers fixed monthly payment whereas conventional home loans offer without fix monthly payment during inflation. As result in this paper Islamic home financing does not have any relationship with interest rates, when compared in term of this to conventional home loan. Islamic home financing does not have any positive or negative relationship to inflation and deflation. On the other hand, conventional home financing has positive relationship with inflation and deflation.

3. RESEARCH METHOD

The secondary data source has been used for this paper .Information was collected from the financial statements in the bank's annual reports, Bursa Malaysia, articles, books and other publications. This paper has only considered financial information derived from year 2006 to 2010. By pooling all data together, a total of 50 observations were collected for conventional banks and 30 from Islamic banks. The reason for choosing this period for the study was due to lack of available data. The banks do vary in terms of how they effect on the banks performance and comparative analysis between Islamic and conventional banks in Malaysia. Therefore, in the sample data used for this paper try comprised of six Islamic and eleven conventional banks and two types of bank products were selected namely as Al-Bai' Bithaman Ajil (BBA) and house finance for Islamic bank and conventional banks respectively. As the Islamic banks selected include Affin Islamic bank, Bank Islam Malaysia, Bank Mumalat Malaysia, Hong Leong Islamic bank, Am Islamic Bank Berhad and CIMB Islamic Bank Berhad. For conventional banks, Affin Bank Berhad, CIMB Bank Berhad, Citibank Berhad, Maybank Berhad, Public Bank Berhad, RHB Bank Berhad,

Alliance Bank Malaysia Berhad, Bangkok Bank Berhad, Hong Leong Bank Berhad, HSBC Bank Malaysia Berhad and OCBC Bank (Malaysia) Berhad were selected.

This paper examines about the impact of efficiency ratios and profitability in the performance of Al *Bai' Bithaman Ajil* (BBA) and house finance.

It has two models with different dependent variable. Three independent variables are used as listed Return on asset, asset utilization and operating efficiency ratio. We also examined the impact of the hypothesis for each of variables namely: ROA, AU, OER, LPR and EM on Islamic banks and conventional banks based on the Al *Bai' Bithaman Ajil* BBA and house finance.

Model specification for regression analysis:

$BBA_t = b_0 + \beta 1\ ROA_{t-1} + \beta 2\ AU_{t-1} + \beta 3\ OER_{t-1} + \beta 4EM_{t-1} + \beta 4LPR_{t-1} + e_t$

$HF_t = b_0 + \beta 1\ ROA_{t-1} + \beta 2\ AU_{t-1} + \beta 3\ OER_{t-1} + \beta 4EM_{t-1} + \beta 4LPR_{t-1} + e_t$

Dependent variables of bank performance (either BBA OR HOUSE FINANCE)

b_0= Constant,

β_i = Measure coefficient of each of the independent variables

Which are:

ROA: Represent net profit to total asset ratio in year t

AU: Represent total operating income to total asset ratio in to year t

OER: Represent operating expenses to total operating income ratio in year t

EM: Represent total asset to total equity

LPR: Represent loan income in either BBA/HF to net income

While**, e_t** = is an error term.

Formulation of Hypothesis among BBA and house financing

H1: there's a positive and significant impact of return on asset (ROA) on Al *Bai' Bithaman Ajil* (BBA).

H2 1: there's a positive and significant impact of asset utilization (AU) on Al *Bai' Bithaman Ajil* (BBA).

H3 1: there's a positive and significant impact of operating efficiency ratio (OER) on Al *Bai' Bithaman Ajil* (BBA).

H4 1: there's a positive and significant impact of equity margin (EM) on Al *Bai' Bithaman Ajil* (BBA)

H5 1: there's a positive and significant impact of loan profit ratio (LPR) on Al *Bai' Bithaman Ajil* (BBA)

H1 1: there's a positive and significant impact of return on asset (ROA) on house finance.

H2 1: there's a positive and significant impact of asset utilization (AU) on house finance.

H3 1: there's a positive and significant impact of efficiency ratio (OER) on house finance.

H4 1: there's a positive and significant impact of equity margin (EM) on house finance

H 1: there's a positive and significant impact of loan profit ratio (LPR) on house finance

4. RESULTS

This paper has managed to do a comparative performance analysis of Islamic banks and conventional banks in terms of BBA and house finance. Moreover, it is based on the evidence of profitability and efficiency ratios. This analysis also compares the banks' financial performance from 2006 to 2010. For the analysis, three types of software were used, namely Microsoft excel, E-Views and Statistical Package for Social Sciences (SPSS).

Table 1: Descriptive statistic for Islamic banks (BBA)

	BBA	AU	EM	LPR	OFR	ROA
Mean	0.189019	0.043061	16.90912	8.623986	-0.488303	0.011479
Median	0.155118	0.039781	15.23289	8.169492	-0.475419	0.006904
Maximum	0.484402	0.102347	52.58020	12.04586	-0.307782	0.088767
Minimum	0.083520	0.017251	9.052004	5.475070	-0.705221	0.001235
Std. Dev.	0.094730	0.016395	8.016972	1.730865	0.089576	0.017585
Skewness	1.713974	1.530591	3.032524	0.221856	-0.500729	3.560848
Kurtosis	5.767488	6.895921	14.19224	1.989116	3.403273	14.98099
Jarque-Bera	24.26228	30.68630	202.5639	1.523457	1.456935	242.8283
Probability	0.000005	0.000000	0.000000	0.466859	0.482648	0.000000
Sum	5.670559	1.291835	507.2737	258.7196	-14.64908	0.344356
Sum Sq. Dev.	0.260238	0.007795	1863.884	86.88091	0.232692	0.008968
Observations	30	30	30	30	30	30

In table 1 above, one describes the variables used in this paper using mean, standard deviation, skewness and kurtosis.

Based on the average, the mean value of BBA in between 6 Islamic banks is 0.189019 and the mean value of 5 independent variables is positive but only operative efficiency ratio (OFR) is -0.488303. The equity margin shows that the highest mean value is 16.90912 and the highest standard deviation is 8.016972 thereby showing a huge amount of money that was put up by the investor in banks. The loan profit ratio shows a mean score of 8.623986 and standard deviation of 1.730865. As shown, the asset utilization and return on asset have mean of 0.043061 and 0.011479 respectively. But return on asset has higher standard deviation as compared to asset utilization.

Table 2: Correlation of Islamic bank between independent variables

	BBA	AU	EM	LPR	OFR	ROA
BBA	1					
AU	0.278973	1				
EM	0.551442	-0.06025	1			
LPR	0.339143	-0.29373	0.098602	1		
OFR	0.2163983	0.168410	0.082516	-0.207112	1	
ROA	0.7515619	0.522918	0.641181	-0.102393	0.160179	1

In table 2 above, a correlation matrix shows that all variables are not as strong as each other, their values are less than 0.2, but only indicate asset utilization of -0.207112566 which is a higher correlation with each other. For OFR correlation with AU, it is negative and significant. Moreover, the correlation between EM and AU is negative and significant of -0.060254588. As for ROA and LPR it has a negative and significant -0.102393579 correlation.

Table 3: Regression model 1

Variable	Coefficient	Std. Error	t-Statistic	Prob.
AU	-0.279187	0.844584	-0.330562	0.7438
EM	-0.000397	0.001882	-0.211103	0.8346
LPR	0.024685	0.005666	4.356989	0.0002
OFR	0.201278	0.106271	1.894010	0.0703
ROA	4.385413	1.001838	4.377365	0.0002
C	0.042818	0.088408	0.484331	0.6325

R-squared	0.773969	Mean dependent var	0.189019
Adjusted R-squared	0.726879	S.D. dependent var	0.094730
S.E. of regression	0.049507	Akaike info criterion	-2.996562
Sum squared resid	0.058822	Schwarz criterion	-2.716323
Log likelihood	50.94843	Hannan-Quinn criter.	-2.906911
F-statistic	16.43601	Durbin-Watson stat	1.683472
Prob(F-statistic)	0.000000		

Dependent variable: BBA

Substituted Coefficients:

BBA = 0.042818-0.279187*AU - 0.000397*EM + 0.024685*LPR + 0.2012775*OFR + 4.3854126*ROA + 0.042818

That the explanatory variable which is accounted for R-squared is 0.773969 of the variation in the BBA model. This indicates that 0.773969 of deviation of BBA is explicated by deviation of independent variables. In fact, the independent variables are affecting the dependent variable. The regression shows that variables such as LPR,

OFR and ROA are significant at 5percent level and 10 percent level, except for AU and EM which have P-values of 0.7438 and 0.8346 respectively. Therefore, it shows that it is insignificant in BBA.

Table 4: Descriptive statistic for conventional banks

	HF	EM	AU	LPR	OFR	ROA
Mean	0.091541	13.19306	0.041801	4.802075	-0.456010	0.010529
Median	0.093577	12.79178	0.043389	4.730743	-0.493164	0.010892
Maximum	0.261209	21.01406	0.057253	8.879942	0.305216	0.025635
Minimum	0.001032	1.000000	0.004347	1.765885	-0.835103	-0.008554
Std. Dev.	0.062743	3.599360	0.010264	1.588739	0.170122	0.005902
Skewness	0.298435	-0.480837	-1.663121	0.487295	2.157424	-0.184757
Kurtosis	2.515282	4.401076	6.873069	2.814649	10.50529	4.779065
Jarque-Bera	1.231677	6.016312	54.30115	2.050374	156.1402	6.878359
Probability	0.540188	0.049383	0.000000	0.358729	0.000000	0.032091
Sum	4.577048	659.6531	2.090045	240.1037	-22.80049	0.526470
Sum Sq. Dev.	0.192899	634.8142	0.005162	123.6805	1.418138	0.001707
Observations	50	50	50	50	50	50

The above table 4 describes the variables used in this paper through mean, standard deviation, skewness and kurtosis.

Based on the average, the mean value of house financing (HF) between 10 conventional banks it is 0.091541 and the mean value of 5 independent variables is positive but with only operative efficiency ratio (OFR) of -0.456010. The equity margin shows that the highest mean value is 13.19306 and the highest standard deviation is 3.599360 whereby it shows huge amount of money that was put up by the investor in connectional bank. The liquidity profit ratio shows mean of 4.802075 and standard deviation of 1.588739. As shown, the asset utilization and return on asset give the mean of 0.041801 and 0.010529 but asset utilization has higher standard division as compared to return on asset .

Table 5: Correlation of conventional bank between independent variables

	HF	EM	AU	LPR	OFR	ROA
HF	1					
EM	-0.413847	1				
AU	0.181323	-0.247807	1			
LPR	-0.009708	0.362314	-0.24276	1		
OFR	0.193585	0.009684	0.003490	0.001542	1	
ROA	0.057215	0.134908	0.090880	0.162539	0.228480	1

The above table 5 on correlation matrix shows that all variables are not so strong as each other, where the value are less than 0.4, but only indicate EM -0.41384774 which is a higher correlation with each other . HF correlation with EM has a negative and is significant. More over correlation between AU and EM has a negative and significant -0.24780787. Whereas LPR and AU correlation has a negative and significant of -0.24276131

Table 6: Regression model 2

Variable	Coefficient	Std. Error	t-Statistic	Prob.
EM	-0.007984	0.002503	-3.189879	0.0026
AU	0.650323	0.848715	0.766244	0.4476
LPR	0.006937	0.005695	1.218018	0.2297
OFR	0.069623	0.049657	1.402074	0.1679
ROA	0.400327	1.472976	0.271781	0.7871
C	0.163917	0.061822	2.651415	0.0111

R-squared	0.245841	Mean dependent var	0.091541
Adjusted R-squared	0.160141	S.D. dependent var	0.062743
S.E. of regression	0.057500	Akaike info criterion	-2.761884
Sum squared resid	0.145477	Schwarz criterion	-2.532441
Log likelihood	75.04711	Hannan-Quinn criter.	-2.674511
F-statistic	2.868620	Durbin-Watson stat	1.682893
Prob(F-statistic)	0.025100		

Dependent Variable: HF

Substituted Coefficients:

HF = 0.163917-0.0079844*EM + 0.65032275*AU + 0.006937164*LPR + 0.0692278*OFR + 0.400326551*ROA + 0.16391656

That the explanatory variable accounted for R-squared is 0.245841of the variation in the house financing (HF) model .As such, this indicates that 0.245841of deviation of house financing (HF) is explicated by deviation of independent variables. In fact independent variables are affecting the dependent variable. The regression result shows that there is only one variable that is significant for conventional bank. We find that EM indicate 0.0026 which is significant at 5 percent level and 10 percent level, that variables such as AU, LPR , OFR and ROA are insignificant in house financing(HF) show that of 0.44,0.22,016 and 0.78.

The performance indicators of BBA and HF have been used as the dependent variables to test our hypothesis described in research method. The variables in the regression analysis between Islamic banks and conventional banks in Malaysia. The following table reintroduces the hypothesis and is compared with the empirical results

Table 7: Summary result of hypothesis test

Variable	BBA	HF
ROA	Positive	Negative
AU	negative	Negative
OFR	positive	negative
EM	Negative	Positive
LPR	Positive	Negative

5. CONCLUSION

This paper has shown that the financial performance between Islamic and conventional banks by examined in term of BBA and housing finance. The literature review was discussed in section two using information from previous journals and articles. Moreover, the study also examined the impact of asset utilization, return on

asset and operating efficiency ratio on the performance of Islamic and conventional banks.

In section three, we discussed on the methodology which is based on the hypothesis and using the Ordinary Least Squares (OLS) method of regression analysis for the data analysis. A total of six Islamic banks and ten conventional banks were used in the study for the years between year 2006 and 2010 with a total of 30 observations in Islamic banks and 50 observations in conventional bank. Furthermore, foreign Islamic banks such as Al Rajhi Banking and Investment Corporation (Malaysia) Berhad, HSBC Amanah Malaysia Berhad, Kuwait Finance House (Malaysia) Berhad and Asian Finance Bank Berhad could not offer Syariah products as they are not allowed to do so. Moreover, in order for foreign Islamic banks to do business in Malaysia they have to look forward on the concept of Syariah, in terms of BBA by Bai al -inah in Islamic financing. Currently, it is used for contract of sale and purchase of asset by the bank and sells it back to the buyer or customer at a lower price. In Malaysia, such sale is considered valid by the Syafii jurist but illegal or prohibited if does not follow them.

In a conventional bank, the model indicates that the equity margin (EM) is negatively related with its house financing, while it is positive related.in Islamic bank. However, loan profit margin ratio (LPR), operating efficiency ratio (OFR) and return on asset (ROA) are significantly related for Islamic bank's BBA in Malaysia. As for the regression model, it shows that EM is positive to BBA. As such, Islamic banks in Malaysia should focus more on increasing their equity performance rather than to increase the investment margin.

According to Rosly (2003) whereby in his study, ROA and other profit ratios were used, performance ratios such as ROD, PM, NOM and OFR were incorrect but are still reliable in order to find out their financial performance. Islamic banks can therefore develop their economic scope so as to increase profitability. They can also provide efficiency in carrying out their business. In addition, the regression analysis do show that profitability and efficiency ratio can have an impact on the financial performance, thus Islamic banks can make an impact on the system practiced by conventional banks.

This study deals with making the comparison of financial performance in Islamic banks in Malaysia. From an analysis of the financial statements of the banks has indicated the differences and similarities between BBA and housing loan. Alternative conventional banking systems could also be looked at by Islamic banks. Since a few studies that have been considered the effect of BBA in Islamic bank. By using more variable for such research one can make more it interesting for people or researcher in order to find out about BBA in Malaysia. Although house financing has a relationship with BBA, with further analysis one could make good justification and explanation by comparing them. With more studies in the future, can make suitable finding for accomplish.

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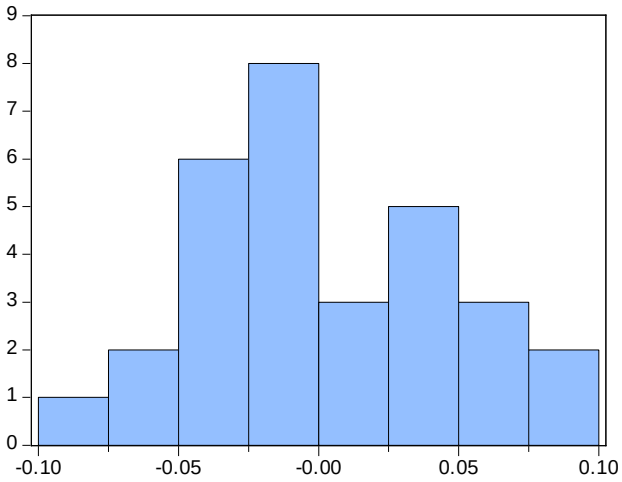
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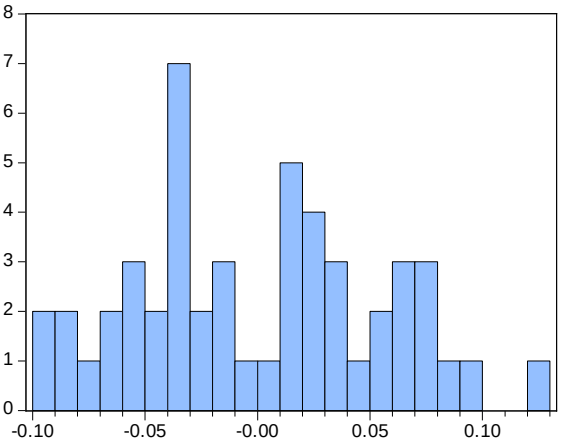
APPENDIX

Normality test of Islamic bank



Series: Residuals	
Sample 1 30	
Observations 30	
Mean	5.09e-18
Median	-0.012772
Maximum	0.096167
Minimum	-0.092467
Std. Dev.	0.045037
Skewness	0.267075
Kurtosis	2.398439
Jarque-Bera	0.808988
Probability	0.667314

Normality test of Conventional banks



Series: Residuals	
Sample 1 50	
Observations 50	
Mean	1.94e-17
Median	0.000713
Maximum	0.121917
Minimum	-0.099468
Std. Dev.	0.054488
Skewness	0.152113
Kurtosis	2.159828
Jarque-Bera	1.663421
Probability	0.435304

BOARD OF DIRECTORS' CHARACTERISTICS AND VALUE RELEVANCE OF ACCOUNTING INFORMATION IN MALAYSIAN SHARIAH-COMPLIANT COMPANIES (A PANEL DATA ANALYSIS)

Hussain Khalifa Hussain Alkdai[1]
Mustafa Mohd Hanefah[2]

ABSTRACT

To achieve its objectives, this study uses the panel data approach for 270 Malaysian Shariah-compliant companies over the period of three years from 2007 to 2009. This study examines the relationship between some board of directors characteristics represented in the board of directors size, number of independent non-executive directors in the board, the CEO duality, and the number of Muslim directors in the board. In addition, some company's specific characteristics, namely, company's size, company's leverage, company's profitability and size of audit firm (Big4) were regressed in the model as control variables. The Ohlson's (1995) Valuation Model was used to examine these relationships. Furthermore, three panel data estimations namely Pooled OLS, Fixed and Random effects models were conducted. The findings after correcting for heteroscedasticity and autocorrelation, making sure that the model does not suffer from multi-collinearity, and after transforming the data to be normally distributed indicate that the board size is not an important factor to affect the value relevance of accounting information, because of their negative non-significant relationship. Additionally, it was revealed that there is a positive but non-significant relationship between the board independency and value relevance of accounting information. The study failed to find that splitting the roles of CEO from that of the board chairman increases value relevance of accounting information. The result also indicates that there is not strong influence for availability of Muslims in board of director on value relevance of accounting information.

Keywords: board of directors, value relevance of accounting information, panel data, Malaysian Shariah-compliant companies.

1. INTRODUCTION

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The role of board of directors gets a great deal of attention in the related literature. The effectiveness of a board of directors is expressed in various terms such as its size and composition. Therefore, the relationship between the board of directors' characteristics and corporation's performance and value as well as with the earnings management practice has attracted the academic researchers, the regulators and different corporations' related stakeholders such as financial markets. However, there has been a lack of researches undertaken to investigate the relationship between board of directors' characteristics and value relevance of accounting information. In this vein, this study attempts to investigate this relationship in the Malaysian shariah compliant companies.

Malaysia has taken various reforms in order to enhance the foreign investors' confidence that was lost after the Asian financial crisis of 1997 in the capital market. One of these is the establishment of the framework of corporate governance best practices (Alkdai and Hanefah, 2012). In the light of Malaysian code of corporate governance, the board of directors is considered to be one of the mechanisms that should be effective and able to control for any potential conflicts of interests between the owners and managers and reduce agency costs. According to Fama and Jensen (1983), the board of directors is mainly established as a solution for such conflicts. The board of directors is considered as the strongest internal monitor of the top management because the board has the power to hire, fire, and compensate the top management.

Malaysia with its unique nature as a fast developing country with its own historical background, multiple races, cultures and religions with the majority of its population being Muslims has become a hub for Islamic finance, and attract many foreign investors and Islamic banks to operate in this country. To comply with Islamic Shariah laws, companies listed in Bursa Malaysia are classified as Shariah-compliant and non-shariah compliant. Shariah-compliant companies are companies that conduct activities which are not contrary to the Islamic principles and have been approved and classified as shariah-compliant companies by the Shariah Advisory Council (Othman et al., 2009). The importance of the Shariah-compliant listed companies in contributing to the Malaysian economic growth is undeniable. The Malaysian shariah-complaint companies include large and small, private and public companies from different sectors.

This study investigates the effect of board of directors' characteristics on value relevance of accounting information. A balanced panel data approach of 270 shariah-compliant companies is employed over a period of three years from 2007 to 2009. Three panel data estimations (pooled OLS, fixed effect, random effect) are estimated.

This study aims to achieve the following objectives: firstly, to examine the effect of board of directors' size and value relevance of accounting information, secondly, to study the relationship between value relevance of accounting information and the present of independent non-executive directors in the board, thirdly, to investigate the effect of CEO duality on value relevance of accounting information, and finally, to investigate the effect of the presence of Muslims in the board on value relevance of accounting information.

This study contributes to the literature by understanding more deeply the effect of effective board of directors' attributes on value relevance of accounting information in a fast developing East Asian country like Malaysia and in a very important and fast growing sector – Islamic finance and Shariah indexed companies. This study also contributes to the literature by studying the influence of the number of Muslim members in the board on value relevance of accounting information.

The remaining of this study is organized as follows. The second section provides a brief review to the related literature and the research hypotheses development. The third section presents the methodology used in this study to achieve its objectives and the sample selection procedures. The forth section shows the data analysis and the fifth section displays the empirical results and conclusion for the study.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

In the last four decades, the usefulness of accounting information has been a topic of increasing interest. The ability of accounting and financial variables to explain stock market values (returns and/or prices) has been under investigation since the initial work of Beaver (1968) and Ball and Brown (1968). It can be argued that accounting data plays some roles in changing the expectations of users and ultimately results in the increase or decrease in stock market prices. The value relevant of accounting information is defined as "the ability of accounting numbers to summarize the information underlying the stock prices, thus the value relevant is indicated by a statistical association between financial information and prices and returns (Liu and Liu, 2007).

In the literature, it is widely accepted that providing high quality financial accounting information is important because it positively influences capital providers and other stakeholders to take investment decision, credit, and similar resource allocation decisions enhancing overall market efficiency. Financial reporting should be prepared with integrity (Norwani et al., (2011). The value relevance of accounting information is considered as one of the quality of accounting information dimensions. In this vein, companies exhibit high quality of accounting when they provide information with less earnings management, more conservatism accounting, and more value relevance of accounting information.

In order for the board of directors to fulfill its duties effectively, several characteristics are widely suggested within the structure of corporate governance. Some of these characteristics are the size of the board of directors, independency of BOD, the CEO duality and the number of the Muslims directors in the board.

1. **The size of the board of directors**: the size is referred to here as the total number of the directors in the board, and in this context, there could be large and small size of the board of directors based on its number. The researchers differ about the effectiveness of the larger and the smaller board of directors in

mitigating the earnings management practice and minimizing the agency costs among companies. Some researchers have viewed the larger boards as effective by having greater ability to safeguard shareholder interest as it has more capabilities, a wider range of experience and varied expertise, all of which could increase the synergetic governance of the board. The larger and powerful board helps to strengthen the link between corporations and their environments, provide counsel and advice regarding strategic options for the firm and play a crucial role in creating corporate identity (Zahra and Pearce, 1989 and Abdul Rahman and Ali, 2006). On the other hand, some researchers have criticized this point of view and argued that small boards are more effective than the larger once. The premise underlying this argument is that the larger boards make coordination, communication and decision-making more complicated than it is in the smaller boards.

According to Forbes and Milliken (1999), board size affects board effectiveness in the following ways: First, larger boards are likely to have more knowledge and skills at their disposal and second, the abundance of perspective they assemble is likely to enhance cognitive conflict. On the other hand, larger boards are likely to have difficulty in coordinating the individual contributions of group members. According to them, this is because, with larger boards, it is more difficult for the company to use the knowledge and skills of all the board members effectively. Further, larger boards have difficulty in building personal relationships, trust relationships, maintaining cohesion and strong norms. Furthermore, Abdellatif (2009) analyzed the literature related to board size and composition, and concluded that the board size is negatively related to corporate performance and positively related to firm value. In some cases, in some developing countries, board size has no relation to firm value and performance. This study hypothesizes that the larger board of directors is not effectively influence the value relevance of accounting information.

H1: ***The size of the board of directors is negatively related to the value relevance of accounting information.***

2. The independency of the board of directors: the board independence reflects the extent to which the board is independent of the company management. The independency is referred to here as the number of the outside non-executive directors on the board of directors. The appointment of independent non-executive directors NEDs is a crucial device to assist the board of directors in monitoring the company's management. The OECD Principles of Corporate Governance (2004) stated that "Independent board members can contribute significantly to the decision making of the board. They can bring an objective view to the evaluation of the performance of the board and management. In addition, they can play an important role in areas where the interests of management, the company and its shareholders may diverge such as executive remuneration, succession planning, changes of corporate control, take-over defenses, large acquisitions and the audit function". Recognizing the importance of having a number of independent directors on the board of directors, the Malaysian code of corporate governance (2000) requires companies to have at least one-third of the members on the board to be independent non-executive directors to ensure that there is enough independence in the board process that can act on behalf of the shareholders. Several

studies document a positive relationship between board independence and actions that are in the best interests of shareholders. Furthermore, the percentage of outside or independent directors on the board has been commonly used by prior research to measure board independence. Previous studies consistently have shown that the percentage of independent directors is positively associated with the effectiveness of monitoring managers in preparing financial reports. For example, Beekes et al., (2004) found firms with a relatively high proportion of outsiders on the board to be more conservative. Similarly, Kiel and Nicholson (2003) examined the relationship between board demographics and corporate performance in 348 of Australia's largest publicly listed companies in 1996. The study found that there is a positive relationship between the percentage of inside directors and company performance. On the other hand, there have been some studies found a negative relationship between the number of the independent non-executive directors on the board and firm performance. For instance, the study of Agrawal and Knoeber (1996), found a significant negative relationship between board outsider and firm performance.

Empirically, Klein (2002) found a negative relationship between board-independence and abnormal accruals. Furthermore, Davidson et al., (2005) showed that the majority of non-executive directors on the board are negatively associated with the likelihood of earnings management in Australia. Accordingly, this study hypothesized that the bigger number of independent non-executive members on the board of directors can affect positively the value relevance of accounting information.

H2: ***the larger the proportion of independent directors on the board, the more the value relevance of accounting information.***

3. CEO Duality: According to related literature, there have been two different types of leadership structure, the combined leadership structure and the separated leadership structure. In the combined leadership structure the CEO is also working as the chairman of the board. In the separated structure on the other hand the positions and the responsibilities of CEO and that of chairman of the board are clearly separated (Ponnu, 2008). The CEO duality occurs where the CEO also serves as the chairman of the board. The chairman of the board is responsible for running the board of directors and whose responsibilities may include the tasks of selecting new board members, monitoring the executive directors' performance and settling any conflicts which arises within the board. The CEO on the other hand is responsible for the day to day management of the company, including the implementation of board decisions. In this context, many countries around the world have understood importance of splitting the activities of the board chairman and the CEO between different directors to obtain good corporate governance practice. The Saudi Arabia Kingdom for instance and in order to achieve this strategic objective, most Saudi companies separated the activities of the Chairman and CEO, and split these activities between different directors. This clearly supports the importance of separating the responsibilities of the Chairman (running the board) and CEO (running the business) to achieve an effective corporate governance system (Al-Harkan, 2005). The Malaysian Code of Corporate Governance emphasizes on the need to distinct and separates the

responsibilities of the CEO and Chairman of the board in order to ensure the balance of power of the two designations as well as to avoid conflict of interest. It is also to avoid a single person in the board to control the others in decision making process so to promote fair judgment and reasonable concern.

According to Osma (2006), the boards of directors are expected to be more independent and efficient in fulfilling their monitoring duties when the CEO is not the chairman of the board. The agency theory argues that CEO dominance can lead to opportunistic behaviour which can reduce shareholder wealth (Stiles, 1998). Furthermore, Lin and Liu (2009) argued that, when the board of directors' chairman does not occupy the position of CEO, he or she will be able to govern the company in a more impartial manner, and thus, enhance the monitoring role of the corporate governance mechanism. This study is based on the hypothesis that there is a negative relationship between the CEO duality and value relevance of accounting information.

H3: ***CEO duality is negatively related to the value relevance of accounting information.***

4. The number of the Muslim members in the BOD: It is also widely accepted that the presence of more Muslim members on the corporate board of directors increases the diversity of the backgrounds, skills and experience of its members, which may increase the effectiveness of decision-making process. Islamic Shariah requires Muslims to adopt Islamic instructions in all aspects of their life and dealings, and these regulations are enforced by Allah. As a result, Shariah is taken to cover all the main principles that set out the way that the different treatments should be conducted in the light of the framework of Islamic rules. The real Muslim managers believe that they are held answerable to their stakeholders in addition to their answerability to Allah in the hereafter life; therefore, they ought to do what is necessary to discharge their accountability. The obligation originates from this accountability, requiring the managers to maintain the property and the resources under their responsibility and use them efficiently, honestly and with integrity to serve the owners interests, to ensure that there is no maladministration and to desist from going beyond the interests of the shareholders and the community. Shariah also stipulates that consultants should have certain skills and features; they should be honest, capable, qualified and expert, in addition to undertaking their responsibility to perform their functions in an appropriate way in order to discharge their duties (Falgi. 2009). It is expected that the presence of Muslim members in the board of directors will enhance and strengthen the role of corporate governance in increase the quality of financial statements and the information contained in these statements.

H4: ***the larger the proportion of Muslim directors on the board, the more the value relevance of accounting information.***

In the literature, some empirical studies on the relationship between the board of directors' characteristics and value relevance of accounting information have been employed in developing and developed countries. Jamaluddin et al., (2009) investigated the influencing of Malaysian corporate governance reform on the equity book value and earnings' value relevance using the model of Ohlson of (1995), and using a sample

of companies listed in the main board in Bursa Malaysia for a period of three years from 1999 to 2001. Based on 560 company-year observations, the findings of this study revealed that the regulatory change experienced in Malaysia did not have an impact on the valuation of equity book value and earnings. Additionally, it was found that board of directors' composition to be statistically insignificant in explaining the relationship between equity book value and earnings with the companies' value suggesting that most of the Malaysian companies may not have met the intended purpose of MCCG, but merely conformed to the minimum requirements. In contrast, mixed results for leadership structure were found where the value relevance of equity book value increase whilst the value relevance of earnings decrease when companies practice CEO duality structure in 2000, implying that the role of CEO and Chairman of the board should be splitting to improve the value relevance of earnings.

Habib and Azim (2008) mentioned that corporate governance is an extensively researched area in the literature on accounting**.** However, they also mentioned that the impact of corporate governance on the value relevance of accounting information remains unexplored fully. Furthermore, they examined the relationship between corporate governance attributes and the value relevance of accounting information in the top 500 Australian listed companies for the period from 2001-2003. The value relevance of accounting information was measured throughout regressing stock price on earnings and equity book-values. In addition, the board of directors' size and independency, audit committee size, independency and financial literacy within the audit committee, CEO duality and audit firms size represented by big 5 were used as corporate governance attributes. Regression results reveal that better corporate governance structures increase the value-relevance of accounting information in the Australian companies.

More recently, Rani (2011) examined empirically weather there is a link between audit committee characteristics and value relevance of accounting information measured by regressing stock prices on earning and book values as in the Ohlson's Model (1995). Variables such as audit committee financial literacy and audit committee independence were used to investigate their effect on value relevance of accounting information in a sample of 105 companies listed on the New Zealand Stock Exchange over the years from 2007 to 2009. The study assumes that strong and effective corporate governance characteristics have a positive effect on the value relevance of accounting information. But, the study findings inversely reveal that there is no change in the value relevance of accounting information after incorporating the corporate governance characteristics with EPS and BVPS in New Zealand. The results also showed no positive effect of audit committee expertise on the value relevance of accounting earnings. The study justified theses results could be due the problem of that New Zealand is a very small economy and has a distinctive legal and regulatory systems different from that in the US, the UK or Germany.

3. Research methodology and sample selection

The research population of this study represents the Malaysian Shariah-compliant listed companies. The research sample of 270 shariah compliant companies was chosen based on certain criteria that the

companies which do not have electronic website in the Bursa Malaysia, companies which did not publish its annual reports for the years from 2007 to 2009, companies that have been classified as Shariah complaint companies after 2007, banks & financial companies, insurance companies, companies whose websites were under maintenance during the data collection period, and companies that had difficulties in downloading its annual reports as well as the companies that have missing data and extreme values in the DataStream database were excluded in order to chose the appropriate research sample.

3.1 Data and Model Specification

Data for this study was collected from secondary sources comprising of 270 companies listed in Bursa Malaysia. The companies' annual reports and the DataStream database were used mainly to be the source of data. The panel data includes 270 shariah compliant companies for the period 2007-2009, giving a total of 810 company- year observations. Among the 270 companies, 92 companies from the industrial products sector, 52 companies from consumer products, 54 from trading and services, 28 properties companies, 16 construction companies, 11 companies from the plantation sector, 1 mining company, and 16 from the technology sector. In order to empirically investigate the relationship between board of director characteristics as independent variables and value relevance of accounting information as dependent variable, the Ohlson (1995) model where a firm's share price is a function of both earning and book value of equity was used. Three equations are used to test this relationship. The model is drawn as follows:

$$\mathbf{MP_{it}} = \beta_0 + \beta_1 (EPS_{it}) + \beta_2 (BV_{it}) + \beta_3 (BS_{it}) + \beta_4 (BI_{it}) + \beta_5 (CEOdu_{it}) + \beta_6 (MB_{it}) + \varepsilon_{it} \quad \text{..... (1).}$$

A number of control variables are included in the regression, namely, company's size, leverage, the company's profitability and the size of the audit firm.

1. Size (LOGTA): In this study the company's LOG of the total assets is used as a proxy for the company's size.
2. Profitability (COPRO): Return on total assets is used in this study as a proxy to the company's profitability.
3. Leverage (LEV): The ratio of total debt to total assets is employed in most studies and also in this study to measure leverage ratio.
4. Audit firm size (AUDBIG): This study codes this variable as a dummy variable valued (1) if the auditor is one of the big 4 firms and valued (0) otherwise. The model after adding the control variables is as follows:

$$\mathbf{MP_{it}} = \beta_0 + \beta_1 (BV_{it}) + \beta_2 (EPS_{it}) + \beta_3 (BS_{it}) + \beta_4 (BI_{it}) + \beta_5 (CEOdu_{it}) + \beta_6 (MB_{it}) + \beta_7 (LOGTA_{it}) + \beta_8 (LEV_{it}) + \beta_9 (COPRO_{it}) + \beta_{10} (AUDBIG_{it}) + \varepsilon_{it} \quad \text{.....(2).}$$

$$\mathbf{MP_{it}} = \beta_0 + \beta_1 (BV_{it}) + \beta_2 (EPS_{it}) + \beta_3 (BS_{it}) + \beta_4 (BI_{it}) + \beta_5 (CEOdu_{it}) + \beta_6 (MB_{it}) + \beta_7 (LOGTA_{it}) + \beta_8 (LEV_{it}) + \beta_9 (COPRO_{it}) + \beta_{10} (AUDBIG_{it}) + \beta_{11} (BV*BS_{it}) + \beta_{12} (BV*BI_{it}) + \beta_{13} (BV*CEODU_{it}) + \beta_{14} (BV*MB_{it}) + \beta_{15} (BV*LOGTA_{it}) + \beta_{16} (BV*LEV_{it}) + \beta_{17} (BV*COPRO_{it}) + \beta_{18} (BV*AUDBIG_{it}) + \beta_{19} (EPS*BS_{it}) + \beta_{20} (EPS*BI_{it}) + \beta_{21} (EPS*CEODU_{it}) + \beta_{22} (EPS*MB_{it}) + \beta_{23} (EPS*LOGTA_{it}) + \beta_{24} (EPS*LEV_{it}) + \beta_{25} (EPS*COPRO_{it}) + \beta_{26} (EPS*AUDBIG_{it}) + \varepsilon_{it} \quad \text{..... (3).}$$

Where, MP_{it} is the price of a share of firm i at fiscal year-end. The EPS_{it} is the reported earnings per share of firm i for year t. BV_{it} is the book-value per share of firm i at the end of year t. BS is the BOD size, BI is the BOD independency, CEOdu is the CEO duality, and MB is the percentage of Muslim members in the BOD.

3.2 Descriptive statistics

Table 1 suggests several conclusions. First, the average board of directors' size is 7.679 directors, while, on average, the number of independent director on the board represented 0.43%, meaning that 3.3 directors are non-executive on average. This suggests that the average board of directors have no balance between the executive and non-executive directors. Also, this indicates that companies were complying with The Malaysian code of corporate governance of (2001) that suggests at least board must have one third of the board to be independent directors. On contrast, looking in the minimum value of percentage of independent members in the board, there were some companies did not comply with this code by having just 16.7% independent directors in the board. The biggest number of directors on the board was 18 as well as the smallest one was 3. Furthermore, the mean of CEODU was 0.17, which means that 83% of the Malaysian shariah complaint listed companies in the sample were splitting the roles of the chairman of the board and the CEO, and 17% of these companies did not split this role. It is important to mention that 83% of the Malaysian shariah complaint listed companies in this sample comply with the Malaysian code of corporate governance. The table also descriptively explains on average that the percentage of the Muslim members in the board of directors was 34.6%, meaning that the vast majority of the Shariah complaint listed companies in Bursa Malaysia are run by non-Muslim directors.

Table 1: Results for descriptive statistics:

Variable	Mean	Median	Max	Min	S.D	Jarque-Bera
BS	7.679	7	18	3	2.07	0.000
BI	0.4302	0.147	0.833	0.1667	0.12	0.000
CEODU	0.1704	0	1	0	0.376	0.000
MB	0.3462	0.285	1	0	0.257	0.000
LOGTA	19.58	19.44	27.09	16.88	1.23	0.000
LEV	0.384	0.37	0.98	0.34-	0.205	0.000
CORPO	0.043	0.048	1.426	-2.94	0.153	0.000
AUDBIG	0.614	1	1	0	0.48	0.000

3.3 Testing for normality:

The P value of Jarque-Bera test indicated that data were not normally distributed. Consequently, The Normal Scores using Van Der Waerden's Formula was utilized to overcome the violations of the normality (Abdellatif, 2009). After the transformation process, data was found to be normally distributed and parametric analysis was undertaken.

3.4Testing for non-stationary (unit root test)

The Hadri test is considered as the appropriate based when the period is short. It is important to test for stationary in the level firstly. Furthermore, in the case that the variables are found non-stationary or have panel unit root in the level, the stationary of panel data is to be tested at the first difference. Table 2 presents the results of the Hadri test at level in constant and constant plus time trend. The results show that the null hypothesis of a panel unit root in the level of the series with intercept and intercept plus time trend can be rejected, meaning that the variables are stationary at 1%, 5% and 10% . Consequently, the results of the regression will be sufficient and problem of spurious results can be rejected.

Table 2: the result of Hadri unit root test for stationary

HADRI UNIT ROOT TEST		
	Model with intercept	*Model with intercept and trend*
	p-value	*p-value*
BS	0.0000	0.0000
BI	0.0000	0.0000
CEODU	0.0000	0.0000
MB	0.0000	0.0000
LOGTA	0.0000	0.0000
LEV	0.0000	0.0000
COPRO	0.0000	0.0000
AUDBIG	0.0000	0.0000
MP	0.0000	0.0000
EPS	0.0000	0.0000
BV	0.0000	0.0000

3.5 Testing for multi-collinearity

The multi-collinearity problem occurs when there is a high correlation between one or more explanatory variables. Variance inflation factor VIF and tolerance (TOL) are commonly used for multi-collinearity problem. The VIF values exceed 10 or TOL values less than 0.10 indicates high degrees of multi-collinearity. Based on VIF and TOL results displayed in the table 3, it is concluded that there is evident against the present of multi-collinearity problem.

Table3: Multi-collinearity test for relationship between BOD variables and VR

	Variance Inflation Factors (The dependent variable NMP	
Variable	**Tolerance**	**VIF**
BV	0.485655	2.059073
EPS	0.273638	3.654461
BS	0.769592	1.299390
BI	0.8155	1.226242
CEODU	0.962862	1.038570
MB	0.817273	1.223581
LOGTA	0.499173	2.003312
LEV	0.669652	1.493313
COPRO	0.341825	2.925473
AUDBIG	0.888011	1.126112

3.6 An analysis to the relationship between value relevance of accounting information and board of directors' characteristics:

From the tables (4_A) and (4_B) it can be clearly noticed based on R-square values which represents the explanation power of the models that The highest R-square is 90.9877% for the fixed effects model in the equation (3), which means that 90.9877% of the variation in the dependent variable is explained by the model. In more details, comparing the (R^2) values in the three equations in the above tables indicate that the fitness of the model is improved in the third equation (the full model after including the interaction variables) compared to the equation (1) and (2). These values were 56.104%, 90.0838% and 40.6684% in the equation (1) for the pooled OLS, fixed effects and the random effects methods respectively. These values are firstly improved in the equation (2) after including the control variables in the regression model, these values became 60.2848%, 90.3753% and 45.2793% in the three mentioned above methods respectively. Furthermore, the values were then improved secondly in the third equation, the R^2 values became 63.3215% for the pooled model and 90.9877% and 48.7832% in the fixed effects and random effects models, respectively. It can be concluded that adding the interaction variables have increased the explanatory power of the model. Furthermore, the third equation is used for further diagnostic tests such as testing for the autocorrelation and heteroscedasticity problems.

Table 4_A Regression result of relationship between value relevance of accounting information and BOD characteristics (dependent variable MP)

	Equation 1			**Equation 2**		
	Pooled OLS	FE	RE	Pooled OLS	FE	RE
C	-0.002386	-0.010184	-0.004180	-0.001671	-0.004436	-0.001596
	(0.9185)	(0.4693)	(0.9001)	(0.9402)	(0.7524)	(0.9590)
BV	0.460249	0.574617	0.497671	0.469899	0.500678	0.452730
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)
EPS	0.362689	0.117936	0.278050	0.136763	0.097556	0.154209
	(0.0000)	(0.0001)	(0.0000)	(0.0012)	(0.0214)	(0.0001)
BS	0.056725	-0.014022	0.028409	0.026637	-0.014633	0.005301
	(0.0302)	(0.7704)	(0.3691)	(0.3079)	(0.7587)	(0.8643)
BI	0.010001	0.057373	0.049672	0.001129	0.051255	0.035530
	(0.7011)	(0.0919)	(0.0776)	(0.9639)	(0.1293)	(0.1891)
CEODU	0.019041	0.182255	0.055809	0.047006	0.196583	0.076662
	(0.6307)	(0.0067)	(0.2383)	(0.2155)	(0.0034)	(0.0895)
MB	0.120062	0.039411	0.134804	0.080421	0.041773	0.095346
	(0.0000)	(0.5331)	(0.0000)	(0.0017)	(0.5046)	(0.0031)
LOGTA				0.169867	0.177196	0.172358
				(0.0000)	(0.0134)	(0.0000)
LEV				0.067464	-0.027801	0.027313
				(0..133)	(0.5248)	(0.3780)
COPRO				0.228795	0.034401	0.133687
				(0.0000)	(0.3589)	(0.0002)
AUDBIG				0.065005	0.260789	0.130688
				(0.0655)	(0.0032)	(0.0037)
R^2	0.561040	0.900838	0.406684	0.602848	0.903753	0.452793
DW	0.907679	2.813819	1.860193	1.016241	2.89774	1.903851
F Stat	171.0537	17.44755	91.73524	121.2822	17.64374	66.1143
	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)	(0.0000)

Table 4_B Regression result of relationship between value relevance of accounting information and BOD characteristics (dependent variable MP)

	Equation 3					
	Pooled OLS		FE		RE	
	Coeff	Prob	Coeff	Prob	Coeff	Prob
C	-0.110173	0.0001	0.052764	0.1265	-0.058167	0.0966
BV	0.476842	0.0000	0.646269	0.0000	0.472741	0.0000
EPS	0.117827	0.0169	0.074638	0.1434	0.159973	0.0006
BS	0.032928	0.2014	-0.016660	0.7302	0.003728	0.9009
BI	0.007878	0.7502	0.182833	0.0066	0.064456	0.1444
CEODU	0.050762	0.1830	-0.045243	0.1876	-0.039337	0.1391
MB	0.081056	0.0015	0.045752	0.4660	0.100444	0.0013
LOGTA	0.171667	0.0000	0.051536	0.5129	0.168463	0.0000
LEV	0.070571	0.0127	-0.001183	0.9820	0.028939	0.3617
COPRO	0.280069	0.0000	0.039495	0.3412	0.149072	0.0002
AUDBIG	0.061030	0.0821	0.278948	0.0180	0.104164	0.0186
BV*BS	-0.044100	0.1544	0.015138	0.7459	0.002682	0.9355
BV*BI	0.028203	0.3610	0.055779	0.1092	0.062528	0.0367
BV*CEODU	-0.056524	0.2423	-0.087976	0.1720	-0.070837	0.1656
BV*MB	-0.052666	0.0864	-0.122847	0.0177	-0.058735	0.0817
BV*LOGTA	0.003543	0.9073	0.190698	0.0003	0.049544	0.1330
BV*LEV	0.015844	0.5757	-0.009140	0.8153	0.013571	0.6265
BV*COPRO	-0.025264	0.3716	-0.033571	0.2701	-0.071567	0.0078
BV*AUDBIG	0.004374	0.9182	0.089426	0.2784	0.004269	0.9285
EPS*BS	0.018668	0.5633	-0.038971	0.2366	-0.012635	0.6764
EPS*BI	-0.049310	0.0757	-0.016618	0.5542	-0.038077	0.1395
EPS*CEODU	-0.030633	0.5343	-0.022781	0.6488	-0.037164	0.4237
EPS*MB	-0.005060	0.8764	-0.001333	0.9696	-0.003916	0.9010
EPS*LOGTA	0.073425	0.0281	0.075664	0.0270	0.093246	0.0029
EPS*LEV	-0.008710	0.7677	-0.004323	0.8839	-0.023504	0.3950
EPS*COPRO	0.125016	0.0000	0.019400	0.3894	0.083133	0.0001
EPS*AUDBIG	-0.062996	0.1394	-0.045978	0.3282	-0.053108	0.2005
R^2	0.633215		0.909877		0.487832	
DW	1.152283		2.974669		1.932372	
F Stat	51.99096 (0.0000)		17.40440 (0.0000)		28.68443 (0.0000)	

In order to choose between pooled OLS regression compared to fixed effects model, the redundant fixed effects tests are employed. The redundant fixed effects results in table 5 show that the statistic value and the associated p-values which are statistically significant, in rejecting to the null hypothesis that the fixed effects are redundant. This highlights that there is presence of strong cross-section and period effects separately and jointly. The cross-section and period fixed effects model is preferable over the pooled OLS. It can be clearly seen from the redundant fixed effects results in table (5) that the statistic value and the associated p-values which are statistically significant, in rejecting to the null hypothesis that the fixed effects are redundant. This highlights that there is presence of strong cross-section and period effects separately and jointly. The cross-section and period fixed effects model is preferable over the pooled OLS.

Table 5: Summary of redundant fixed effects tests

Effects tests	Statistics	d.f.	Prob
Cross-section F	5.196565	(269,512)	0.0000
Cross-section Chi-square	1066.339905	269	0.0000
Period F	77.271494	(2,512)	0.0000
Period Chi-square	213.661810	2	0.0000
Cross-section / Period F	5.799800	(271,512)	0.0000
Cross-section / Period chi-square	1136.914168	271	0.0000

To choose the appropriate between fixed effects and random effects models, the Hausman test was carried out. The decision is depend on the probability of chi^2 of the Hausman test. This test prefers the random effect model in the case that the p value is larger than significant level of 5%, and on the other hand prefers the fixed effect model when the p value is less than 5%. According to the results of the Hausman test shown in table 6, that the Chi-square value is 98.82, which is statistically significant indicating the fixed effects model is the most appropriate model compared to the random effects model.

Table 6 Summary of Hausman Test

Chi-Sq statistic	**Chi-Sq. d.f.**	**Prob**
98.817375	26	0.0000

3.6.1 Testing for the presence of Autocorrelation

Based on the Durbin-Watson (DW) statistic of (2.974669) in the table (4_B), it can be indicated that there is an evident of the presence of first order autocorrelation in the model. Further autocorrelation correction steps are taken in order to overcome the autocorrelation problem.

3.6.2 Testing for the presence of heteroscedasticity

The white test is conducted to detect the presence of heteroscedasticity in this model. Table (4.36) shows the results of white test for heteroscedasticity. The null hypothesis of equal variance of residual across the companies (homoscedasticity) is strongly rejected, the p-value is less than the value of (5%), in additional, Comparing the LM statistical value of (390.5618) with the chi square critical value of (310.3965) shows the LM value is larger the critical value of chi square, this indicates that the test statistics rejects the null hypothesis of equal variance of residual across the companies, providing a strong evidence that there is a heteroscedasticity problem in the regression model. Consequently, a heteroscedasticity correction is implemented to eliminate this problem.

The table 7 the result of white test for heteroscedasticity

Heteroscedasticity Test: White			
F-statistic	1.845951	**Prob. F(271,538)**	0.0000

Obs*R-squared	390.5618	**Prob. Chi-Square(271)**	0.0000

After making sure that there is presence of heteroscedasticity problem in the model, it is important to take further corrective technique, the GLS weight and White standard errors & covariance have been taken into account to correct for heteroskedasticity and autocorrelation. Table (8) presents the relationship between board of directors' characteristics and value relevance of accounting information after correcting for Heteroskedasticity and autocorrelation.

Table 8 Results of relationship between BOD characteristics and value relevance of accounting information after heteroscedasticity and autocorrelation correction

	coefficient	**std. error**	**t-ratio**	**p-value**
C	-0.064351	0.041179	-1.562696	0.1185
BV	0.497282	0.044654	11.13634	0.0000
EPS	0.098399	0.062061	1.585524	0.1133
BS	0.022670	0.029550	0.767176	0.4432
BI	0.073533	0.047564	1.545972	0.1225
CEODU	-0.005244	0.025190	-0.208154	0.8352
MB	0.070349	0.031787	2.213138	0.0272
LOGTA	0.200146	0.038598	5.185384	0.0000
LEV	0.032881	0.034864	0.943107	0.3459
COPRO	0.153266	0.058414	2.623787	0.0089
AUDBIG	0.078779	0.045637	1.726218	0.0847
BV*BS	-0.027260	0.034516	-0.789788	0.4299
BV*BI	0.036868	0.024034	1.533960	0.1254
BV*CEODU	-0.062057	0.063889	-0.971325	0.3317
BV*MB	-0.076619	0.032170	-2.381672	0.175
BV*LOG_TA	0.019639	0.026511	0.740782	0.4590
BV*LEV	0.022919	0.025466	0.899966	0.3684
BV*COPRO	-0.040532	0.030372	-1.334523	0.1824
BV*AUDBIG	0.042619	0.044807	0.951165	0.3418
EPS*BS	-0.006635	0.030579	-0.216972	0.8283
EPS*BI	0.023466	0.022463	1.044656	0.2965
EPS*CEODU	-0.044100	0.052777	-0.835594	0.4036
EPS*MB	-0.001489	0.034446	-0.043221	0.9655
EPS*LOG_TA	0.069981	0.029637	2.361246	0.0185
EPS*LEV	-0.011384	0.027917	-0.407759	0.6836
EPS*COPRO	0.080762	0.022801	3.541984	0.0004
EPS*AUDBIG	-0.064643	0.044884	-1.440215	0.1502
Sum squared resid 772.0873			**S.E. of regression 0.994278**	
R-squared 0.576564			**Adjusted R-squared 0.561383**	
F stat 37.97985			**P-value(F) 0.000000**	
Durbin-Watson (DW) 1.829				

4. RESULTS AND DISCUSSION

To predict the effect of CGCs on value relevance, some interaction variables are used in the existing related literature (Rani, 2011; Habib and Azim, 2008). The interaction variables of each BODCs*BV and each BODCs*EPS are earning and equity book values weighted by each board of directors characteristics. If there is a strong effect of board of directors characteristics on the accounting information, then the coefficients of the BI*BV, MB*BV, BI*EPS, MB*EPS are expected to be positive and significant. While, BS*BV, BS*EPS, CEODU*BV and CEODU*EPS are expected to be negative and statistically significant.

The table (8) shows the result of fixed effects model after correcting for heteroscedasticity and autocorrelation. Regarding the effect of board size on value relevant of accounting information, the current study is based on hypothesis ($H1_c$) which states that the larger board of directors in the companies, the less value relevance of accounting information. The findings reveal that the coefficients of BS*BV and BS*EPS were negative and statistically not significant. This indicates that the board size is not an important factor to affect the value relevance of accounting information. This expected result is consistent with the well known point of view in corporate governance related literature that the smaller boards of directors are more effective mechanism to monitor, because of higher degree of membership coordination they have, less communication difficulties they face, lower information costs they borne, and a lower incidence of severe free-rider problems. Furthermore, the study supports the results of Yermack, (1996) who found that the smaller boards of directors are strongly related with higher market valuation.

In regard to the board of directors' independency, the agency theory postulates that independent non-executive directors are needed to be appointed on companies' boards of directors to monitor and control the actions of non-independent directors (Fama and Jensen, 1983). In order to investigate the relationship between having a large number of independent non-executive directors in the board on value relevance of accounting information, this study follows the value relevance literature by employing BI*BV and BI*EPS interaction variables, If board of directors' independency effects positively the value relevance of accounting information the coefficients of these interaction variables are expected to be positive and significant. It is hypothesized in this study that having more independent directors in the board affects positively the value relevance of accounting information. The results displayed in table (8) indicate based on board independency interaction variables coefficients (BV*BI & EPS*BI) that they are positive and statistically not significant in rejecting to (H2). This is weak evidence that the independency of board of directors affects positively value relevance of accounting information. This unexpected result could be due to using of Ohlson's (1995) model in measuring value relevance of accounting information, then this result needs to be tested using different models. Due to lack of related literature, in order to ensure the nature of relationship between board independency and value relevance of accounting information, they should be regressed individually; this is recommended to be studied in further studies.

Regarding the relationship between CEO duality and value relevance of accounting information, it is hypothesized (H3) that splitting the roles and duties of CEO and chairman of BOD enhances the value relevance of accounting information. The related coefficients displayed in table 8 indicate that splitting the roles of CEO and the chairman of BOD is not a key factor to affect strongly the value relevance of accounting information, because of the negative and non-significant relationship between the CEO duality and value relevance of accounting information. The study fails to find strong evidence to support that splitting the CEO's role from the chairman of board of director increases value relevance of accounting information, this result in turn does support neither agency theory nor the stewardship theory.

The study also hypothesized that the more Muslim members in the BOD, the more value relevance of accounting information. But the results inversely indicate based on the interaction variables' (MB*BV and MB*EPS) coefficients that they are found to be negative but not statistically significant. This indicates that there is no strong effect of the availability of Muslim members in the board on enhancing the value relevance of accounting information.

From the set of four control variable based on the result in table 8, only two control variables were found to have positive and significant relationship with the value relevance of accounting information the company's size and profitability. Regarding the size of company, both earnings and book values related interaction variables (LOGTA * BV and LOGTA * EPS) are found to be positive, and the second is statistically significant meaning that the size of the company is a vital factor helps to enhance the value relevance of accounting information. This result is not surprising that the larger companies have all the expected features that may make accounting information more reliable and therefore, more closely to be associated with stock price, that these companies are more likely to be profitable, to adopt high internal control systems, to adopt good corporate governance mechanism to mitigate earnings manipulation, and to adopt also more conservative accounting. This result supports what was found by Habib and Azim (2008) in the Australian environment. The company profitability was found to be positively and significantly related to value relevance of accounting information. By contrast, the leverage was found to have not significant relationship with value relevance of accounting information. According to result of this study, the high leveraged companies are more likely to practice earnings management, and then therefore provide earnings information less credible to the market. Regarding the audit firm size variable, the result did not provide strong evidence that being a client to Big 4 audit firm affects positively the value relevance of accounting information, the coefficients of AUDBIG * BV and AUDBIG * EPS were statistically not significant. This result could be due to that there is no great different between being client to Big 4 audit firm and being audited by non-Big 4 audit firm in the Malaysian context. This result does not support that effective and high audit quality as a control mechanism of corporate governance can provide the best oversight and create credible financial information.

5. LIMITATION AND FUTURE STUDIES

The limitations that may face the results' generalization of this study are the study used a short period of time. As result, further studies may be undertaken to cover a longitudinal period of time, and may compare the relationship between audit committee characteristics and value relevance of accounting information before and after 2007. Another limitation of this study is this study employed only the Ohlson (1995) for value relevance of accounting information. Further studies using different value relevance models would enable to understand in-depth and robust the results of this study

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THE INFLUENCE OF CORPORATE GOVERNANCE AND ORGANIZATIONAL CAPACITY ON THE PERFORMANCE OF MALAYSIAN LISTED COMPANIES

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Abstract

This study assesses the association between corporate governance and performance of companies listed on Bursa Malaysia. Although there is no clear evidence in the literature indicating that organizational capacity is influencing corporate performance, this study further examines the influence of corporate governance by combining it with organizational capacity. This study employs mail questionnaire in assessing the performance of companies. Using the data from the mail questionnaire, no significant relationship was found between independent director, CEO duality, board size, ownership concentration, financial management and corporate performance. Additionally, findings from the mail questionnaire showed that organizational learning was significant in explaining corporate performance. Two contributions are acknowledged in this research. First, the application of a mail questionnaire extends the research methodology on corporate performance and adds value in respect of how findings from the questionnaires highlight the perceptions of individuals pertaining to the research objectives. Second, using organizational capacity as an explanatory factor, this study documents that organizational learning emerges as an important aspect in influencing the performance of Malaysian companies.

Keywords: Corporate governance, organizational capacity, agency theory, resource-based view perspective (RBV)

1.0 INTRODUCTION

This study was conducted to establish the association between corporate governance practices and structures, as well as the elements of organizational capacity and the performance of Malaysian public listed companies. Although the link between corporate governance and corporate performance among Malaysian companies has long been

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researched, there is little empirical evidence concerning the assessment of the impact of organizational capacity on corporate performance. Hence, it is sufficient to test the association between these two variables and corporate performance to offer new findings in Malaysia. The first research objective is presumed to provide better investigation concerning the link between corporate governance and the performance of listed companies on Bursa Malaysia. Additionally, the second research objective is to identify the organizational capacity features in explaining corporate performance using the existing theoretical framework initiated from prior studies in developed countries.

2. 0 LITERATURE REVIEW

With respect to this study, several theories were used in accordance with the multiple issues being investigated concerning corporate governance and organizational capacity and their impact on the performance of companies. The main theory being employed in the present study is the agency theory developed by Berle and Means (1932), which explains how to organize the relationship between the party that identifies the work and the party that takes the responsibility and apparently acts on behalf of the principal, known as the agent. In order to reduce the agency costs, to protect the shareholder interests and to ensure the alignment of the agent-principal interest, the agency theory prescribes a variety of corporate governance instruments. Based on the discussion with regard to the literature (Murray, 2003; Lopez, Peon and Ordas, 2005; Ho, 2008) underpinning the development of skill and the capability of a company is the resource-based view of the firm (RBV) perspective. According to the RBV perspective, every organization employs a set of resources in creating its wealth by creating value in such a way that is exceptional and able to achieve competitive advantage. Examples of the resources are governing structure, financial monitoring, leadership, staffing, facilities, technology and human resources. Accordingly, very limited studies on organizational capacity in Malaysia have been identified (Tayles, Pike and Sofian, 2007; Khong and Eze, 2008; Fatt, Khin and Heng, 2010).

2.1 Hypotheses Development

2.1.1 Corporate Governance Mechanisms

Nonetheless, there are several studies in Malaysia (Abdullah, 2004; Leng, 2004; Rahim, Yaacob, Alias and Nor, 2010; Ponnu, 2008; Haat, Rahman and Mahenthiran, 2008; Ghazali, 2010) that provide evidence that there is no statistical significant relationship between independent directors and company performance, indicating that board independence is not an important attribute in explaining company performance of Malaysian corporations. The findings also imply that independent directors do not influence company performance.

The Chief Executive Officer (CEO) and the Chairman are two separate individuals with different roles on the board. The analysis of results by Shakir (2009) on 81 property listed firms in Malaysia for the period 1999 to 2005 support the earlier findings by Donaldson and Davis (1991), and Coles, William & Sen (2001), suggesting that a single leadership structure where the positions of a CEO and a Chairman are held by one individual will not lead to a decline in firm performance. A later finding by Abidin, Kamal and Jusoff (2009) show support to the prior results suggesting that role duality among Malaysian companies still has no influence on company performance.

As recommended by the Malaysian Code on Corporate Governance (MCCG) Revised 2007, every company should examine its board of director's size in order to determine the impact of the number upon the board's effectiveness. The KLSE/Price Waterhouse Coopers Joint Survey of Corporate Governance Practices in Public Listed Companies 1998 found that the average board size in Malaysian corporations was to be eight persons. On the other hand, the results of 73 companies listed on Bursa Malaysia show that board of directors in Malaysian companies perform more effectively in a larger group with more ideas and skills that can be shared among board members (Abidin et al., 2009).

Meanwhile, a published study by Chen, Cheung, Stouraitis and Wong (2005) evidenced that there is no statistical significant relationship between family ownership concentration and firm operating performance at any level of ownership and further identified that corporate governance mechanisms in Hong Kong firms appeared to be weak. In the case of Malaysia, Haniffa and Hudaib (2006) supports the findings of prior studies that illustrate that concentrated ownership produces better accounting results. The positive impact of ownership concentration on company performance implies that better performance of company is explained by ownership concentration. Thus, this finding is consistent with the theoretical expectation that concentrated ownership lowers agency costs. Based on the theories and mixed findings from prior studies, the following hypotheses have been developed:

$H_{1IndDir}$: Independent director has no association with corporate performance.

$H_{1Duality}$: CEO duality has no association with corporate performance.

$H_{1BrdSize}$: Board size has no association with corporate performance.

$H_{1OwnCon}$: Ownership concentration has no association with corporate performance.

2.1.2 Organizational Capacity Element

In terms of organizational capacity, Prieto and Revilla (2006) provides evidence that organizational learning could explain business performance. Two recent studies on financial training centres and technological companies in Taiwan (Lin and Kuo, 2007; Ho, 2008) support the finding by Prieto and Revilla (2006) that organizational learning (comprising several types – learning practices, information-sharing patterns, enquiry climate and achievement mindset) has a direct and positive significant influence on both financial and market performance. Thus, it is expected that organizational capacity can lead to better corporate performance.

$H_{2FinMgt}$: Financial management has a positive association with corporate performance.

$H_{2OrgLearn}$: Organizational learning has a positive association with corporate performance.

3. 0 RESEARCH METHOD

3.1 Research Design

In examining the relationship between corporate governance as well as organizational capacity and performance of company, four corporate governance variables and two organizational capacity variables were measured in the current study. The measurement for the questionnaire data is presented in Table 1.

Table 1: Variable Measurement for Mail Questionnaire

Variable	Acronym	Measured as	Expected signs of relationship
Corporate Governance			
Independent Director	*IndDir*	Score of 1 corporate governance item	+
CEO Duality	*Duality*	Score of 1 corporate governance item	-
Board Size	*BrdSize*	Score of 1 corporate governance item	+/-
Ownership Concentration	*OwnCon*	Score of 1 corporate governance item	-
Organizational Capacity			
Financial Management	*FinMgt*	Total score of 8 organizational capacity items	+
Organizational Learning	*OrgLearn*	Total score of 8 organizational capacity items	+
Corporate Performance	Performance	Total score of 10 company performance items	
Demographic characteristics of respondents	Demographic	Descriptive studies of respondents' profile	

3.2 Data Collection and Estimation Approach

The data was collected from a population of eight hundred (800) Malaysian listed companies. The targeted respondents were the Chief Financial Officer (CFO), Company Secretary or accountant of every company. The complete mail questionnaire survey was conducted from December 2009 to the end of April 2010.

The researcher adopted several items from two recent surveys in examining the influence of corporate governance mechanisms (i.e. independent director, CEO duality, board size, and ownership concentration) on the performance of companies. The two surveys are the "Corporate Governance Survey Report 2004", a joint study by the University of Nottingham and the Minority Shareholders Watchdog Group (MSWG) and the "Corporate Governance Screencard 2005", a joint study by the MSWG and the Universiti Teknologi MARA (UiTM). Meanwhile, the questionnaire pertaining to organizational capacity elements, consist of financial management and organizational learning, was developed based on a research by the Inter-American Development Bank and the International Development Research Centre (IDRC), as compiled by Lusthaus, Andrien, Anderson, Carden and Montalvan (2002).

The respondents were asked to give their perception on their company's performance relative to their competitors using a seven-point interval scale for each item. The researcher runs the Mann-Whitney U test to determine whether the early and late respondents have a significant difference in opinions. This study also conducted factor analysis to summarize the information contained in a number of original variables into a smaller set of new factors (Tabachnick and Fidell, 2001). The researcher also runs descriptive analysis together with multiple regression analysis in achieving objectives of the study. The Pearson Correlation was run to understand the interrelationships between the explanatory variables in the study. Model of the study is further presented as follow:

$$\text{Performance} = \alpha_i + \beta 1\text{IndDir} + \beta 2\text{Duality} + \beta 3\text{BrdSize} + \beta 4\text{OwnCon} + \beta 5\text{FinMgt} + \beta 6\text{OrgLearn} + \epsilon$$

(Equation 1.0)

4. 0 RESULTS

With respect to the estimation approach, the descriptive analysis as well as the multiple regression analysis has been employed in regressing the mail questionnaire data. Based on the Mann-Whitney U test, the result shows that there were no significant differences (Sig. two-tailed >.05) in response to the questionnaire between the five early and late respondents for all variables. After conducting the factor analysis, the organizational capacity elements and corporate performance variables have been factorised into three variables. The reliability test was conducted and all constructs have a Cronbach's alpha value well above 0.7, which indicates more than acceptable.

Meanwhile, the results of Kaiser-Meyer-Olkin Measure of Sampling Adequacy (KMO) for organizational capacity and corporate performance constructs were above the acceptance value which testifies that organizational capacity and corporate performance were constructively valid. The Pearson Product-Moment Correlation shows that none of the independent variables seems highly correlated with each other as correlation coefficients are below 0.7 (Hair, Black, Babin and Anderson, 2010). Table 2 illustrates the descriptive results of all companies as a whole.

Table 2: Descriptive Statistics for Corporate Governance, Organizational Capacity and Corporate Performance

Independent Variables	**Mean**	**Median**	**Max**	**Min**	**Std. Deviation**
Corporate Governance Mechanisms					
Independent Director (IndDir)	5.4835	6	7	3	1.2593
CEO Duality (Duality)	5.5714	6	7	1	1.3345
Board Size (BrdSize)	5.2198	5	7	1	1.3400
Ownership Concentration (OwnCon)	4.4835	4	7	1	1.6355
Organizational Capacity Elements					
Financial Management (FinMgt)	5.5124	5.6250	7	3.38	0.9134
Organizational Learning (OrgLearn)	5.0687	5.2500	6.88	2.63	0.9452
Corporate Performance Characteristics					
Corporate Performance	4.6154	4.7000	6.40	1.70	0.9950

Results of the regression on the effect of corporate governance and organizational capacity on corporate performance for all companies are demonstrated in Table 3. In the model of regression, the findings implies that approximately 29.5 per cent (Adjusted R^2 = 0.295, $p < 0.01$) of the total variance of corporate performance is explained by corporate governance mechanisms and organizational capacity elements in the model as a whole.

Analysis on the regression result in Table 3 shows that only one variable was found to be significant which is organizational learning (OrgLearn) ($\beta = 0.535$, $p < 0.01$). On the other hand, all the other five independent variables comprising independent director (IndDir) ($\beta = -0.187$, $p = 0.138$), CEO duality (Duality) ($\beta = 0.113$, $p = 0.290$), board size (BrdSize) ($\beta = 0.079$, $p = 0.490$), ownership concentration (OwnCon) ($\beta = -0.053$, $p = 0.635$) and financial management (FinMgt) ($\beta = 0.073$, $p = 0.559$) were determined as not associated with performance of company.

Table 3: Results of Multiple Regression Analyses of Corporate Governance and Organizational Capacity on Company Performance

Predictor	**Standardized Coefficient Beta (β)**	**t statistics**	**Significance value (p)**
(Constant)		2.382	0.019
Independent director	-0.187	-1.498	0.138
CEO duality	0.113	1.064	0.290
Board size	0.079	0.693	0.490
Ownership concentration	-0.053	-0.476	0.635
Financial management	0.073	0.587	0.559
Organizational learning	**0.535*** **	4.170	0.000
R^2	0.342		
Adjusted R^2	**0.295**		
F Change	7.285		
Significance	0.000		
Durbin-Watson Index	2.038		

Note: ***p<0.01, **p<0.05, *p<0.10

Consistent with the findings by Amran and Ahmad (2010) and Rahim et al., (2010), the result with regard to proportion of board independence on board implies that companies do not fully utilize the functions of independent directors. Therefore, the finding is not aligned with the agent-principal perspective. Apart from that, the finding also does not support the stewardship theory suggesting that board of directors prefers having more executives or inside directors than independent directors. According to the stewardship theory, there exists a strong relationship between executives' pursuit of the objective of the company, the satisfaction of the owners and the stakeholders in the company. The insignificant result implied that independent directors on board of directors do not have an influence on corporate performance.

With respect to CEO duality (duality), the result shows no significant relationship with corporate performance. Hence, the finding does not support the agency theory prediction

which argues that the Chairman is responsible to administer the company's management while the CEO is responsible to manage the company through protecting the shareholders' shares. Moreover, the result in this study is also not consistent with the recommendation made by the MCCG 2001, that the role of the CEO and the Chairman should be separated. The association between CEO duality and company performance is also not aligned with the stewardship theoretical framework that proposes combination of the roles of the CEO and Chairman will improve company performance through a smoothing progress of decision making process while maximizing shareholder's wealth. It is interesting to note that perhaps employees in Malaysian companies these days cannot accept that having a CEO who is believed to be capable of being a leader with multitasking positions duality is an essential factor to a better performance.

Finding in the current study also shows that board size is not related to performance of a company. The finding does not support the findings by Yermack (1996), Rahim et al. (2010) and Ibrahim & Samad (2011) which documented that smaller board with less number of people on board could bring greater performance to companies. As group increase in size, they become less effective because less coordination among the people involved somehow devastates the decision making process.

Further finding in this study indicates that ownership concentration (OwnCon) measured as the percentages of top ten largest shareholding is evidenced to have no impact on company performance. The finding is inconsistent with the finding by Haniffa and Hudaib (2006) reporting that concentrated ownership produces better accounting results. However, the result supports studies by Franks and Mayer (2001), Leng (2004) and Chen et al. (2005) suggesting that largest shareholders do not influence company performance through business strategies.

With regard to organizational capacity, the resource-based-view (RBV) perspective provides a notion that firms must obtain sources of competitive advantage and may use these resources to create and implement valuable strategies. Firm resources are described as assets, capabilities, organizational processes, organizational attributes, knowledge,

information, technologies, etc., controlled by a firm (Barney, 1991). The result of the empirical test reports that financial management was not statistically significant in explaining performance of companies. For instance, plan and sufficient budget of companies and auditing did not assist in generating value to companies.

On the other hand, the finding pertaining to organizational learning was found to be consistent with the proposed RBV perspective which shows that performance of company was significant and positively influenced by this organizational capacity element. This finding supports prior studies by Murray (2003), Lopez et al. (2005) and Ho (2008).

Therefore, the positive and significant finding with regard to organizational learning implies that employees are capable of making decision concerning their job. Consequently, individuals are given the opportunity to learn new knowledge and skills, and at the same time, gain experience during their employment period. The positive significant impact of organizational capacity of company also suggests that a company has to further develop and transform simultaneously through higher learning.

Particularly, this study finds that independent director (IndDir), CEO duality (Duality), board size (BrdSize), ownership concentration (OwnCon) and financial management (FinMgt) were not significant in explaining performance of Malaysian listed companies. However, organizational learning (OrgLearn) was statistically significant which provide evidence on the association between organizational learning and corporate performance. Therefore, findings in the current study fail to reject $H_{1IndDir,}$ $H_{1Duality,}$ $H_{1BrdSize,}$ $H_{1OwnCon}$ and $H_{2OrgLearn}$ but rejects $H_{2FinMgt.}$

5.0 CONCLUSION

In conclusion, even though the requirement of the implementation of good corporate governance is essential to companies in Malaysia, but findings in this study evidenced that not all aspects of corporate governance has significant effect on corporate

performance. In addition, this study further finds a positive statistical significant association between organizational capacity element, organizational learning (OrgLearn) and corporate performance. The finding contributes towards highlighting the importance of companies to create competitive advantage resources towards enhancing long-term performance.

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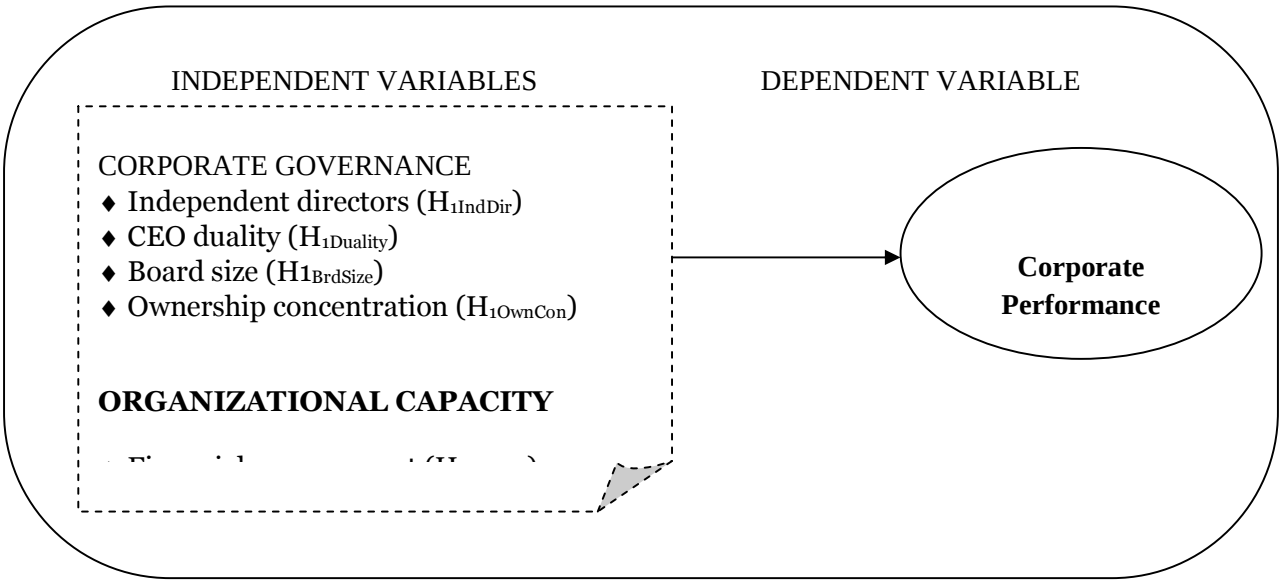
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APPENDIX

Figure 1

Theoretical Framework of Corporate Governance and Organizational Capacity and the Influence on Corporate Performance



THE DIVIDEND POLICY, PYRAMID STRUCTURE AND AGENCY PROBLEMS: THEORY AND EVIDENCE FROM MALAYSIAN PERSPECTIVE

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Norhana Salamudin[2]
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Abstract

Pyramid structure is a business entity whose ownership structure depicts a top-down chain of control. The ultimate owners are located at the peak of structure with successive layers of firms below it. A direct consequence of this structure is a divergence of ultimate owners' actual ownership and control, particularly at the lower level of the structure. This research is important because the ownership of public listed companies in Malaysia is highly concentrated. Hence, there is high incidence of pyramid structure issue which leads to severe agency problems in Malaysia. The concentrated ownership such as Malaysia, agency conflict is occurred between controlling shareholders and minority shareholders. Previous research have documented that in many East Asian firms, the ultimate owners showed a mismatch in cash flow rights and control rights which leads to severe expropriation of minority shareholders' interest. Therefore, this study intends to reveal several theories in order to relate the dividend policy, nature of pyramid structure and agency problems. These include the theory of rent-seeking, agency theory and pyramid structure theory. Apart from that, theoretical evidence on dividend policy based on rent-extraction hypothesis is also examined as a governance mechanism to reduce potential agency problems among pyramid structure in Malaysia.

Keywords: Pyramid structure, ultimate owner, agency problems, dividend policy

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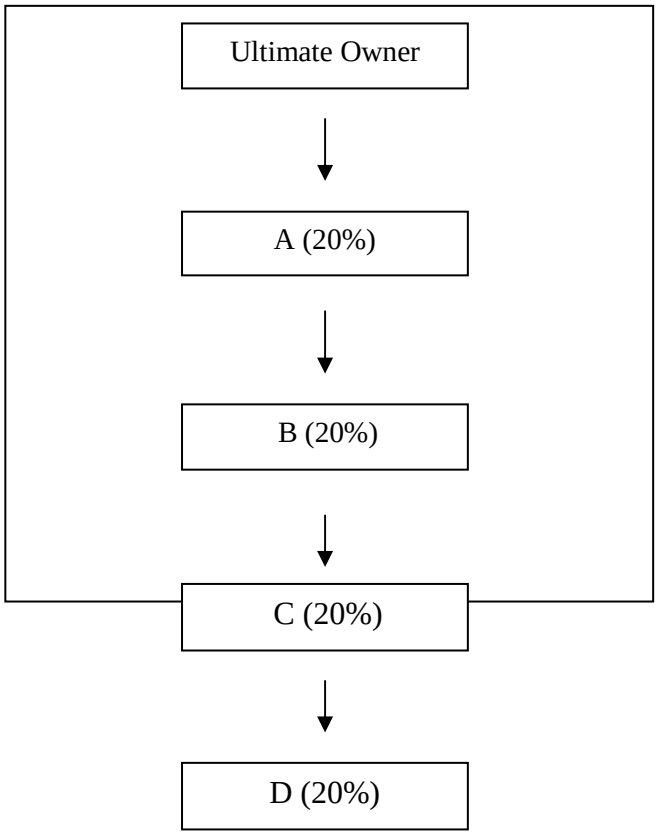
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1. INTRODUCTION

This study attempts to provide a comprehensive review of several theories in order to relate the dividend policy, nature of pyramid structure and agency problems in Malaysia. These include the theory of rent-seeking, agency theory, pyramid structure theory and dividend policy theory based on rent-extraction hypothesis. A pyramid structure is defined as a business entity comprising of a group of companies whose ownership structure displays a top-down chain of control. According to Attig, Fischer and Gadhoum (2003), a firm is considered as affiliated to pyramidal firms if it is controlled through pyramidal structure and has at least one intermediary firm in its ownership chain. In such a structure, the ultimate owners are located at the apex with successive layers of firms below. Accordingly, the length of layers of pyramidal firms leads to the opportunistic behaviour of ultimate owners to expropriate the minority shareholders' interest.

La Porta, Lopez, Shleifer and Vishny (1999) is the first study that investigates the issue of pyramid firm and its ultimate control. For instance, they trace the chain of ownership to find who has the most voting rights. Ultimate owners around the world usually control an array of affiliated companies through hierarchical intermediary corporations forming a pyramid structure. Figure 1 shows an example of a pyramid structure with the ultimate owner located at the apex and successive layers of firms below (Attig, Fischer and Gadhoum, 2003).

Figure 1: Example of pyramidal structure



(Arrows indicate direction of ownership)

Source: Bertrand and Mullainathan (2003)

A direct result of the pyramid structure is a separation of actual ownership, (cash flow rights) from voting power (control rights) especially for firms placed in the lower level of the structure (Claessens, Djankov and Lang, 2000). Cash flow rights represent owner's actual ownership in a company (Claessens et al., 2000b). Chapelle (2005) defined control with respect to the majority voting rule where the control ratio of a shareholder is obtained by dividing the share of control he can exercise directly or indirectly over a given company, by the percentage of shares he actually owns in that company. Logically, the owner's cash flow rights that arise from his actual investment should represent owners' control rights in a company. However, because of the pyramid structure effect, these two rights may not be equal.

The divergence of actual ownership and control occurs because the pyramid structure enables the ultimate owner to establish control disproportionately to the amount of

ownership in each of the successive firms. Consequently, with such a pyramid structure, the ultimate owner's actual ownership position needed for control becomes smaller at each succeeding layer of the structure. Claessens et al. (2002) and Lemmon and Lins (2003) empirically show that the separation of cash flow rights and control rights of the ultimate owner devalue the interest of other shareholders. Both studies conclude that the interest of other shareholders was adversely affected whenever cash flow rights and control rights divergence exists because it enables the ultimate owner to misuse his control rights over the company's resources without being penalized for misconduct.

Previous study by Claessens et al. (2000) on the other hand showed that the level of control that Asian pyramidal firms have over the Asian economies is significant. For example, East Asian pyramidal firms controlled 80% of the East Asian economies, as measured in terms of total corporate assets. Malaysia in particular, pyramidal firms control around 28% of the value of listed corporate assets for year 2000. Their study also found that Malaysia has the third highest concentration of control after Thailand and Indonesia. Family control in Malaysia increased from 57.5 % to 67.2% of total listed company as the cut off level of voting rights increased from 10% to 20%. For state-owned firms in Malaysia, these firms comprised between 13.4% to 18.2% for 20% and 10% cut off point respectively.

Many studies have been done about pyramidal structure in term of its separation of ownership and control (La Porta et al., 1999, 2000a; Classens et al., 2000a), correlation between firm performance and ownership structure (Lemmon and Lins, 2003., Baek, Kang and Park, 2004., Hughes, 2009), tunnelling effect of pyramidal structure (Friedman, Johnson and Mitton, 2003., Cheung, Rau and Stauraitis, 2006., Riyanto and Toolsema, 2008) and other aspects. However, this study examines the theoretical evidence between dividend policy based on rent-extraction hypothesis, nature of pyramid structure and agency problems specifically in Malaysia.

Empirical evidence of the role of dividend policy towards agency problems is still relatively limited especially in Malaysian context and an extensive investigation based on rent-extraction hypothesis in this direction is warranted. A dividend can reduce tunneling in Asian countries specifically Malaysia as has been discovered by

Gugler and Yurtoglu (2003). This proves that dividend payment could reduce the expropriation of ultimate owner and consequently reduce potential agency problems in Germany. On the other hand, dividend reduction may increase the potential rent extraction by leaving more money at the discretionary use of the ultimate owner and generate larger negative wealth effects in the pyramid structure.

It is essential to extend governance mechanism such as dividend policy based on rent-extraction hypothesis towards the issue of separation of ownership and control as well as agency problems among Malaysian pyramidal firms. Bartram et al. (2008) and Mitton (2004) show that companies with severe agency problems or weak corporate governance should pay dividends. This study select Malaysian firm because it has the most number of pyramidal firms and also reported that tunneling is quite significant compared to the other countries (Lemmon and Lins, 2003). Pyramidal firms tend to have lower dividend payout and face severe agency problems because ultimate owners often have significant discretion and the incentives to extract private benefits of controls. This incentive arises because the ultimate owner bears only a fraction of the costs from their private benefit activities but receives the full benefits from such ill practices (Bany et.al, 2009). The consequences of ultimate owner expropriation include highly ownership concentration (Faccio and Lang, 2002), lower dividend payments (La Porta et al., 1999., Faccio et al., 2001) and lower firm valuation (La Porta et al., 2002., Claessens et al., 2000b). Meanwhile, Bertrand, Mehta and Mullainathan (2000) report that the ultimate owners of the companies' pyramids in India have strong incentives to divert resources from firms low down in the pyramid towards ones high up in the pyramid. Thus, the empirical evidence presents that when the ownership concentration is high, the excess funds are often redistributed on paying excessive compensations, using firm's assets as collateral for personal loans, and investing in high private benefits projects. This situation leads to reduction in dividend payment which creates potential agency problems.

Therefore, by incorporating high dividend payment can help to alleviate wealth expropriation, which is an agency problem in pyramid firms. Dividend payments are pro-rata payout for both the ultimate owner and other shareholders in limiting rent extraction undertaken by ultimate owner. The ultimate owner, by granting dividends to other shareholders, can signal his unwillingness to exploit them. The higher

dividend payout will lower probability of affiliation to a pyramid, and the chance for agency problems will be lower. In contrast, the lower dividend payout might be associated with higher probability of a firm affiliation to pyramidal firms which leads to severe agency problems as well as rent extraction (Gugler and Yurtoglu, 2003).

Gugler and Yurtoglu (2003) also showed similar result that in Germany, larger deviations of control rights from cash flow rights are associated with lower dividend payments. In other words, the lower dividend payment of majority-controlled firms in Germany is related to the probability that controlling shareholders extract private benefits at the expense of minority shareholders. Indeed, they find that increases in dividend payments are associated with significantly positive abnormal returns among firms where rent extraction is most likely given the discrepancy between cash flow rights and control rights. According to the other study by Feng Xu'nan (2011), dividend payout was found to decrease with the separation of ultimate ownership and control right; this may reflect the tunneling motive of the family owners which eventually affect the firm corporate value.

In order to relate the pyramid structure with this negative valuation effect, this study has reviewed several theories including theory of rent-seeking, agency theory, pyramid structure theory and dividend policy theory based on rent-extraction hypothesis. With completion of this review process, this study would have established the necessary theoretical framework to explain such adverse phenomena. Thus, the objective of this study is to provide a comprehensive review of the theoretical evidence that serve as a framework for understanding dividend policy, nature of pyramid structure and agency problems in Malaysia.

2. LITERATURE REVIEW

2.1 Theory of Rent-Seeking

According to Morck and Yeung (2000), rent-seeking business practices imply the extraction of uncompensated value from others without taking actions to improve productivity or to create a mutually beneficial transaction. In a similar study, they

presented evidence that corporate control gives pyramid firms in Canada economies of scale in political rent-seeking. Particularly, these firms have been able to pressure the government to impose tariffs on goods from other countries for it to continue to enjoy the monopoly of the market. Although it may be unethical in nature, given the urgency of the firm in maximizing shareholder wealth along with various economic constraints, rent seeking may be the only solution (Krueger, 1974).

Krueger's (1974) model shows that firms that seek rent try to create a barrier of entry into the market and monopolize the production line in which the rent is created. This distortion created an artificial market price for a product that, in turn, created a higher profit margin for such firms. Murphy, Shleifer and Vishny (1993) found that rent-seeking activities exhibited naturally increasing returns for firms that practiced it, which tend to be more attractive than productive activity. However, this is costly to firm growth because resources were channeled to rent-seeking instead of production.

Murphy et.al (1993) also illustrated that firms that choose to maximize their rent-seeking activities instead of production had most of their resources diverted into unproductive activities. For example, instead of channeling corporation funds into research and development, funds were used to finance the lobbying of a specific government agency. If the lobbying was successful, it helped the participating firms maintain their competitive edge over their rivalry, but in an unethical manner. In the long run, the economy lost, as no product development occurred but corruption and unhealthy business conducts prevailed. Malaysia also provides a rent seeking opportunities through the debt and diversification in a highly concentrated ownership environment. These rents benefit managers and controlling owners as it allows additional income than the minimum that they would have accepted. Besides that, Malaysian market is a tinny-traded and there is non-synchronous trading bias on prices due to the thin trading problem in semi-strong market (Dawson, 1981). Therefore, only few securities so actively traded that prices are recorded continuously.

2.2 Agency Theory

The agency theory describes dividends as a mechanism to resolve potential conflicts between principals (shareholders) and agents (managers). Meanwhile, agency

problem refers to the principal-agent problem where the principle is shareholder and the agent is the manager. The main duties of the manager would be to run the firm effectively and efficiently so as to maximize firm value and also maximize returns to the shareholders. However, an agency problem arises when managers' and shareholders' interests are not aligned. This may arise when the manager is not acting in the interest of shareholders, for instance, the manager is not investing in projects that shareholders consider worth investing. Hence, the cost of monitoring managers is referred to as the agency costs.

The literature on agency theory addresses three types of problems that could transpire from the separation of ownership and management which might consequently affect firm value (Byrd, Parrino and Pritsch, 1998). They are the effort problem, the assets' use problem and differential risk preferences problem. The effort problem concerns whether or not managers apply proper effort in managing corporations so as to maximize shareholders' wealth (Jensen and Meckling, 1976). Problems arise because principals are not able to determine if the managers are performing their work appropriately. Managers may not exert the same high effort levels required for firm value maximization as they would if they owned the firm.

The use of assets problem concerns insiders who control corporate assets (Jensen, 1986). They might abuse these assets for purposes that are harmful to the interests of shareholders such as diverting corporate assets, claiming excessive salaries and manipulating transfer prices of assets with other entities they control (Shleifer and Vishny, 1997). The differential risk preferences problem arises because the principal and managers have different views on risk taking (Arnold and de Lange, 2004). Managers may not act in the best interest of shareholders and may have different interests and risks preferences.

Malaysia also faces with severe agency problems. It is because Malaysian corporate scenario is faced with Type II agency problems between majority shareholders and minority shareholders (Berle and Means, 1932) and (Jensen and Meckling, 1976). The Type II agency problems appears when controlling shareholders use their controlling position in the firm to extract benefits at the expense of minority shareholders. The problem becomes more acute in highly concentrated firms in which controlling

shareholders at the same time are the managers who have power and ability to make decisions that will significantly affect minority shareholders. Another study by Haniffa and Hudaib (2006) also provide an evidence of ownership concentration in Malaysian corporate scenario. They reported that ownership concentration is undiluted overtime. This Type II agency problems is more apparent in developing market, such as in Malaysia, where high ownership concentration is well documented (Claessens, Djankov and Lang, 2000., Haniffa and Hudaib, 2006., Khatri, Leruth and Piesse, 2002 and Mitton, 2002).

To mitigate the agency problems, dividend payment can be used as a governance mechanism (Harjito and Nurfauziah, 2006). So, it is interesting to examine and apply the theoretical evidence on dividend policy based on rent-extraction hypothesis to reduce agency problems in Malaysia. By impose high dividend payment, it shows that controlling shareholders are not interested to expropriate minority shareholders (Gugler and Yurtoglu, 2003). Gugler and Yurtoglu (2003) also found that when there is ownership concentration, the conflict arise is between controlling shareholders and majority controlled firm (proportion of ownership more than 50%) and minority controlled firm (proportion of ownership less than 50%). They test this dividend change with rent extraction hypothesis. Their findings show that high dividend make market react positive which is in line with rent-extraction hypothesis. When the market intends to interpret increased in dividend, the controlling shareholders will not exploit for the benefit of themselves towards minority shareholders.

The agency theory clearly depicts on how the agency problems exist. There is a high incidence of the conflict of interest between controlling shareholders and minority shareholders especially among Malaysian pyramidal firms. Generally, controlling shareholders try to abuse their power for their personal utility with no concerns to minority interest. Hence, it will affect the corporate value as well as dilution of minority interest. Corporate mechanism such dividend policy based on rent-extraction hypothesis could be one of the solution for interest alignment as well as it can resolve agency conflict between controlling shareholders and minority shareholders in Malaysian corporate environment.

2.3 Pyramid Structure Theory

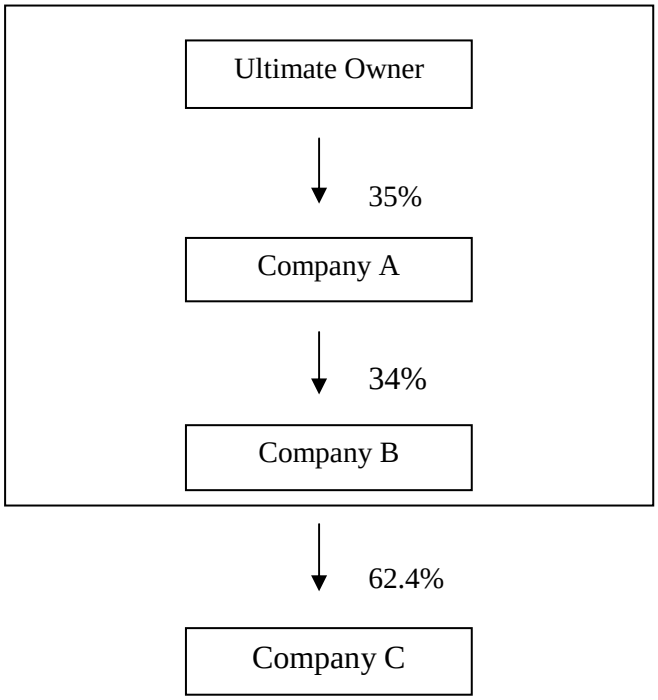
The controlling family often organizes the ownership of the group member firms in a pyramid structure. In such structure, the family achieves control of the constituent firms by a chain of ownership relations; the family directly controls a firm, which in turn controls another firm, which might itself control other firms, and so forth (Wolfenzon and Heitor, 2004). This process can be repeated a number of times. Claessens, Djankov and Lang (1999) found that many firms in East Asian countries showed a high degree of cash flow rights and control rights separation due to the existence of pyramid firms**.** In East Asia, it takes on average 19.76% ownership of all shares to obtain 20% of control rights. The companies in East Asia seem not to use shares with superior voting rights. They also stated that 38.7% of the investigated companies are involved to the use of a pyramid structure by ultimate control at the 20% level. The number is largest in Indonesia (66.9%) and the smallest in Thailand (12.7%). Singaporean companies also showed a high incidence of pyramiding while only a quarter of non-widely held companies in Hong Kong are controlled through pyramid structure. So, high concentration of ownership and control of corporation is dominated by Hong Kong, Indonesia, Korea, Malaysia and Thailand families which have control over the majority of corporations (Claessens, Djankov, Fan and Lang, 2000).

Bertrand and Mullainathan (2003) state that firms in many countries are often held in groups with complicated ownership structures (referred to as pyramids) raised very distinct questions about firm behavior especially for developing countries such Malaysia where these groups are most obvious. According to Bebchuk, Reiner and Triantia (2000), the pyramid structure allowed the ultimate owner to achieve control of a firm with small cash flow rights. For example, an ultimate owner who directly owns 50% of a firm, which in turn owns 50% of a different firm, achieves control of the latter firm with ultimate cash flow rights actual ownership of only 25%, but control rights of 50%. They further explained that if the ultimate owner could control a firm with small stakes, this would encourage them to acquire and establish more new firms. As more and more firms were in their control, the ultimate owner business would have relative control over the economics of the country in which they operate (Bany and Law, 2008., Faccio and Lang, 2002., Claessens, Djankov and Lang, 2000).

2.3.1 The Nature of Pyramid Structure and Separation of Actual Ownership and Control

The nature of pyramid structure and issue of separation of ownership (cash flow right) and control (control right) can be illustrated as in Figure 1. Ultimate owner, owns 35% of shares of Company A, making him the majority shareholder and ultimate owner of the company. At the same time, the corporation owns 34% of shares in Company B. Thus, Company A becomes the controlling shareholder of Company B. The fact that ultimate owner controls Company A which in turn is a major shareholder of Company B; this gives ultimate owner the right to control Company B also.

Figure 2: Pyramidal structure with ultimate owner



Source: Almeida and Wolfenzon (2008)

In this pyramid group, ultimate owner has a direct ownership of Company A only. For the rest of the firms, the ownership comes indirectly. For instance, ultimate owner's ownership in Company B comes through Company A. For Company C, ultimate owner's ownership arises from his share in Company A and Company B. Resulting from this particular arrangement, ultimate owner's actual ownership (CFR) in Company C is 7.43%, determined in the following manner:

Actual ownership (CFR) in Company C = 35% x 34% x 62.4%

= 0.07426 ~ 7.43%

Since, theoretically, ownership arises from one's investments, if the amount of ultimate owner's ownership in Company C is 7.43%. This means that his investment in Company C is also 7.43%. Assuming that Company C is worth RM10,000,000, an investment worth RM 743,000 (7.43% x RM10,000,000), enables ultimate owner to control a company worth RM10,000,000.

Ultimate owner's indirect control of Company C is proxies by the control right (CR). The control arises from his controlling share in Company A which then controls Company B, and finally the control of Company C by Company B. La Porta, Lopez, Shleifer and Vishny (1999) and Claessens, Djankov, Fan and Lang (2000b) define the weakest link in the line of control as the control ratio (CR). Based on this definition, the control ratio (CR) that ultimate owner has over Company C is 35% (i.e., the weakest link in the chain of ownership).

The structure provides ultimate owner the rights to influence (indirectly through Company A and Company B) matters such as firm policy and board of director (BOD) appointments in Company C. Evidently, because of the pyramid structure, with 7.43% ownership or RM 743,000 worth of investment, ultimate owner has 35% control ratio (CR) in a firm (Company C) worth RM10,000,000. This significant separation of ownership (CFR) and control (CR) clearly deviates from the traditional idea of one share – one vote (Grossman and Hart, 1988). Crucially, the incentives to expropriate other shareholders may also arise from this separation (Claessens, Djankov, Fan and Lang, 2000b).

As in La Porta, Lopez, Shleifer and Vishny (1999) and Claessens, Djankov, Fan and Lang (2000b), the separation can be measured by looking at both the ratio of cash flow right (CFR) to control right (CR) and the difference between cash flow right (CFR) and control right (CR). The following illustrates how such separation can be measured using ownership data in Figure 1.

The separation of cash flow right (CFR) and control right (CR) in Company C can be measured in two forms:

I. Using the ratio of cash flow right (CFR) to control right (CR):
= Cash flow right (CFR) / Control right (CR)
= 7.43% / 35%
= 0.2123

II. Using the difference between cash flow right (CFR) and control right (CR):
= Control right (CR) – Cash flow right (CFR)
= 35% - 7.43%
= 27.57%

Based on these techniques of computation, the smaller the ratio of cash flow right (CFR) to control right (CR) indicates wider separation between actual ownership (CFR) and control (CR) in the hand of the ultimate owner. In a similar manner, the larger difference between cash flow right (CFR) and control right (CR) also indicate wider separations between actual ownership (CFR) and control (CR). The wider the separation shows the greater the possibility of expropriation which is known as agency problems. Such separation also can be detrimental to the well being of shareholders interest.

Indeed, this study has presented an example in which the cash flow rights (CFR) of the controlling ultimate owner in some of the pyramid firms are comparable to the small share of the managers of the most diffusely held corporations. By allowing cash flow right (CFR) and control right (CR) to diverge, pyramid firm permits the same divergence of interest problem as well as agency problems in dispersed firms (Jensen and Meckling, 1976).

So, in this case, ultimate owner's action over the matter is a typical given Malaysian corporate scenario. However, it is the action of Company B, board of directors that are in questions. The incident provides two important evidence of Malaysian corporate governance, firstly, majority shareholders have the absolute uncontested

power to make firm' decision to safeguard their interest at the expense on minority shareholders. Secondly, firm' non-owners executive are powerless to protect the best interest of the firm and other shareholders. As most Company B top management team, their decision to bail out Company A causes Company B share prices to drop. Such incident suggests that most Malaysian firms attempt to emulate the developed market with emphasizing interest alignments and issuing corporate policy such as dividend which can provide incentives for firms' managers to enhance firm's performance, so that the interest of owners is well taken care of.

This study transparently revealed the Malaysian pyramid control firm seems interesting to be emphasized in this study. Practically, less attention has been placed on this particular issue especially in Malaysian pyramidal affiliated firms. Previous study by Claessens, Djankov, Fan and Lang (2002), Lemmon and Lins (2003) and Lins (2003) empirically showed that the ultimate owner gives no regard to the interests of other shareholders in companies when there is separation of actual ownership and control. So, this study is a useful contribution to the literature, in which the nature of pyramid structure as well as separation of cash flow right and control right among Malaysian pyramidal firms is explored thoroughly to indicate any indirect expropriation potential within such structures and thus provides additional insights into corporate finance and also governance. Besides that, this study has established the necessary framework to explain such phenomena. This study is a significant research one value-added to the existing of empirical studies especially for Malaysian case. Even if the idea is proven otherwise, this study still represent as one of the pioneering efforts to examine the prevalent of pyramid structure specifically for Malaysia. Furthermore, it can provide better generalization of research finding.

2.4 Dividend Policy Theory

In this section, it reviews the theories of dividend and then provides the theoretical evidence of dividend policy based on rent-extraction hypothesis. The term 'dividend policy' refers to "the practice that management follows in making dividend payout decisions or, in other words, the size and pattern of cash distributions over time to shareholders" (Lease et al., 2000). The payment of dividend is a common practice for many publicly traded firms as a primary approach to return cash or assets to their

shareholders. However, firms can also return their cash to shareholders in the form of share repurchases, where certain amount of cash is used to buy back outstanding shares in the firm and reduce the number of shares outstanding.

This issue of dividend policy is one that has engaged managers since the birth of the modern commercial corporation. Surprisingly then dividend policy remains one of the most contested issues in finance. The study of dividend policy has captured the attention of finance scholars since the middle of the last century. They have attempted to solve several issues pertaining to dividends and formulate theories and models to explain corporate dividend behavior. The dividend enigma has not only been an enduring issue in finance, it also remains unresolved. Almost three decades ago Black (1976) described it as a "puzzle", and since then an enormous amount of research has occurred trying to solve the dividend puzzle. Allen, Bernardo and Welch (2000) summarized the current consensus view when they concluded "Although a number of theories have been put forward in the literature to explain their pervasive presence, dividends remain one of the thorniest puzzles in corporate finance".

Dividend policies theories have been discussed over the last century where three schools of thought have emerged. One group sees dividends as attractive and as a positive influence on stock price. A second bloc believes that stock prices are negatively correlated with dividend payout levels. The third group of theories maintains that firm dividend policy is irrelevant in stock price valuation. Theoretical and empirical models of corporate dividend policy of late better separate into a different taxonomy. In this taxonomy, the qualifying criterion is the nature of the market structure and / or the underlying rationale of the investor. Accordingly, recently models are broadly segregated based on their rationale into models formulated in states with full information, models in states with information asymmetries and models using behavioral principles (Frankfurter and Wood, 2002).

How much cash should firms give back to their shareholders? And what form should payment take? Should corporations pay their shareholders through dividends or by repurchasing their shares? Firms must make these important decisions over and over again (some must be repeated and some need to be reevaluated each period) on a regular basis. It is because these decisions are dynamic and they are labeled as payout

policy. The word policy implies some consistency over time, and those payouts, and dividends in particular, do not simply evolve in an arbitrary and random manner.

Much of the literature in the past forty years has attempted to find and explain the pattern in payout policies of corporations. Payout policy is formulated by the financial management team and it is very important to use as a suitable policy to avoid any undesirable outcome such as shareholder expropriator which may leads to negative stakeholders' reaction. Payout policy is important not only because of the amount of money involved and the repeated nature of the decision, but also because payout policy is closely related to and interacts with most of the financial and investment decisions firms make. It involves of how much cash and in what forms should firm pay to their shareholders. Understanding payout policy may also help to better understand the other pieces in this puzzle (Allen and Michaely, 2003). For instance, investigating dividend policy based on rent-extraction hypothesis as a governance mechanism to mitigate agency problems is not only interesting but also a must as much of existing information on dividend policy and wealth expropriation is focused on developed markets data which may reflect the specific financial trading and business ownership environment especially in Malaysian context.

2.4.1 Dividend Policy Based on Rent-Extraction Hypothesis

Dividend policy can be used as a governance mechanism to reduce agency problems between controlling shareholders and minority shareholders, both at high and low concentrated ownership structure in Malaysian corporate environment (Syafaruddin, 2009). Therefore, corporate dividend policy in a firm with concentrated ownership is predominantly determined by how the conflict among the firm's shareholders about distribution of profits (benefits) is resolved. Generally, cash dividends and total distribution decrease as the divergence of cash flow rights and voting rights widens. This is consistent with rent-extraction hypothesis. In a corporation with low cash flow rights to control rights, dividend payments are expected to be low since controlling shareholders seek to retain corporate resources (Faccio et al., 2001). However, a rational investor, perceiving risk of expropriation will attach a lower value to the shares of these corporations and will be less willing to supply capital. Dividend policy can address this concern. Firms with low ownership rights relative to control rights

can refrain from expropriation by committing to a high dividend policy and hence, reducing cash flow that may be potentially expropriated. By paying dividends, corporate earnings are returned to investors and are no longer available to management to benefit themselves (Rozeff, 1982). Dividend policy is important which bring a positive investor psychological impact. Investors perceive cash dividend announcements as positive signals of future performances and investment opportunities. Cash dividend could lead to a decrease in share prices to a desired range which makes the stocks more attractive to investors. Cash dividend offer positive abnormal return for investors who hold the shares that can be traded. As the abnormal return of a dividend increase is likely related to the size of the dividend increase. A larger dividend increase means a larger signal and a larger decrease in agency problems. Therefore, this study provides further theoretical evidence on the role of dividend policy to mitigate agency problems based on rent-extraction hypothesis.

Testing the rent-extraction property of dividends, Gugler and Yurtoglu (2003) examine the conflict between large and small outside shareholders using high ownership concentration in Germany. They provide evidence that the voting rights of the largest shareholder significantly reduce dividend payout. They also report that the divergence between cash flow rights and voting rights significantly lowers dividend payout. Similarly, Mancinelli and Ozkan (2006) find that as the voting rights of the largest shareholder increase, firms make lower dividend payments. They argue that the results can be interpreted as a support for the conjecture that a higher level of ownership concentration is associated with a higher probability of expropriation of outside shareholders. To the extent that, there are private benefits of the largest shareholder for holding larger amounts of cash, lower payouts will increase the ability of the larger shareholders to expropriate the outside minority shareholders. Therefore, when large owners gain nearly full control of the firm, they prefer to generate private benefits of control that are not shared by minority shareholders (Shleifer and Vishny, 1997). Such high dividend payout may have been facilitated by the more healthy relationship between the control rights of the majority shareholder with its cash flow rights. In the case of locally-controlled companies, the control rights were usually well in excess of the cash flow rights of the controlling shareholder, usually because of the pyramid of companies in the same group. This could explain their much lower

dividend payout and their greater propensity to reinvest their profits even in unrelated activities, at least in part to maximize the insider's private benefits of control.

The effect of incorporating dividend payment as a signal towards agency problems based on rent-extraction hypothesis has been proved by several researchers. For instance, Bany et.al (2009) in their study of Indonesian pyramidal firms proposed that dividend payments can signal the interest alignment between the ultimate owner and other shareholders in a pyramidal firm. According to the authors, ultimate owner's often have significant discretion and the incentives to extract private benefits of controls. This incentive arises because the ultimate owner bears only a fraction of the costs from their private benefit activities but receives the full benefits from such ill practices. Dividend payments, on one hand, guarantee a pro-rata payout for both the ultimate owner and other shareholders. Dividends are, therefore, an ideal device for limiting rent extraction by the ultimate owner. The ultimate owner, by granting dividends to other shareholders, can signal his unwillingness to exploit them. On the other hand, dividend reductions may increase the potential rent extraction by leaving more money at the discretionary use of the controlling ultimate owner. Based on this justification, the proposed rent extraction hypothesis expects positive abnormal returns for dividend increases, since higher dividends reduce the cash in hand of the ultimate owner. They also discover that increases in dividend do contain new relevant information that creates movements in the market and the reactions eventually produce positive abnormal return to the investors. Conversely, a negative abnormal return for announcements of dividend reductions can be expected, since lower dividends increase the cash that the ultimate owner can potentially expropriate for the firm with high ownership concentration. The analysis of firm-level ownership and control structures incorporates the most common arrangements for separating control from cash flow rights which is pyramid structure. In this circumstance, dividend policy based on rent-extraction hypothesis can be one of solution to resolve the separation of actual ownership and control as well as agency problems in pyramid structure which also can be applied to local scene such Malaysia.

As part of the analysis to prove the hypothesis, the authors discriminated between firms with ultimate owner (which predominately acquired control through pyramid group) and firms not associated with any pyramidal group. The abnormal returns of

both groups resulting from the dividend announcement were then analyzed. The standard event methodology was used in their analysis. From the descriptive statistics, it is shown that firms with ultimate owners have lower dividend payout ratios as compared to non pyramidal firms. In addition, from the observation of the abnormal returns, when firms with ultimate owners announced a dividend cut, negative market reactions followed, while a dividend increase led to a positive reaction. Thus, it can be concluded that such phenomena are consistent with the rent-extraction hypothesis proposed. Their study depicts the same result as has been studied by Gugler and Yurtoglu (2003) in their study on German pyramidal firms. They show that the lower dividend payout of majority-controlled firms in Germany is related to the probability that controlling shareholders extract private benefits at the expense of minority shareholders. Indeed, they find that increases in dividend payments are associated with significantly positive abnormal returns among firms which reduce the potential for rent-seeking behavior by controlling shareholders.

Other than that, Baek et.al (2002) also report for evidence of rent-extraction of ultimate owner among Korean pyramidal firms by observing the merger announcements that were made from 1981 to 1997 involving firms associated with the Chaebol pyramidal group and comparing such announcement to the announcements of Non Chaebol pyramidal firms. Using standard event study methodology, they found that for Chaebol firms, the announcement effects were mostly negative due to their pyramidal influence. To further substantiate the rent-extraction hypothesis, they regressed the separation of cash flow right and control right measurement (i.e. ratio of cash flow right to control right) with the cumulative abnormal return. The relationship of the separation ratio and the stock returns (i.e., cumulative abnormal return) was positive. Indirectly, this situation provides proof of the proposed rent-extraction hypothesis since the smaller the ratio (which implies high agency problem), the lower the cumulative abnormal return due to the negative reaction of the market towards the merger announcement.

Based on the background of these facts, dividend policy may provide information about the magnitude of the conflict between controlling shareholders and minority shareholders. Therefore, it is quite interesting to highlight governance mechanism such as dividend policy to overcome agency problems based on rent-extraction

hypothesis in pyramidal firms. Even if the idea is proven otherwise, this study still represent as one of the pioneering efforts to examine the effectiveness of adopting dividend policy in a highly concentrated ownership environment specifically for Malaysian case.

3. CONCLUSION

A lot of studies have been carried around the world on this issue, but yet little research done in Malaysia. Thus, the objective of this paper is to provide theoretical evidence on dividend policy based on rent-extraction hypothesis, nature of pyramid structure and agency problems. Malaysia provides an interesting background to examine the pyramid structure issues that are mainly characterized as highly concentrated in nature and are controlled by large shareholders. The exacerbation of agency problems as a result of the pyramid structure may have detrimental influence towards firm value as well as dilution on minority interest. Dividend policy based on rent-extraction hypothesis can be used as a governance mechanism to solve the agency problems which would indicate possible or potential wealth expropriation situation in a highly concentrated ownership environment especially Malaysia. For instance, test information content in dividend announcement based on rent-extraction hypothesis. According to rent-extraction hypothesis, it stated that the market will react positively and increased in dividend announcement and in contrast, the market will react negatively when announced dividend decreased. In other words, it can be interpreted as a signal where controlling shareholders unwilling to expropriate towards minority shareholders and vice-versa at decreased in dividend announcement (Gugler and Yurtoglu, 20003).

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ENHANCING THE EFFECT OF CORPORATE GOVERNANCE ON INVESTOR CONFIDENCE BY SHARIAH STATUS: TOWARD AN UNDERSTANDING OF THEORETICAL AND EMPIRICAL PERSPECTIVE

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Abstract

Series of worldwide corporate failures have put the role of corporate governance as one of the factors in enhancing investor confidence into question. In this paper, being Shariah-compliant companies (i.e included into the list of Shariah-compliant securities) is proposed to be one of the potential solutions in overcoming the above problem. The purpose of this paper is to provide an overview of the investor behavior with regard to theoretical elements and empirical evidences of the role of Shariah status (inclusion into the list of Shariah-compliant securities) in the relationship between corporate governance mechanisms and investor confidence. In addition, this paper also seeks to highlight issues of Shariah-compliant companies in Indonesia with regard to both - corporate governance mechanisms and investor confidence – as well. On the bases of the relevant literatures reviewed; the investor behavior, among others, is premised on cognitive and emotional bases of trust. Corporate governance mechanisms are of cognitive component of trust while Shariah status is of emotional component of trust. Consequently, a conceptual framework of investor confidence was proposed. The developed framework supports the concept of trust and proposes an integrative model of investor confidence's model to study the phenomenon. Theoretically, it has been shown that a Shariah-compliant company is expected to be better in enhancing the relationship between corporate governance mechanisms and investor confidence.

Keywords: corporate governance mechanisms, investor confidence, Shariah status

1.0 Introduction

Corporate scandals and failures have caused many investors suffering wealth losses in stock market leading to drop stock price in capital market. Investors highly demand on better corporate governance mainly for higher quality of boards of director and management, and higher information disclosure as means of powerful monitoring and

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supervision and enhancing ethical behavior of corporate managers in conducting any business activities of a company.

It has nearly reached a consensus among investment community that the series of corporate scandals and failures such as among others, Enron in US, Parmalat in Europe, Satyam Computer Service in India, Samsung Life's and Song Kil Global in Korea, Malaysian Airlines System (MAS) in Malaysia, Century Bank, Bumi Resources, and Bank Negara Indonesia 46 in Indonesia were caused by lack of corporate governance effectiveness, auditors, as well as unethical top management practices (e.g., Sverige, 2004; Claessens & Fan, January 2003; McGee, 2008). Likewise, most scholars blamed lack of corporate governance effectiveness, auditors, as well as unethical top management practices to be the causes of fraud expanding for ten years (e.g., Abu-Tapanjeh, 2007; Bakhtiar & Nazli, 2003). Most of the scholars agree that several primary causes of these corporate failures are accounting fraud, corruption and unethical practices such as financial manipulation and questionable accounting practices on the part of corporate executives, members of its board of directors, external auditors and high government officials. They suggested that companies needed to reinforce their accountability and integrity in order to prevent fraudulent activities and to maintain investor confidence. Consequently, strengthening corporate governance especially in improving boards function, supervising, and corporate ethical culture is crucial for building investor confidence in corporate securities investment.

Sharia compliant stock is an alternative investment for Muslim investors who want to allocate their funds for investments allowed by Sharia principles. General objective of the inclusion of the company in the list of Sharia compliant companies is to obtain greater confidence of investors especially Muslim investors to invest in Sharia compliant company.

The successful of company in passing Islamic screening criteria to be included in list of Sharia compliant company revealed that company's stock has been categorized as halal stock or has a status as Sharia compliant stock. Consequently, the assurance of Sharia council toward stock compliance should be able to reduce Muslim investors' dissonance and increase investor confidence in halal investment.

Company with Sharia status reflects high commitment of company's leaders as management executives and company's boards of director as monitoring mechanisms for the alignment of company policies and operations with Sharia principles in capital market. For that reason, Sharia status can reflects that internal governance mechanisms have worked out in a company because of the commitment of corporate leaders and the previous preparation should be conducted by a company in order to be able to fulfill Sharia screening criteria. This argument is supported by Beekun, R. I. (1997) arguing that the consistency of company inclusion in list of Sharia compliant companies will increase investor confidence in the board of directors functioning as monitoring mechanisms for aligning of corporate activities with Islamic principles.

Moreover, Sharia status can also serve as external corporate governance mechanisms, because the conformity of Sharia compliant companies is periodically oversight the compliance of their activities in capital market. When companies have fulfilled all of Islamic principles, it is believed that the companies have operated in appropriate manner complying with Sharia principles.

Thereby, Sharia status (halal status) can be an attribute providing signal to investors especially Muslim investors that company issuing Sharia compliant stock has been operated based on Islamic principles as well as good corporate governance practices. Then Sharia status ultimately may increase investor confidence in Sharia compliant stock as an alternative investment fulfilling Islamic principles.

Globally, Islamic capital markets products and services have experienced tremendous growth in recent years. The annual growth of Islamic capital markets was approximately by 12% to 15% over the last decades (Sadeghi, 2008; Hussein, 2007), and it has spread in more than 75 countries (Haron & Nursofiza, 2008) including in the Middle East, South East Asia, Europe and the United States (El Qorchi, 2005). The tremendous growth indicated that Islamic fund has highly potential latent fund in global financial fund that was just achieved approximately US$230 billion or 17.69% of estimated $1.3 trillion latent Islamic fund in global financial institutions (Sadeghi, M. (2008). The small proportion of Islamic fund in Islamic capital market showed that Islamic capital market products and services are still not able to attract the enormous Islamic funds in Islamic capital market. Sharia compliant stocks still have relatively

small proportion compared to total market capitalization especially in Indonesia that is one of the countries with a highly bright market potential (approximately 85% of 230 million of Indonesian population is Muslim) whereas the market share was merely around 1% of its total market capitalization. Nevertheless, Sharia compliant stocks listed on the Jakarta Islamic Index (JII) have forceful growth by 54%, climbing from 199.75 at the end of 2005 to 307.62 at the end 2006 (Abubakar & Rizal, 2007). Therefore, the potential market of Sharia compliant stock is a promising market opportunity to grow in Islamic capital market particularly in Indonesian capital market (Abubakar & Rizal, 2007).

This paper seeks to explore theoretically the relationship between corporate governance mechanisms, the status of Sharia, and investor confidence in investment decision making process based on concept of trust. This paper attempts to integrate cognitive base and emotional base in forming trust based on the logical modified conceptual trust for recognizing the role of corporate governance mechanisms in protecting investors' interest. The integration concept of corporate governance mechanisms-investors relation proposed in this paper suggests that cognitive awareness on the essential role of corporate governance mechanisms integrated with emotional base of trust in Sharia status of company simultaneously have a greater impact on investor confidence. This paper contributes to the expansion of application of the concept of trust based on the component of cognitive and emotion of trust in sociology and the elaboration of such concept in the concept of buyer-supplier relationships.

2.0 Investor confidence - the fundamental concept and theoretical framework

Investor confidence plays important role in developing capital market that is a critical area for companies to obtain equity with lower cost of capital. Investors are allowed to own companies by investing share of companies or derivatives. If investors' confidence shaken, the capital market will be shaking as well.

Investors have potential funds required by companies to finance firm activities. Investors will invest their funds if they have confidence that they will get future earnings consistent with their expectations. If investors loss their confidence, then

they will move their fund to other kind of investment or just keep them. As a result, investors' confidence play essential role to maintain the sustainability of companies.

Investor confidence is defined as the sense of trust or believes or optimism about risky asset. In other words, investor confidence is a desire or an appetite for investing in risky asset (Froot & O'Connell, 2003). When investors feel confidence it means that there is nothing to worry about their investments (Shiller, 2000). This is a form of personal expectations that no one thing that will make them disappointed (Luhmann, 2000) and they feel optimisms (Wise, 2002). Therefore, if investors feel confidence, they will entrust their earned-cash on corporate securities and belief that their money will be properly protected and receive reasonable earnings.

The relationship between company and investors is similar to supplier and buyer in general. The basic concept of buyer-supplier relationship is the relationship revealing the integration between economic and ethical interests. The relationships based on this concept can create trust in a business context (Gullett, et al., 2009).

There have been many studies discussing the trust yet it has not derived general agreement on how to conceptualize trust explicitly (Cvetkovich, 1999). Nonetheless, no one denied that confidence is a part of trust (Luhmann, 2000), and most of scholars agree that trust is closely related to individual confidence, because confidence was formed from the trust (Moorman, Zaltman, & Deshpande, 1992). Meanwhile, most studies did not mentioned definition of "trust" and "confidence" clearly. They merely measured the level of investor confidence without defining it explicitly (Burghardt & Riordan, 2008; Doran, Peterson, & Wright, 2010; Gates, Lowe, & Reckers, 2007; Lee & Shailer, 2008). On the other hand, particular studies attempted to distinguish between the concept of trust and confidence (Luhmann, 2000; Moorman, Deshpandé, & Zaltman, 1993). Trust was defined as an individual confidence or a person's willingness to depend on the exchange partner whom he has confidence (Moorman, et al., 1992) while confidence is defined as sense of faith in an act or sense of trust in an act (Stout, 2002). Because of the existence of disagreement in conceptualization of trust, its concept is commonly used interchangeably in particular in term of financial (Stout, 2002). In addition, concept of trust in interpersonal relations is to be distinguished by concept of confidence. However, for functional relationships, like political and economic relations, especially in the context of financial relations, the

concept of confidence is more needed than the concept of trust (Luhmann, 2000) in addition to be able to be used on a reciprocal basis as well (Perotti & Laeven, 2002). Therefore, this paper assumes that the concept of trust can be used for analyzing confidence. Likewise, if the term of trust is mentioned, it means that the confidence is being talked.

Trust or confidence requires risk that must be borne by decision makers (Chiles & McMackin, 1996) when they face a decision-making under uncertainty or risky conditions (Siegrist, Gutscher, & Earle, 2006). Trust or confidence is constructed on the basis of three dimensions namely cognitive, emotion, and behavior (Lewis & Weigert, 1985). In constructing individual trust, cognitive dimension will be used in the processes of distinguishing which person and institutions that can be trusted, cannot be trusted and who cannot be recognized to be trusted. In the same way, individuals would consider the cognitive reason that can be used as "evidence" to take risks in making choice to trust or not to the person or institution. The second dimension of constructing trust is emotional. It fit out the element of cognitive base. The second dimension of constructing trust is emotional fitting out cognitive content of trust (Johnson, 2010). The emotional base of trust comprises of emotional relation among individuals or groups that provide contribution to cognitive base for generating and sustaining trust. In contrast, Betrayal of an individual trust will evoke the emotional anger because of betrayal feelings. The emotional anger is not only raises indignation of the individuals who feel betrayed, but also can have devastating relationship between the two parties (Lewis & Weigert, 1985). The third dimension is behavioral. This dimension implies the desire of individual or group in making decisions considering the level of perceived risk (Johnson, 2010).

The basic concept of buyer-supplier relationship is the relationship revealing an integration between economic and ethical interests (Gullett, et al., 2009) leading to generate trust in a business context (Hosmer, 1995). Company as a supplier should absolutely be aware of how to generate relationship with buyer, because better relationship between supplier and buyer can generate sustainable relationships that can attain lower cost of capital, and ultimately can increase firm value. To maintain the sustainability of the buyer-supplier relationship, (Koulikoff-Sourviron & Harrison, 2006) suggested seven dimensions should be owned by the company. These dimensions are goals, information sharing, relationship structure, coordination

mechanisms, locus of decision making, top management commitment, and compatibility. In the context of investment decision, these dimensions should be reflected in corporate governance mechanisms as defined as “the ways in which suppliers of finance to corporations assure themselves for getting a return on their investments and fulfill other expectations” (Shleifer & Vishny, 1997). On the other hand, investor as a buyer entrusts their funds to corporate managers in order to obtain the benefits for both parties.

However, the interest between buyer and the supplier was in fact not necessarily the same so that it leads to the pressures and conflict of interest between the two parties (Moeller, 2006,).In the context of investment decision, this matter is commonly called as agency problems between corporate managers and controlling shareholders and outside investors. A series of corporate failures, which have abolished investors’ wealth, have compelled investor to more aware on the function of corporate governance mechanisms in particular internal corporate governance mechanisms serving to direct and control company on the track line of investor interest. Therefore, corporate governance mechanisms can be a device that balances the interests of both investors and corporate managers which in turn lead to increase investor confidence (Jesover & Kirkpatrick, 2005). If the company can boost investor confidence, it will increase corporate value and eventually the company will be able to keep sustainable relationship with their investors.

Empirical evidences revealed that investors took into account the elements of corporate governance mechanisms. Auditor, who serving as corporate control mechanisms and one of the element of corporate governance mechanisms, has been shown to has an impact on investor confidence. Auditor quality which is one of the elements of corporate governance mechanisms was deemed as a measure for effective or stronger corporate governance. Evidence in Zimbabwe Stock Exchange indicated that foreign investors considered the independence of audit committee showed by the positive association between foreign ownership and independent audit committees (Mangena & Tauringana, 2007). Meanwhile, auditor was also deemed can reduce earnings management (Carcello, Hollingsworth, Klein, & Neal, 2006). They found that the expertise of independent audit committee have higher role on the mitigation of earnings management. Boards and audit committees are also responsible to direct and monitor corporate managers to restrain corporate managers from managing firms'

reported earnings (Constantinos & Christos, 2010) so that likely corporate managers provide favorable earnings and accurate earnings' forecast (Karamanou & Vafeas, 2005). Supported findings was found by Karamanou & Vafeas (2005) who studied on Fortune 500 firms. They suggested that market reaction to the announcement of management forecast associated with board and audit committee characteristics. This evidence implied that investors look into boards and audit committees as a signal of the existence of monitoring effectiveness that can enhance the confidence of investors in investment decision making process.

The important role of improving corporate governance mechanisms has been much documented that led most investors, scholars and market participants agree that corporate governance can improve corporate monitoring mechanism to reduce agency problems (Huang, Chan, Huang, & Chang, 2011) leading to improved investor confidence. Previous evidences have revealed the linkage between corporate governance mechanisms and stock price. The case of Taiwan indicated that corporate governance has negative effect on stock price volatility (Huang, et al., 2011). Some other studies also found the relationship between corporate governance and the change of stock price including Chung, Liu, & Lee (2008) who suggested that governance index (G-index) negatively related with individual sentiment beta; Glushkov (2006) argued that security price was directly influenced by corporate governance. In addition, the change of corporate governance level was also proved have negative effect on the sensitivity of individual sentiment of a firm. Whereas, Dyreng, Mayew, & Williams (2009) showed that abnormal returns was negatively associated with corporate governance index. These results indicated that the change of corporate governance level play significant role on the variety of sentiment beta on stock returns. By view of those findings, it can be implied that investors highly concern with corporate governance in their investment decision making leading to influence stock price due to the change of demand in stock market. Therefore, corporate governance mechanisms are the most critical factor in determining the confidence of investor although there have been many factors considered can affect investors' confidence either from macroeconomic or microeconomic views. For example, from macro-economic point of view, investors confidence were related to interest rate, exchange rate (Bumgarner & Prime, 2000), societal and political issue (Anderson & Snow, 2003) (Anderson & Snow, 2003), country-specific risk (Li,

2003), demographic variables (Doran, et al., 2010), future consumption growth rate, real GDP, industrial production (Bansal & Shaliastovich, 2009). In the mean time, from micro-economic point of view, several factors associated with investors' confidence are price-dividend ratio (Bansal & Shaliastovich, 2009), board-related reforms (Lee & Shailer, 2008), internal audit report (Holt & DeZoort, 2009), transparency in financial reporting (El-Gazzar, 2006) corporate governance practice (Kim & Purnanandam, 2009) while other studies related investment decision with personal analysis and market price (Srivastava, 2005), as well as individual beliefs of his abilities to beat the market and the individual views of market efficiency (Doran, et al., 2010).

Moreover, the concept of buyer-supplier relationship demands corporate managers as well as other corporate insiders to take into account investors' desire towards investors' moral preferences in addition to wealth maximization as a form of ethical duties and perceived trustworthiness (Gullett, et al., 2009). Religiosity is one of six-factor ethical framework (Gullett, et al., 2009) which is a form of the psychological contract used for examining ethical duties and perceived trustworthiness between the two parties. In the context of Islamic investment, this psychological contract is manifested by the certification of Sharia owned by companies issuing Sharia compliant stocks in which listed in list of Sharia securities (DES). Sharia status is a means to convince investors on the conformity corporate activities with Islamic principles. As a result, this status can be a solution for investors, and should be able to rebuild even to enhance investor confidence in Shariah-compliant corporate. Evidence in Malaysia showed the positive influence of stock inclusion and inverse impact of stock deletion in list of halal stocks determined by Malaysian Syariah Advisory Council's towards stock return and trading volume of stocks (Bacha & Abdullah, 2001). This implied that investors were keen on the inclusion stocks in list of halal stocks. Investors formed market segmentation (Schleifer, 1986) in making investment decision process. In another words, they tend to choose stocks included in the specific group issued by reliable institutions including S & P 500 index, Nikkei 500 index, Dow Jones Islamic Index, Indonesia Sharia stock index. By investigating stocks included in S&P 500, Shleifer (1986) argued that the inclusion of stocks in S & P 500 index would make investors interested to choose these stocks which in turn would affect the stock price and stock volume. Other finding documented investors' reaction

to the inclusion of stocks either in S&P 500 or Fortune 500. These findings demonstrated that investors provide significant attentions to the inclusion of stock. Persuasive evidence of the influence of the inclusion of stock into certain group of shares is also shown by several studies such as significant change of trading volume due to the changes of stocks included in Nikkei 500 (Shinhua Liu, 2000), the significant abnormal returns because of the announcement stock's inclusion in a blue chip index in Central and Eastern Europe (Bankoviča & Praņevičs, 2007), significant effect of the inclusion of stocks in S&P Index on investors awareness and stock liquidity.

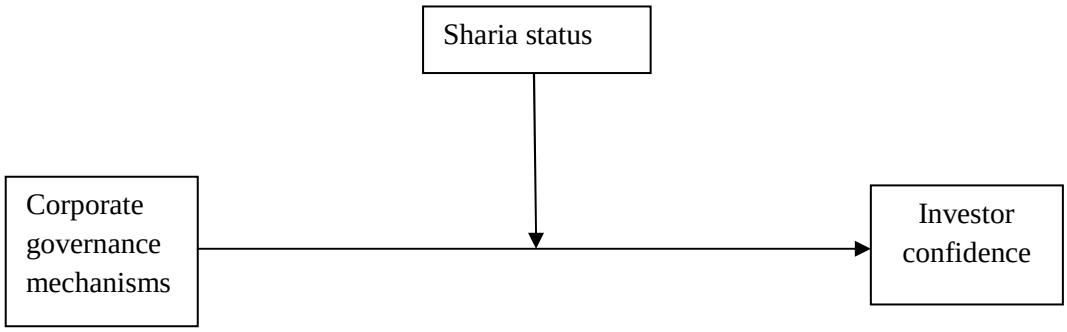
Regarding with corporate governance mechanisms, religion is deemed as external governance mechanism (Ni, 2011). Likewise, Sharia status which reflects the conformity of Islamic principles can be perceived as a religion variable that can serves as external governance mechanisms because of the Islamic screening criteria that function to monitor and control the conformity of Sharia compliant company to Islamic principles. These criteria are subject to protect investors on the unlawful investment (Daud & Salihu, 2012) as well as to protect investors' wealth or property Ali (2009). In addition, external mechanism is complementary to the internal mechanism to enhance the effectiveness of internal mechanisms for ensuring that the interests of stakeholders are satisfied (Grais & Pellegrini, 2006). Based on the above discussions, it is inferred that Sharia status is able to strengthen the relationship between corporate governance mechanisms and investor confidence. In addition, the status of Sharia can protect investors from high corporate risk due to the prohibition of usury and debt proportion requirements for Shariah-compliant companies (Chapra, 2004). Using these rationales, it is believed that investors will have more optimism in investment decision making process if companies have good internal governance mechanisms supported by external governance mechanisms as a system that are able to protect investors from unlawful investments and investors' wealth and property as well as to bridge investor interest in a business contract.

Despite little studies documenting about the role of internal corporate governance mechanisms and Sharia status on the level of investor confidence, several studies demonstrated the role of religion as external corporate governance mechanisms on economic behavior such as restrain distorted behavior of corporate managers in discretionary accruals deviations and less tax avoidance (Dyreng, et al., 2009),

reduced cost of capital ((Ni, 2011), accounting restatements and accounting risk (McGuire, S., T. Omer cited in Ni, 2011). In the term of individual economic decision making, it was argued that individuals chose particular religious groups and makes preference that in accordance with the principles of conduct prohibited by religious groups for avoiding punishment in the hereafter.

In consideration of the explanation above, the following framework is built (shown in figure 1). This framework reflects the critical role of internal corporate governance mechanisms strengthened by Sharia status as external corporate governance mechanisms for increasing investors' confidence.

Figure 1: theoretical framework, the role of corporate governance mechanisms and Sharia status on investor confidence



3.0 Proposition Development

The evidences of corporate fraud and failures which lead to global financial crisis have made investors highly require better corporate governance mechanisms to convince them in investment decision (McGee, 2008). Therefore, it is extremely critical for companies to implement corporate governance practices in order to enhance the credibility of company (Punani, 2012) either for conventional or sharia compliant companies.

There are four main elements of internal corporate governance mechanisms. First, board of directors, who responsible to keep the effectiveness of overall internal controls and financial reporting process, second, boards committee, who responsible to assist boards of director in undertaking supervision, internal control and communication with management and external auditor, and third, management of company who responsible to conduct company's operation to achieve company's goal

and to meet shareholders' interest (Li, Rupley, & Johnstone, 2007), fourth, shareholders activist, who is a shareholder trying to use his or her rights in a listed company to monitor and control the company. Several preceding studies have investigated the elements of corporate governance either respectively or simultaneously determining corporate value or corporate performance such as ownership structures (Huang, et al., 2011), board characteristics, CEO duality (Babatunde & Olaniran, 2009), and audit committee (Murhadi, 2009). Generally, these studies found significant impact of those elements of corporate governance mechanisms on corporate value. Because of the important role of corporate governance mechanisms in determining corporate performance or corporate value, investors may take into account corporate governance mechanisms as a means in assessing a company for investment.

Survey on 200 institutional investors from 31 countries showed that investors required higher corporate transparency (52%), more independent boards (44%) and greater effective boardroom (38%). They have enormous apprehension of corporate governance as well as financial performance in their investment decision (McKinsey & Company, 2002). Moreover, companies with enhanced performance have a tendency to perform sound corporate disclosure mechanisms as a way of signaling that they have higher firm performance potential (Chi, 2009). Persuade suggestion about the important role of corporate governance for increasing investors confidence was also provided by many scholars and market participants (Sappin & Sais, 2004). Several codes of conduct related with corporate governance reforms have been undertaken aiming to increase investor confidence such as the new edition of the UK Code of Corporate Governance. This code was issued in the expectation of welcoming market response so that would be able to assist investors to gain better return and lower risk (Bruner, 2011). These findings implied that investors took into account internal corporate governance mechanisms in their investment decision. Moreover, the important role of corporate governance in determining stock returns or stock price (Baek, Bandopadhyaya, & Du, 2005) and corporate value or corporate performance (Adams, Mansi, & Nishikawa, 2010) have strengthened empirical literatures regarding with the role of corporate governance mechanisms toward investor confidence. Based on those findings, therefore, it can be assumed that

corporate governance seems to remain a major factor taken into consideration for restoring investor confidence.

The underlying rules of Islamic investment is that an investment should be comply with Islamic principles that is every company activity does not contain the elements of Riba, Al-maysir, Al-Gharar, fraud, injustice, lies, and misinformation in obtaining halal profit (Osmani & Abdullah, 2009). Muslim Investors are not allowed to invest in stocks that are not comply with Islamic principles so that Muslim investors require to screen whether investing in a company is allowable based on Islamic principles (Derigs & Marzban, 2008). When Muslim investors make decisions to invest in stocks, they should consider whether the shares were in accordance with Islamic principles such as what types of products offered by a company, the practical application of Islamic principles in managing company's fund, and how the company distribute its funds to the Islamic community (Keigher & Bauer, 2000).

Sharia compliant securities listed in capital markets are the answer for solving the problem of Muslim investors, because the securities have been selected based on Islamic screening criteria (Donia & Marzban, 2009) and included in list of Sharia securities established by Sharia council cooperated with the policy maker of capital market (Donia & Marzban, 2009). In addition, Sharia compliant securities are evaluated periodically to assure that the company issuing Sharia compliant securities remain fulfilled Islamic principles in operating its activities (Obaidullah, 2008).

The securities included in the list of Sharia securities provide certainty and protection to investors who are going to conduct halal (Sharia compliant securities) investments. Additionally, securities included in the list of Sharia securities provide assurance and protection to Muslim investors who are going to make *halal* investment (Obaidullah, 2008). Therefore, the securities, which have the status of Sharia (halal investment) are intended to be able to provide positive signals regarding with the compliance of securities on Islamic principles leading to rebuild the confidence of investors especially Muslim investors in investment decision making process.

Sharia status can be a factor driving to reduce investors' risk in investment due to less corporate operating risk exposure which in turn will increase risk appetite of investors or investor confidence. The change of investor risk appetite or investor confidence has been universally presumed as critical determinant factor of asset price (Bekaert,

Hoerova, & Scheicher, 2009). As a result, the increase in investor confidence will impact on investor pricing which in turn will induce the reduction of vulnerability of stock price crash. This rationale is inspired from several studies including Kumar, Page, and Spalt (2009); Renneboog and Spaenjers (2008); Shu, Sulaeman, & Yeung (2010), Grullon, Kanatas, and Weston (2010), Dyreng, Mayew, and Williams (2009), and McGuire, Omer, and Sharp (2010). These studies sought to associate religiosity with corporate risk exposure and investment decisions.

Islamic screening criteria are the requirement that should be fulfilled by company issuing Sharia compliant stock to assure that the operation of company is comply with Islamic principles. These criteria aim to generate the betterment of Muslims and humanity in general (Billah, 2007). For example, one of the criteria is the prohibition of gharar and uncertainties in each corporate activity. This criterion are intended to prevent the unbridled pursuit for selfishness that generate a zero sum game that gains are always at the expense from one another. Other criterion is the restrictions on the proportion of debt financing and interest (Berrone, Surroca, & TribÃ³) bearing debt. This criterion is intended to protect investors from wealth losses because of the large proportion of corporate debt financing. Despite leveraged companies may increase their gains in booms, investors (shareholders) face high investment risk, because the companies will face a great losses in the downturn of business, and even went bankrupt that cause shareholders and creditors suffer. Whereas, equity financing based on Islamic principles can convince normal returns in booms and survival in slumps, and investors will be protected from corporate failures and suffering from loss of their wealth (Shaikh, 2010). For that reason, Sharia status reflecting the compliance with Islamic screening criteria prompt investors' judgment that companies issuing Sharia compliant stock provide high protection to the possibility of wealth expropriation from corporate managers and the controlling shareholders. Thus, Sharia status can be perceived to serve as external monitoring mechanisms that can strengthen the effect of internal monitoring mechanisms to solve the problem of certainty protection and ultimately can enhance investors' confidence in investments.

Preceding studies documented that investors concerned with Shari'ah compliant stock. Farida Rahmawati, 2002 cited in Sulfiantono (2009) found that performance of portfolio Shari'ah stock outperformed compared to conventional stock in terms of

return and risk. In the case of Islamic index, Hussein (2004) argued that there were significantly positive abnormal returns in the bull market period. Earlier evidence about ethics in conventional stock also supported the findings of Sharia stock about the influence of announcement related to corporate ethical affair also showed the significant effect to stock return and price. Companies included in List of Islamic securities are considered to be ethical stocks, because they have fulfilled Islamic screening criteria. The Shariah-compliant companies, as a result, are deemed to be ethical companies satisfying Islamic principles. Although studies investigating the impact of Sharia status are still in limited numbers, studies in conventional stocks related to corporate ethics have ever been done. By using market model approach, Klassen and McLaughlin (1996) argued that the announcements of environmental event either they are negative or positive has a significant effect to abnormal returns of companies stocks. Related studies from conventional perspective have documented as well. Generally, these study indicated that market concerned about the information of corporate ethics. Gunthorpe (1997) studied the impact of illegal-corporate activity towards stock prices by using 69 US corporations that engaged in illegal activities. His finding demonstrated that there was statistically significant effect of the announcing of unethical corporate activities toward stock prices. In terms of risk, several studies illustrate that corporate activities related to ethical operations connected with risk and stock price. Feldman, Soyka, & Ameer, (1997) examined the improvement of both environmental management system and environmental performance have an effect on reducing companies' perceived risk in the market place as well as increasing their stock price. The examination about association between varieties of ethical screens on portfolio performance has been conducted by Diltz (1995). His result proved that there was positive impact of military exclusion screen and environmental behavior screen on performance conversely the negative impact was showed in the relationship between the provision of a family-related benefits screen and portfolio performance.

Based on cautious theoretical and empirical approaches formerly explained, it can be assumed that Sharia status is able to be function for overseeing the conformity of companies' activities with Sharia principles. Sharia status can serve as an external corporate governance mechanism as well as serve as a complement of internal corporate governance mechanisms to ensure investors' protection. Subsequently, this

will make investors more confidence on companies with Sharia status. In other words, it can be expected that investor confidence will be higher, when companies have Sharia status (included in List of Sharia Effect). Thereby, this study proposes the following proposition:

Proposition: *The increase of internal corporate governance mechanisms quality will lead to greater investor confidence, especially when the companies included in List of Sharia Compliant Securities (Companies with Sharia Status)*

4.0 Conclusion:

The amazing growth of Islamic investments has attracted many countries to pay more attention to extend Islamic investment as an alternative investment. In addition, the slump of investor confidence due to a series of corporate scandal and failures has resulted investment community more recognize the importance of corporate governance and ethical business to keep investor protections.

Although many studies have discussed the important role of corporate governance and ethical business in relation to investor behavior, studies discussing investor behavior related with investor confidence is still highly limited in number because of the difficulty of conceptualizing the definition of confidence itself. This paper finds that the concept of confidence is closely related with the concept of trust integrating the cognitive and emotional processes that subsequently form human behavior reflecting the actions of perception of trustworthiness. In term of investment decision, these dimensions (cognitive, emotional and behavior) are the basic characters of a person in investment decision making.

Confidence is a part of trust. Therefore, by understanding and recognizing the dimensions of trust building, investor confidence can be built by focusing on improving the quality of corporate governance mechanisms and preserving the inclusion in List of Sharia Compliant Securities (the status of Sharia) that can strengthen investor confidence in the integrity and capability of the company in maintaining trustworthiness of corporations in complying with Islamic principles as well as in protecting investor wealth.

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A REVIEW OF ISLAMIC BANKING PRODUCTS OFFERED BY AGRO BANK BETWEEN 2008 AND 2012

Dr. Muhammad Ridhwan Bin Ab. Aziz[1]

Abstract

As an organized religion, Islam goes into great detail on the subject of agriculture, which plays a very significance role in the daily life of a Muslim. The Islamic teaching puts a very high value on efforts to consolidate the agricultural industry. Nevertheless, with regard of Islamic financing facilities for agro entrepreneur, Agro Bank is considered as the champion for the rapid development of agricultural activities in this country. Agro Bank is a Government Linked Company (GLC) that functions under the supervision of the Ministry of Finance, Ministry of Agriculture and Agro-based Industry and the Central Bank of Malaysia. Agro Bank is unique because it focuses mainly on financing and banking in agricultural areas. Thus, the objective of this paper is to explore and compare the Islamic banking products and services offered by the bank between 2008 and 2012 in order to analyze the differences, development and improvement of Islamic banking products and services offered by the bank within the time frame, as the current aims of the bank is to be a full Islamic bank by 2015. The methodology of research in this paper is through document analysis, interviews with relevant Agro Banks' officers and observation from pamphlets and website of the bank. The finding shows that Agro Bank needs to improve in many areas in order to attain the status of a full Islamic bank by the year 2015.

Keywords: Agro Bank, Islamic Banking Products, Agro Entrepreneur

1. Introduction

Production function in the Islamic economics has been regulated by the concept of livelihood (*al-Rizq*) as well as lawful (*halal*) and unlawful (*haram*) sources of earnings. The term *al-Rizq* is applied to connote livelihoods and means of further production,

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which has been intimated by the Prophet Muhammad (*s.a.w.*) and predetermined by Allah (*s.w.t.*).

Agriculture has been an important source of food production for mankind since ancient times and therefore, should not be neglected. Earnings through agriculture and becomes agro entrepreneurship is regarded honorable endeavors from the Islamic spirit.

The Prophet Muhammad (*s.a.w.*) was very mindful about the economic utilization of resources, with the concept that all the resources are a gift from God containing the suggestion that they should be utilized carefully. As such, the Holy Prophet (*s.a.w.*) has laid emphasis on intensive development of human resources, and assigned a high value on industry, efficiency and labor[2].

Parasitic dependence on others, idleness or beggary are discouraged by Islam. People are encouraged to put in hard work and earn livelihoods instead of wasting their energy in idle pursuits. It is in this spirit that pasttimes, which do not add any utilities have been disliked by the *shariah*[3].

In his prayer, Prophet Muhammad (*s.a.w.*) asked Allah (*s.w.t.*) to refuge himself from hunger, poverty and destitution. The Prophet (*s.a.w.*) said in the following *hadith*:

> "*Allah, I seek thy refuge from hunger for it is the evil bed-fellow*"[4].

> "*Allah, I seek thy refuge against poverty, and I seek thy refuge from paucity and humiliation, and I seek thy refuge that I do wrong or wrong is done to me*"[5].

[2] Muhammad Akram Khan (1992), *Economic Teachings of Prophet Muhammad*, Delhi: Oriental Publications,p. 214.

[3] *Ibid*.

[4] *Sunan al-Nasa'i* (1999), Riyad: Dar al-Salam, "Kitab al-Isti'adhah", Hadith No:5471, p.744; *Sunan Abi Daud* (1999), Riyad: Dar al-Salam, "Kitab al-Witr", Hadith No: 1547, p.228.

Islamic law has therefore prohibited begging, with an exception for a individuals in grave difficulties. The attitude of Islam towards man's position in the world is that Allah (*s.w.t.*) has made the earth for the benefit of man, to whom He has given control over. It is the duty of man to profit from this favor and to exert himself to seek Allah's bounties throughout the earth[6].

Allah (*s.w.t.)* says to the effect:

> "*It is He who has made the earth manageable for you, so traverse ye through its tracts and enjoy of the sustenance which He furnishes, but unto Him is the Resurrection*".
>
> Surah al-Mulk (67):15.

It can be inferred from the above verse that Allah has created the earth full with various kind of sustenance and sources for earnings, water, minerals, and therefore provided many things for man to cultivate and do business with, so that they may enjoy all sustenance for their benefit. As such, man has managed to make paths through deserts and over mountains, through rivers and seas by means of ships, through the air by means of airways, and bridges and tunnels and other means of communication[7].

Man has only been able to do so because Allah (*s.w.t.*) has given him the necessary intelligence and has made the earth tractable to that intelligence. Therefore, man should

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[5] This *hadith* was narrated by Abu Hurairah. See *Sunan al-Nasa'i*, *op.cit.*, "Kitab al-Isti'adhah", Hadith No: 5464, p.743; *Sunan Abi Daud*, *op.cit.*, "Kitab al-Witr", Hadith No: 1544, p.227.

[6] Yusuf al-Qaradawi, *The Lawful And The Prohibited In Islam*. Kamal El-Helbawy *et.al*. (trans.), (1960), Indinapolis: American Trust Publications, p.125; M. Umer Chapra (1992), *Islam and the Economic Challenge*, Leicester: The Islamic Foundation, p.203.

[7] Sayyid Qutub (1986), *Fi Zilal al-Qur´an*, Beirut: Dar al-Shuruf, Vol.6, p.3637; Ahmad Mustafa al-Maraghi (1998), *Tafsir al-Maraghi*, Beirut: Dar al-Kutub al-Ilmiyyah, Vol. 28, 29,30, p.154; *The Holy Qur-an And The Translation Of Its Meanings and Commentary*, Madinah: King Fahd Holy Qur-an Printing Complex, p.1786.

try their best to benefit for all sustenance provided to them and be thankful to Allah, the true creator for everything[8].

One of many ways to obtain benefits of all sustenance provided to mankind is through the agriculture initiative. From the general perception it is clear that agricultural projects seem to be less viable than any initiative in other sectors. While it is admitted that the risks in agricultural investment are higher due to various factors, these risks are very rare in respect to the effect weather and natural disasters on the production of primary produce.

With the introduction of high-technology farming and rapid advancement in the field of bio-technology, the impact weather on agricultural production has been minimized. Nowadays, many opportunities have been given in order to assist agro entrepreneurs not only to finance their projects but also to expand them in a larger capacity, especially by the local Islamic Banks.

2. Background of Agro Bank

Agro Bank is an institution which provides financial and banking facilities. Agrobank gives utmost priority to the needs of customers by providing attractive products and services such as saving activities, banking services, loan facilities, insurance coverage and advisory services.

As it trusted by the government, Agro Bank is likely to be a government-linked-company (GLC) under the Minister of Finance Incorporated (MFI). The bank's financing of the agricultural sector is driven by a policy set forth by the Ministry of Agriculture and Agro-based Industries.

[8] *Ibid*.

Agro Bank is a continuity of the former Bank Pertanian Malaysia, and they already has 40 years of experience in agricultural banking sector and outstanding track record in shaping and developing successful entrepreneurs. Agro Bank is highly in confident of providing the best services to the community by it's wide network of branches throughout Malaysia. The vision of this bank is to be a leading bank with a focus on agriculture. The bank will provide a full range of financial services in a market and client driven with specific target groups such as micro, small and medium entrepreneurs and private individuals[9].

The objectives of the bank are to promote Malaysia's agricultural development, to co-ordinate and run the grant of credit from public funds for agricultural purposes by the various persons or bodies whether incorporate or unincorporated, to afford loans, advances and other credit facilities for the development of agriculture sector and agriculture related business, to mobilize savings with particular regard to the agricultural sector and to accept savings and time deposits, to encourage the well-being of the agricultural community and to carry on the general business and progressive financial services institution for the needs of its customers[10].

3. Islamic Banking Products or Agro Entrepreneur In 2008

The facilities available for financing the agriculture sector, provided by Agro Bank, can be classified into two categories which are namely commercial funds and special funds established by government to provide funds for agriculture sector (that are channeled through Agro Bank). The objective of providing these financing facilities is to give working capital for a new agriculture initiatives and expanding existing agro project[11].

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[9] Agro Bank, http://www.agrobank.com.my, 15th December 2008 and 23rd July 2012.

[10] *Ibid.*

[11] Abd. Rahaman Rasid, "Peluang Pembiayaan Dalam Sektor Makanan", http://banktani.tripod.com/arar.htm, 9th November 2008; "Financing of Agriculture", http://banktani.tripod.com/gm5.htm, 9th November 2008; Agro Bank, http://www.agrobank.com.my, 15th December 2008; *Agro Bank Pamphlet* (2008), "Financing Facilities".

From time to time, the Malaysia government has established schemes and provided funds for financing agriculture sector. These funds can be considered as incentives to promote investments and give priority to agricultural sector. These incentives usually are taken in the form of low cost of financing, longer duration of financing period and higher margin of financing, with these schemes open to all institutions and companies incorporated in Malaysia (as long as the ownership by Malaysians is more than 50%), as well as to all Malaysian citizens[12].

Through these special funds, Agro Bank will continue its social responsibility to finance agriculture sector, as has been assigned by the government through Ministry of Agriculture and Agro-Based Industry in achieving the related policies under Nineth Malaysia Plan (RMK-9)[13]. The examples of funds provided by the Agro Bank are as follows:

[12] Dato' Mohd. Rosli Abd. Aziz, "Financing of Food and Agricultural Production", http://banktani.tripod.com/gm3.htm, 9th November 2008; Dato' Mohd. Rosli Abd. Aziz, "Peranan Bank Pertanian Dalam Memajukan Sektor Pertanian Negara", http://banktani.tripod.com/gm1.htm, 9th November 2008; "Financing of Agriculture", http://banktani.tripod.com/gm5.htm, 9th November 2008; Agro Bank, http://www.agrobank.com.my, 15th December 2008.

[13] Habsah Dinin, "Skim Pembiayaan dipelbagai". *Berita Harian*, August 8, 2008, 30.

Table 1.1: Agro Bank: Fund for Food (3F Loan)

Features:	**Description:**
Objective:	•To promote investment in the food production activities at the reasonable cost. •To promote primary food production (including sea-food, animal husbandry, vegetables and fruits). •To promote the efficient distribution of food and food products.
Eligibility:	•Malaysia citizens residing in Malaysia. •Malaysian owned institutions and companies (at least with 51% ownership).
Financing Limit:	•RM10,000-RM10 million.
Maximum Financing:	•90% of project cost.
Financing Period:	•Up to 10 years.
Shariah Concept Applied:	•*Bay' Bithaman Ajil*.
Collateral:	•Fully secured.
Projects Eligible for Financing:	•Food production, processing and marketing (crops, livestocks and fishery). •Eligible items for crops are vegetables, tea, paddy, roselle, maize, tapioca, production of seeds and planting equipment for food crops and fruits such as banana, mango, guava, watermelon, papaya, pineapple, sugar cane, coffee, cocoa and etc.

Source: Suhaimi Bin Yacob, Executive 2, Financing Division, Agro Bank, Jalan Padang Garong, Kota Bharu, Kelantan. Interview carried out on 14th December 2008 at 11.15 a.m. to 11.50 a.m.; *Agro Bank Pamphlet* (2008), "Financing Facilities"; Agro Bank, http://www.agrobank.com.my, 15th December 2008.

Table 1.2: Agro Bank: Bumiputera Industrial and Business Community Scheme (MPPB).

Features:	Description:
Objective:	•To encourage and develop Bumiputera Entrepreneurs in the agriculture sector. •To provide fixed capital and working capital to Bumiputera Enterprise in developing agriculture project or agro based businesses.
Eligibility:	•Companies with paid up capital exceeding RM100,000. •For farmer and fishermen institutions, they should have equity more than RM100,000. •Priority is given to the individual entrepreneurs who are expanding their businesses.
Financing Limit:	•RM10,0000-RM5 million.
Maximum Financing:	•90% of project cost.
Financing Period:	•Not exceeding 10 years or up to 23rd October 2014.
Shariah Concept Applied:	•*Bay' Bithaman Ajil*.
Collateral:	•Fully secured.
Projects Eligible for Financing:	•Commercial agriculture sector, sectors of agriculture based manufacturing or processing and also agriculture services.

Source: Suhaimi Bin Yacob, Executive 2, Financing Division, Agro Bank, Jalan Padang Garong, Kota Bharu, Kelantan. Interview carried out on 14th December 2008 at 11.15 a.m. to 11.50 a.m.; *Agro Bank Pamphlet* (2008), "Financing Facilities"; Agro Bank, http://www.agrobank.com.my, 15th December 2008.

Table 1.3: Agro Bank: Commercial Agriculture Graduate Entrepreneur Scheme (SUTKS).

Features:	Description:
Objective:	•To reduce unemployment rate among graduates and to produce commercial farming graduates.
Eligibility:	•Unemployed graduates.
Financing Limit:	•RM50,000 and not exceeding RM100,000.
Maximum Financing:	•90% of project cost.
Financing Period:	•Up to 6 years.
Shariah Concept Applied:	•*Bay' Bithaman Ajil*.
Collateral:	•Case by case.
Projects Eligible for Financing:	•All upstream and downstream commercial agricultural production activities (short and medium term or 1 to 5 years projects).

Source: Suhaimi Bin Yacob, Executive 2, Financing Division, Agro Bank, Jalan Padang Garong, Kota Bharu, Kelantan. Interview carried out on 14th December 2008 at 11.15 a.m. to 11.50 a.m.; *Agro Bank Pamphlet* (2008), "Financing Facilities"; Agro Bank, http://www.agrobank.com.my, 15th December 2008.

Table 1.4: Agro Bank: Youth Farmer's Scheme-i

Features:	Description:
Objective:	•Assisting youth in self improvement activities related to the agriculture and agro-based industry.
Eligibility:	•Malaysia citizens. •Individual or group of individuals.
Financing Limit:	•RM15,000-RM50,000.
Maximum Financing:	•90% of project cost.
Financing Period:	•Up to 7 years.
Shariah Concept Applied:	•*Bay' Bithaman Ajil*.
Collateral:	•No collateral and guarantor are required.
Projects Eligible for Financing:	•All upstream and downstream agriculture and agro-based industry projects.

Source: Suhaimi Bin Yacob, Executive 2, Financing Division, Agro Bank, Jalan Padang Garong, Kota Bharu, Kelantan. Interview carried out on 14th December 2008 at 11.15 a.m. to 11.50 a.m.; *Agro Bank Pamphlet* (2008), "Financing Facilities"; Agro Bank, http://www.agrobank.com.my, 15th December 2008.

4. Islamic Banking Products for Agro Entrepreneur In 2012

Following are some of the examples of current financing facilities offered by the Agro Bank until July 2012:

Table 1.5: The Agriculture Financing Provided by Agro Bank Until 2012

Fund For Food (3F Loan)	
Financing Objectives	~ To increase the National food production. ~ To reduce food imports.
Eligibility Sector	~ Commercial agricultural sector (crop, livestock, fishery).
Eligibility for Financing	~ Production of commodities ~ Upstream and downstream projects in food producing industries ~ 50% financing of factory acquisition / construction. ~ Maximum financing of land acquisition lease up to 30%.
Financing Limit	~ Up to 90% of project cost ~ Ranges from RM 10,000 to RM 10 million
Eligibility of Applicant	~ Malaysians ~ Malaysian-owned companies
Return of Investment/interest	~ 3.75 % per year for RM5 million
Financing Period	~ 8 years
Security/Guarantee	~ Full security/guarantee as follows: land for the project, buildings, fixed deposit, certificates, share certificates and other security acceptable to the bank.
Bumiputera Industrial and Business Community Scheme (MPPB)	
Financing Objective	~ To promote and develop Bumiputera entrepreneurs in agriculture sector, particularly in the production of food crop, processing and marketing of agriculture products except for rubber, oil palm, tobacco, cocoa, pepper, forestry, drinks and vegetable oil.
Eligibility Sector	~ Commercial agricultural sector (crop, livestock, fishery). ~ Agricultural sectors of manufacturing/processing food, feed, fish, food and chemicals.
Eligibility For Financing	~ 20% financing of land acquisition/lease.
Financing Limit	~ Up to 90% of project cost. ~ Ranges from RM10, 000 to RM5 million.
Eligibility Of Applicant	~ Individual/group of entrepreneurs/ Bumiputra institution. ~ Bumiputra company with 70% Bumiputra equity
Return of Investment/interest	~ 3.75% per annum
Financing Period	~ Up to 120 months (10 years).

Security/Guarantee	~ Full security/guarantee as follows: land for the project, buildings, fixed deposit certificates, share certificates and other security acceptable to the bank.
Youth Farmer's Scheme-i (SBT-i)	
Financing Objectives	~ Provide financing to assist youth to embark and expand business venture on full time basis.
Eligibility Sector	~ Livestock including bee farming ~ Fishery, farming service ~ Short-term crop
Eligibility for Financing	~ Written recommendation and support from the Youth and Sports Ministry ~ Fixed and working capital
Financing Limit	~ Loan amount: RM5, 000 – RM15, 000 (no guarantor) ~ Loan amount RM15, 001 – RM50, 000 (guarantor with fixed income of at least RM800 per month)
Eligibility of Applicant	~ Individual Malaysian citizen aged between 18-40 years old ~ Must register online as an applicant through the portal of ' Majlis Penggalakan Ekonomi Belia (MPEB)' at www.mpeb.gov.my ~ Pass the screening test conducted by Ministry of Youth and Sport ~ No adverse record with financial institutions.
Financing Period	~ Maximum 7 years
Security/Guarantee	~ Full security/guarantee acceptable by Agrobank are, fixed deposit, fixed assets (land/building) and others
Commercial Agriculture Graduate Entrepreneur Scheme (SUTKS)	
Financing Objectives	~ To encourage graduate to embark in the commercial agriculture sector as an alternative career development.

Eligibility sector	~ Food production and processing involving crops, livestock and fishery ~ Upstream products for food production for example fish fry and feed meal ~ Projects with quick returns are encouraged
Eligibility for Financing	~ Working capital and expansion in productive capacity e.g. purchase of fixed asset
Financing Limit	**~ Maximum financing** RM500,000
Eligibility of Applicant	~ Unemployed graduates with keen interest to develop a full time career in agriculture sector.
Return of Investment/interest	~ 3% per annum
Financing Period	~ 6 years
Security/Guarantee	~ Full security/guarantee acceptable by Agrobank.

Source: Norhidayu Binti Mohamed Nawai, Executive, Agro Bank, Leboh Pasar Besar, Kuala Lumpur. Interview carried out on 9th April 2012 at 11.15 a.m. to 11.50 a.m.; Agro Bank, http://www.agrobank.com.my, 23rd July 2012.

5. Analysis of Islamic Banking Products Between 2008 and 2012

From the above table, we can conclude that most of the contract uses in the financing scheme is *Bay' Bithaman Ajil*. *Bay'* refers to "an opposite word for buying namely selling"[14]. *Al-Bay'* from the *fiqh* terminology can be defined as "the exchanging of property with property based on definite way"[15]. *Thaman* means "price or the value of certain goods in a transaction"[16]. And, *Ajil* refers to "defer or delay"[17].

[14] Ibn Manzur (2003), *Lisan al-Arab*, Riyad: Dar al-Alim al-Kutub, Vol.5, p.371.

[15] This view was given by Hanafi Scholars. See al-Kasani (1998), *Bada'i' al-Sana'i'*, Beirut: Dar Ihya' al-Turath al-Arabi, Vol.5, p.133; Ibn al-Hummam (1995), *Fath al-Qadir*, Beirut: Dar al-Kutub al-Ilmiyyah, Vol.5, p.73.

[16] Ibn Manzur, *op.cit*., Vol.8, p.233.

[17] *Ibid*., Vol.7, p.10.

Therefore, *Bay' Bithaman Ajil* (*BBA*) can be defined in many ways. It can be defined as the sale of goods on a deferred payment basis at a price which includes a profit margin agreed by both parties[18]. *BBA* also refers to a sale agreement between the owner of the goods and the buyer, whereby the buyer will defer the payment of the goods to a specific period of time or will pay by installment[19].

According to Dr. Ma'sum Billah, *BBA* refers to the delivery of a product is taken on the spot but the delivery of the payment is delayed for an agreed period, whereby payment can be made in a lump sum or in installments, provided there is no extra charge for the delay[20].

In terms of a mode of financing, *BBA* operates when the bank initially determines the requirements of the customer in relation to the duration and manner of repayment. The bank then purchases the asset and subsequently sells the relevant asset to the customer at the agreed price, which comprises the actual cost of the asset to the bank and the bank's margin of profit that varies according to the value and type of the project[21].

Based on the explanation above, the contract of *BBA* is a form of Islamic financing with respect of selling and delivery of asset or property to the buyer at the time of contract (on the spot), whereas the payment for the price plus the profit margin will be delivered in the future time by installment[22].

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[18] Bank Kerjasama Rakyat Malaysia Berhad, http://bankrakyat.skali.my/web/guest/syariahbankingconcept, 21st December 2008; Meezan Bank, http://www.meezanbank.com/glossaryB.aspx, 21st December 2008.

[19] Sobri Salamon (1989), *Ekonomi Islam: Pengenalan, Sistem dan Kemungkinan*, Selangor: Ar-Rahmaniah, p.38. See also Nor Mohamed Yakcop (1996), *Teori, Amalan Dan Prospek Sistem Kewangan Islam Di Malaysia*, Kuala Lumpur: Utusan Publications & Distributors Sdn. Bhd., p.80.

[20] Dr. Ma'sum Billah, http://www.applied-islamicfinance.com/sp_finance_3.htm, 21st December 2008.

[21] Bank Islam Malaysia Berhad (1994), *Islamic Banking Practice from the Practitioners' Perspective*, Kuala Lumpur: BIMB, p.72.

[22] Muhammad Uqlah Ibrahim (1987), *Hukm Bay' al-Taqsit fi al-Shari'ah wa al-Qanun*, Jordan: Maktabah al-Risalah al-Hadithah, pp.12-13.

The validity of *BBA* contract is obvious since it uses the sale concept as mentioned in the *fiqh mu'amalat*. Through this kind of contract, the customer will not borrowing any money from the bank, instead the bank will buy the desired asset by the customer and the bank will sell it back to the customer at mark-up sales price. The relationship between customer and bank is similar to the relationship between buyer and seller in the sale contract and not as in loan contract, whereby the connection is between borrower and lender as being practiced by the conventional bank[23].

According to Associate Profesor Dr. Noor Naemah Bt. Abdul Rahman, the contract of *BBA* and *Bay' al-Innah* is lawful since there is a current need to the society as a mode of Islamic financing in order to avoid the prohibition of *riba* in Islam as a temporary means before a better alternative of financing is found[24].

This view is also shared by Associate Professor Datin Dr. Paizah Binti Ismail[25]. She regards that the contract of *BBA* and *Bay' al-Innah* is an alternative towards conventional loan system which is based on interest or *riba*. This concept should be accepted in order to avoid the element of *riba*, which is clearly against the *Shariah* law. She also added that Agro Bank uses the contract of *BBA* and *Bay' al-Innah* intensively for financing agro projects based on the public interest or general good of the society in this country on the

[23] Mustafa al-Khinn *et.al., op.cit*., Vol.3, pp.37-38; Mohammad Hashim Kamali (2002), *Islamic Commercial Law: An Analysis of Futures and Options*, Petaling Jaya: Ilmiah Publishers, pp.132-133; Norazlina Abd. Wahab (2005), "Al-Bay' Bithaman Ajil: Suatu Alternatif Kepada Pinjaman Berasaskan Riba", in Abdullah Alwi Hj. Hassan *et.al*. (eds.), *Teori dan Aplikasi Kontemporari Sistem Ekonomi Islam di Malaysia*, Kuala Lumpur: Utusan Publications & Distributors Sdn. Bhd., pp.90-91.

[24] Associate Professor Dr. Noor Naemah Bt. Abdul Rahman is a lecturer at Department of Fiqh and Usul, Academy of Islamic Studies, University of Malaya, Kuala Lumpur. Her expertise is in principles of Islamic jurisprudence, *fatwÉ* and also in contemporary *fiqh*. She is also a member of Shariah Committee for AMBANK Berhad since 2007. This interview was conducted on 12th March 2009 at 11.00 a.m. to 11.35 a.m. at her office.

[25] Associate Professor Datin Dr. Paizah Binti Ismail is currently teaches at Department of Islamic Law, Ahmad Ibrahim Kulliyyah of Laws, International Islamic University Malaysia, Gombak. Her expertise is in the field of *fiqh* and *uÎËl* as well as in Islamic transactions. She is also a Shariah Advisor for Agro Bank since 2005.

basis of current reality (*Waqi'*). *Shariah* experts cannot be too rigid in validated a *shariah* contract in the rapid growing and expanding of financial sector nowadays[26].

In terms of products offered by the Agro bank, in comparison between 2008 and 2012, the products are mainly the same expect for some aspects which have been adjusted in order to attract the customer such as the current profit rate for Fund for Food (3 F) financing is 3.75%, whereby previously was at 4%. To date, no new or latest product offered by the Agro Bank to expand the agriculture initiatives by the local Malaysian farmers and agro entrepreneurs.

6. Conclusion

This paper has covered aspects relating to the financing facilities provided by Agro Bank in Malaysia for assisting agro entrepreneurs in their pursuit of agro projects. In the being of this paper, there was a discussion of some of many financing facilities offered by the Agro Bank for the agricultural initiatives. Although this paper did not touch on all of the financing facilities provided by the bank but, it can be concluded that there are various aspect that need to be altered in order to show the attractiveness of financing facilities for agriculture in Islam. Agro Bank for instance, needs to introduce different concept of *shariah* contracts in the bank's future products rather than only focus on *Bay' Bithaman Ajil* and *Bay' al-Innah*.

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[26] Interviewed with Associate Professor Datin Dr. Paizah Binti Ismail on 26th March 2009 at 10.10 a.m. to 10.45 a.m. at her office in Gombak.

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Suhaimi Bin Yacob, Executive 2, Financing Division, Agro Bank, Jalan Padang Garong, Kota Bharu, Kelantan. Interview carried out on 14th December 2008 at 11.15 a.m. to 11.50 a.m.

AN ANALYSIS OF BANKRUPTCY COST AMONG ISLAMIC BANKS USING ALTMAN Z – SCORE: A CASE STUDY OF MALAYSIA

Hassanudin Bin Mohd Thas Thaker[1]
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Abstract

Islamic banking and finance has made a significant inroad in the international financial markets that have an achieved growing global awareness. The development of Islamic banking and finance is spread all over the world especially in Muslim country. By looking at the Islamic financial infrastructure, the development of this industry in Malaysia is really robust and fast growing. The market has highly diversified players with the Islamic banks, investment banks, takaful companies, development financial institutions, savings institutions, fund management companies, stock brokers and unit trusts. Since there is strong support from government and people response, Malaysia will continue to be a major contributor to the development of Islamic Banks. Therefore, to see how stable is this industry in Malaysia, this paper aims to analyze the bankruptcy cost among Islamic Banks in Malaysia for the period of 2007 until 2010. Z-Score analysis has been employed to measure the bankruptcy cost among Islamic Banks in Malaysia.

Keywords: Islamic Banking, Z –Score

1. 0 INTRODUCTION

The Islamic banking and finance (IBF) sector has experienced a substantial and extraordinary growth in recent years: growing at a rate of 10-15% per year. Today, more than 500 IBF institutions are operating worldwide, which are claimed to manage assets which are worth not less than $1.2 trillion, while the assets held in IBF institutions were only less than $10 billion in 1985. In Malaysia the IBF institutions

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are planned to capture the 25% of the market share, in terms of assets owned, by 2012, while it is expected that Islamic finance will be the mainstream finance in the Gulf region in the next decade. [3]

Such immense growth has brought Islamic finance to the attention of the international banking and finance community, prompting the major banks to set up Islamic financial windows to take advantage of demand for Shariah compliant finance.

The financial system plays a critical role in the economy. It enables the financial intermediation process which facilitates the flow of funds between savers and borrowers, thus ensuring that financial resources are allocated efficiently towards promoting economic growth and development.

Financial stability describes the condition where the financial intermediation process functions smoothly and there is confidence in the operation of key financial institutions and markets within the economy[4]. Generally, an organizational financial stability relates to the risk effects, capital strength, institution size, management skill applied, experience gained and efficiency of human resources applied.

These papers discuss the venerable Altman Z score model for assessing the distress of selected Islamic banks operating in Malaysia. The motive would be because the financial system plays a critical role in the economy. It enables the financial intermediation process which facilitates the flow of funds between savers and borrowers (in banking system), thus ensuring that financial resources are allocated efficiently towards promoting economic growth and development.

From about 1985 onwards, the Z-scores gained wide acceptance by auditors, management accountants, courts, and database systems used for loan evaluation (Eidleman). The formula's approach has been used in a variety of contexts and countries, although it was designed originally for publicly held manufacturing companies with assets of more than $1 million. Later variations by Altman were

[3] Dr. Mehmet Asutay, B.A.; M.Sc.; Pg. Dip.; MA.; Ph.D, (DCIEF, University of Durham, United Kingdom)

[4] *Overview of Islamic Banking in Malaysia (Islamic Banking Industry)* :Central Bank of Malaysia, Annual Banking Statistic 2007

designed to be applicable to privately held companies (the Altman Z'-Score) and non-manufacturing companies (the Altman Z"-Score)[5].

1.1 Objective of research

This paper focused on determining the financial condition of a group of listed Islamic banks in the main board of Bursa Malaysia and categorizing the studied banking institutions into financially distressed, expansionary and non-distressed categories.

- The research aimed to identify **financial liquidity position** among Islamic Banking and Finance institutes in Malaysia.
- Research objective is to illustrate **the issue of financial liquidity** position among Islamic Banking and Finance institutes in Malaysia.

2. 0 LITERATURE REVIEW

The financial stability is a very crucial focus in any reputable banks which act as important institutions in assist to the growth of a country's economy. After the period of global crisis hit in the mid of 2007, it's become more prominent in monitoring the financial system stability in the context of Islamic banking sector.

One basic difference in the operation is that the conventional bank intermediation is generally based on debt and allow the "transfer of risk", while Islamic banks are more likely asset-based and focused on "risk sharing" (Hasan and Dridi, 2010). According to Solé (2007), understanding the Islamic banking from the perspective of financial stability is important, at least for two reasons. First, Islamic banks may become systemically relevant as they grow and increasingly interact with conventional banks that are systemically important. Second, the lack of Islamic instruments for hedging results in the concentration risks in a small number of institutions.

Point to note that the financial size of the banks do affect the financial stability as proved according to the study made by Čihák and Hesse (2008). Research found that (i) small Islamic banks tend to be financially stronger than small commercial banks;

[5] *The Use of Credit Scoring Modules and the Importance of a Credit Culture* by Dr. Edward I Altman, Stern School of Business, New York University

(ii) large commercial banks tend to be financially stronger than large Islamic banks; and (iii) small Islamic banks tend to be financially stronger than large Islamic banks, which may reflect challenges of credit risk management in large Islamic banks.

According to Imam and Kpodar (2010), the finding of Čihák and Hesse (2008) which states that Islamic banks tend to be less stable when operating at large scale shows that under certain conditions, the growing Islamic banking sector may not be beneficial for economic growth because it can weaken financial stability, especially in countries with lack of prudential regulations. Moreover, Imam and Kpodar (2010) argue that Islamic banking is more considered as a complement to the existing conventional banking, and thereby help diversify the systemic risk.

Authors such as Sundararajan and Errico (2002); Iqbal and Llewellyn (2002); and World Bank and International Monetary Fund (2005) note that the following features need to be taken into account when assessing stability in a financial system with a significant presence of Islamic banks:

- The PLS (profit-loss sharing) financing shifts the direct credit risk from banks to their investment depositors, but it also increases the overall degree of risk on the asset side of banks' balance sheets, as it makes Islamic banks vulnerable to risks normally borne by equity investors rather than holders of debt.
- Operational risk is crucial in Islamic finance. Operational risk is defined as the risk of losses resulting from inadequate or failed internal processes, people and systems or from external events, which includes but is not limited to, legal risk and Sharī`ah compliance risk. According to the theoretical literature reviewed here, the importance of operational risk in Islamic finance reflects the complexities associated with the administration of PLS modes, including the fact that Islamic banks often have limited legal means to control the agent-entrepreneur.
- PLS cannot be made dependent on collateral or guarantees to reduce credit risk.

- Product standardization is more difficult due to the multiplicity of potential financing methods, increasing operational risk and legal uncertainty in interpreting contracts.
- Islamic banks can use fewer risk-hedging instruments and techniques than conventional banks and traditionally have operated in environments with underdeveloped or nonexistent interbank and money markets and government securities, and with limited availability of and access to lender-of-last-resort facilities operated by central banks. However, the significance of these differences has decreased due to recent developments in Islamic money market instruments and Islamic lender-of-last-resort modes and the implicit commitment to provide liquidity support to all banks during exceptional circumstances in most countries.
- Non-PLS modes of financing are less risky and more closely resemble conventional financing facilities, but they also carry risks (such as elevated operational risk in some cases) that need to be recognized.
- Another specific risk inherent in Islamic banks stems from the special nature of investment deposits, whose capital value and rate of return are not guaranteed. Some of the authors quoted above argue that this increases the potential for moral hazard, and creates an incentive for risk taking and for operating financial institutions without adequate capital

Another study on this topic was conducted by Boumediene and Caby (2009) observing the stock return of Islamic banks and the conventional ones during the subprime crisis in 2007. The results showed that in the period of crisis, the return volatility of Islamic banks is relatively lower than that of the conventional banks, indicating that Islamic banks are more resistant than conventional banks. This does not conclude that Islamic banks are protected from various risks, but thus showing different risk characteristics with conventional banks necessitating a better understanding and more precise risk management.

Hasan and Dridi (2010) conducted a study to determine the impact of the global financial crisis on the performance of Islamic banks and its comparison with the conventional banks. By using the banking data in Bahrain, Jordan, Kuwait, Malaysia,

Qatar, Saudi Arabia, Turkey, and the UAE, the results show that in the aspect of profitability, Islamic banks experienced a significant decline in profitability during the global financial crisis period, although on average still relatively similar to conventional bank profitability. In terms of assets and loans, Islamic banks showed much higher growth in the times of crisis and the assessment of external rating agencies indicates relatively stable ratings for Islamic banks.

In considering the ownership structures, Thorsten Beck, Heiko Hesse, Thomas Kick and Natalja von Westernhagen (2009) found consistent evidence that privately-owned banks are less stable than government-owned savings banks and cooperative banks. Furthermore, cooperative banks are farther away from insolvency than government-owned savings banks, but are more likely to become distressed than savings banks.

Measuring the impact of various macroeconomic and bank-specific variables on bank insolvency risk, Lana Iviµci´c Davor Kunovac Igor Ljubaj (2008) discover that bank stability decreases in credit growth, inflation and banking sector concentration. Thus, the stability will vary whenever these circumstances take place.

According to Aisulu Makhmetova (2009), the research states and investigate about two role of bank specialization type – commercial, cooperative, saving and investment – on individual and overall financial stability using cross country data for seven years. It was found that cooperative banks are most stable type of bank specialization, followed by saving banks, commercial banks made up the third place, while investment are most unstable type of bank specialization. Therefore, the research confirms that specialization of the bank is important factor influencing individual and overall financial stability.

3.0 RESEARCH METHODOLOGY

The aim of this research is to

- Determine the bankruptcy cost among Islamic banks in Malaysia through the implementation of the adjusted Z-Score model based on Altman's (2000) Multiple Discriminant Analysis.

$$Z = 1.2X_1 + 1.4X_2 + 3.3X_3 + 0.6X_4 + 0.999X_5$$

where: X_1 = Working Capital / Total Assets

X_2 = Retained Earnings / Total assets

X_3 = Earnings before Zakat and Taxes / Total Assets

X_4 = Market Value of Equity / Book Value of Total Liabilities

X_5 = Sales / Total Assets

Z = Overall Index

Applying the Z-Score model based on Altman's (2000) Multiple Discriminant Analysis (MDA) to determine the bankruptcy cost among Islamic Banks whereby financial ratios are tabulated beforehand before inserted into the said formula, this research will be based on a secondary quantitative data whereby figures needed are extracted from the studied Islamic Banks financial statements. Our primary dependent variable is the z-score as a measure of individual bank risk. The Z- Score has become a popular measure of bank soundness (see, e.g., Boyd and Runkle, 1993; and Maechler, Mitra, and Worrell, 2005). Its popularity stems from the fact that it is inversely related to the probability of a bank's insolvency, i.e., the probability that the value of its assets becomes lower than the value of the debt. The z-score measures the number of standard deviations a return realization has to fall in order to deplete equity, under the assumption of normality of banks' returns. A higher Z- Score corresponds to a lower upper bound of insolvency risk—a higher z-score therefore implies a lower probability of insolvency risk.

3.1 Data Source

The data required for this research are obtained through secondary data as all information is sourced mainly from Bursa Malaysia's website, or the website of the selected company itself.

Annual reports of the selected Islamic Banks are the main tools of the research as all necessary information are sourced from the annual reports published. Annual reports of the selected banks in the past 4 years are retrieved from Bursa Malaysia or the website of the company itself and necessary data are then searched for to be implemented into the proposed formula by Altman (2000). Out of the 2 different types of figures published in the annual reports (group and company figures), the company

figures will be taken for tabulation in the Z-Score model. Part of the data needed are taken as is from the annual reports (Total Assets; Total Liabilities; Retained Earnings; Sales); some are being tabulated (Working Capital= Current Assets – Current Liabilities; Earnings before Zakat and Taxes; Market Value of Equity = Number of Shares X Current Price Share) while some of it are being searched for (the current price share as of the financial year end date). The share price of four or five years back however is retrieved from a program called Bloomberg Trading Machine and Yahoo Finance.

3.2 Interpretation of Z - Score

The financial state of the studied Islamic Banks is based on the Z-Score tabulated. The Z-Score computed could be interpreted as:

No.	Range of Z - Score	Interpretation
1	Above than 2.99	The financial institution is in good position and safe from financial problem
2.	Between 2.99 and 1.81	Warning Sign! It is considered as gray area as the financial institution have chances to faces bankruptcy problem
3.	Less than 1.81	Bad Indication! The financial institution is most likely to be heading towards bankruptcy problem. Necessary actions are needed to avoid from the worst situation.

3.3 List of Islamic Banks

No.	Name of the Islamic Banks
1	Bank Islam Malaysia Berhad
2	Al – Rajhi Islamic Bank Malaysia
3	Bank Mualamat
4	Maybank Islamic Bank
5	Hong Leong Islamic Bank
6	RHB Islamic Bank
7	HSBC Amanah
8	Public Islamic Bank
9	Kuwait Islamic Finance House Malaysia
10	Alliance Islamic Bank Malaysia
11	Standard Chartered Saadiq Malaysia
12	Affin Islamic Bank

4. 0 DATA ANALYSIS

The financial statements of the selected Islamic Banks have been studied and necessary information have been extracted for further study in regards to the adjusted formula based on the original Altman's Z-Score method to determine the financial liquidity position. Listed below are the results of the study.

Z – Score Analysis

No.	Name	Year	Z - Score
1	Bank Islam Malaysia Berhad	2007	4.205346971
		2008	4.645110599
		2009	3.022292544
		2010	7.320628773
2	Al – Rajhi Islamic Bank Malaysia	2007	44.32040836
		2008	10.65198096
		2009	12.25379222
		2010	12.16917001
3	Bank Mualamat	2007	4.713891440
		2008	4.263558449
		2009	4.787992377
		2010	4.215533570
4	Maybank Islamic Bank	2007	0
		2008	2.993137053
		2009	3.023832281
		2010	3.040189572
5	Hong Leong Islamic Bank	2007	1.95218321
		2008	1.81023562
		2009	1.94544210
		2010	1.84423990
6	RHB Islamic Bank	2007	2.083014296
		2008	1.898621905
		2009	2.238880721
		2010	2.134380356
7	HSBC Amanah	2007	0
		2008	1.866456605
		2009	1.830241241
		2010	1.841245937
8	Public Islamic Bank	2007	2.798191052
		2008	1.647863348
		2009	1.344335086
		2010	1.360924571
9	Kuwait Islamic Finance House Malaysia	2007	1.950877394
		2008	1.953904271
		2009	1.990946756

		2010	2.091530841
10	Alliance Islamic Bank Malaysia	2007	0.33115326
		2008	0.43946447
		2009	0.34436754
		2010	0.874087663
11	Standard Chartered Saadiq Malaysia	2007	0
		2008	0.111734956
		2009	0.200232169
		2010	0.368294279
12	Affin Islamic Bank		
		2007	0.528146667
		2008	0.387534387
		2009	0.570029554
		2010	0.576580557

Z –Score Classifications

Non-Distressed Islamic Banks / Safe Zone	
1	Bank Islam Malaysia Berhad
2	Al – Rajhi Islamic Bank
3	Bank Mualamat
4	Maybank Islamic Bank
Islamic Banks in the Gray Area	
5	Hong Leong Islamic Bank
6	RHB Islamic Bank
7	HSBC Amanah
8	Public Islamic Bank
9	Kuwait Islamic Finance House
Distressed Islamic Banks / Danger Zone	
10	Alliance Islamic Bank
11	Standard Chartered Saadiq
12	Affin Islamic Bank

4.1 Discussion of the findings.

i) Islamic Banks in Safe Zone

From the analysis above, BIMB, Al –Rajhi Islamic Bank, Bank Mualamat and Maybank Islamic Bank are in a safe zone. In other words, these banks are in the good position in terms of financial liquidity. Al – Rajhi Islamic bank tends to perform well in terms of Z score among other Islamic banks that fall in the same safe zone category

during this period due to the well usage of liabilities and total assets throughout these periods. This makes Al- Rajhi Islamic able to achieve positive working capital throughout these 4 years. In addition, the market capitalization value for Al Rajhi Islamic Banks tends to increase with relatively stable value. Even though sales figures were negative in 2007 but Al – Rajhi Islamic was able to recoup this problem in the following years by achieving positive sales figures starting from 2008 till 2010.

Moreover, the total deposit in Al Rajhi Islamic bank in 2007 was 2,073,832,000 and this continued to increase about 30% in 2008 that was 2,901,298,000. This was a major contributor as well to the highest Z – Score during these 2 periods. The performance of Bank Islam and Bank Mualamat was significantly stable. The Z - scores for these two banks are in between 2.99 till 5.00 except for Bank Islam, which its Z – Score in 2007 was 7.320628773. The working capital for these 2 banks increased relatively stable throughout this period. In addition, the market capitalization value and sales value were also relatively stable. Due to this, the values for X4 and X5 dropped significantly and this caused the Z –Score fell in this range.

Furthermore, the stable value for number of depositors, profit after tax and Zakat and total interest income were the main reasons for this scenario. The total amount of deposit in these 2 banks is within the range of 12,180,247,000 to 26,763,168,000 throughout these periods. In addition, the stability of liquidity position was supported by Profit after tax and Zakat for these 2 banks showed increase in value from 2007 till 2010 namely between $300,295,000 and $384, 117,000. Lastly, Maybank Islamic Bank is also in a very good financial position and is very popular among Asian countries when it comes to Islamic banking. Furthermore, Maybank Islamic bank is also one of the biggest Islamic banks among Asian region and this makes the Z score falls in the safe zone. The Z – Score is between 2.99 till 3.10 and this was contributed by stable increase in sales, Earnings before Interest and Taxes, Working capital and market capitalization throughout these 4 years.

The bankruptcy cost among these banks is less since the Z – Score is in safe zone

ii) Islamic Banks in the Gray Area

Analysis shows that Hong Leong Islamic Bank, RHB Islamic Bank, HSBC Amanah, Public Islamic Bank and Kuwait Finance Islamic House are in the gray area. In other words, these Islamic banks can be considered as financial distressed institutions. One of the major contributions to this situation is because of high competitiveness among Islamic banks. Each of these banks competes to maintain its own competitive edge. Gray area is basically referred to the financial institution which is going to face financial distressed problem especially in the operations of Islamic banking.

The Z – Score for Hong Leong Islamic Bank is from 1.80 to 1.97. This was mainly contributed by decrease in market capitalization value and instability in working capital and sales which have caused x1 and x4 value to drop significantly. Ironically, RHB Islamic Bank and Kuwait Islamic Finance House are moving on the same direction. The Z –Score for these two banks is between 1.8 and 2.4. Referring to the financial statements of these two banks, total assets are greater than total liabilities and this makes the value of working capital increased. Furthermore, the sales amount shows that the value dropped significantly. The consequences of these variables makes the Z – Score calculation for X1, X2 and X3 values changed dramatically and stayed in the gray area. The scenario is totally different for Public Islamic Bank where all the variables were inconsistent throughout this period. There was a dramatic fluctuation in working capital, total assets, total liabilities, sales, and EBIT and market capitalization value. The Z –Score for Public Islamic Bank in 2007 was 2.79++ and almost reached safe zone but then it started to decrease in 2008 and 2009 before staying at higher scores position in 2010. In addition, the reason public Islamic Bank fell in this category is due to the increase in administration expenses and overhead expenses from 2007 till 2008. In 2008, Public Islamic Bank has spent about 200,000,000 to 500,000,000 for overhead expenses and administration expenses. Due to high competitiveness among Islamic banks, HSBC Amanah was able to maintain its competitive edge even though HSBC Amanah is still new to Islamic banking environment. The Z – Score was slightly affected by fluctuation in all Z – Score variables and this makes the Z – Score to stay in this zone.

To sum up, Islamic banks that fell in this category cans still overcome the financial distressed problem, if necessary corrective actions are taken.

iii) Islamic Banks in Danger Zone

The Z – Score for Alliance Islamic Bank, Standard Chartered Saadiq and Affin Islamic Bank is in Danger Zone. In other words, the operational structure of Islamic Banking among these banks is not good as what have been predicted. According to the Z –Score analysis, Danger zone is referred to that the financial institutions which are about to face financial distressed problem or are currently having a financial distressed problem. Most of these banks are in pioneering stage where they are new to the Islamic banking and finance in Malaysia. Generally speaking, any of these financial institutions which fell under the pioneering stage tends to face higher risk since they are new to the market. This was a main reason that all these three banks are in this category. Interestingly, the performance of Affin Islamic Bank shows an improvement in terms of Z –Score throughout this period even though they are in the dangerous zone. The analysis of financial statements of Affin Islamic Bank clearly indicates that the sales value increased consistently and the working capital increased as well because the usage of assets is greater than liabilities. However, there was an inconsistency in market capitalization value where the value increased throughout 4 years but faced a sudden drop in 2008. The same scenario applied to Earnings before interest and taxes. The changes in these components make X1 and X2 and X4 slightly dropped. From 2007 till 2010, the Z score started to increase slowly and if Affin Islamic can take this opportunity to grow slowly by improving their marketing of product and product innovations. Moreover, the total deposit of Affin Islamic Bank has started to increase from $3,708,613,000 to $4,252,119,000 in 2007 and 2008 but Affin Islamic has spent more on administration expenses and overhead expenses. In addition, the total profit after Zakat and taxes has decreased from $39,440,000 to $28,002,000 in 2007 and 2008 and the value started to decline further in 2009 and 2010.

The performance of Alliance Islamic Bank and Standard Chartered Saadiq in terms of Z – Score is very poor. The main reason behind this scenario is that these institutions are very new to this industry and have faced some fierce competition from the

existing Islamic banks. There was a dramatic fluctuation in all Z – Score variables and this makes the Z- score value became less and stayed in the dangerous zone. In addition, the numbers of depositors in these banks are less as compared to other Islamic Banks. Furthermore, the marketing of Islamic banking in these banks is not well received as compared to the marketing strategies used by other Islamic banks. This was a main reason that the growth in sales and market capitalization is less as compared to other Islamic banks. In addition, there were inconsistent changes in certain variables of financial statements such as total deposit, overhead expenses, administration expenses, and profit after Zakat and taxes

In conclusion, Islamic banks that are operating in this category are most likely going to face bankruptcy cost or are currently facing financial distressed problem.

5.0 CONCLUSION

In conclusion, the empirical analysis which carried out using Altman Z – Score test obviously shows that half of the Islamic Banks in Malaysia were more stable except for three banks that are Affin Islamic Bank, Alliance Islamic Bank and Standard Chartered Saadiq. However, this is not a final observation of abovementioned analysis, this is just an expected problem that Islamic Banks are going to face financial liquidity problem and this has been proven by Altman Z –Score Analysis but the things might be change when we look at other financial ratio such as earning per share, net profit margin, return on assets, return on equity, etc.

From the Malaysia perspective, due to strong support by Malaysia government and people response, Malaysia will become a major contributor to the development of Islamic banking and finance at local and international arena. This may boost the performance of all Islamic banks in Malaysia instead. The methods used by Malaysia government in developing and promoting Islamic bank are also seen very clever. In addition, the number of non Muslim chooses Islamic has increase tremendously. This may help to improve performance of abovementioned Islamic Banks in upcoming future. The Islamic Banking and Finance that Malaysia government practices right now has get recognition in international dais especially middle east country and

European countries. Some of the countries have uses structure of Malaysia Islamic Banking and Finance as the reference. This is because Malaysia has a strategic structure of banking system and Islamic financial system.

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Appendix

BIMB

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.06595312	0.07694531	3.990070254	0.039432427	0.032945856	4.205346971
2008	0.06720551	0.07840643	4.440010744	0.027178022	0.032309892	4.645110599
2009	0.06684315	0.077983675	2.831575393	0.020390457	0.02549987	3.022292544
2010	0.1081672	7.084135331	0.054526932	0.029205405	0.04459391	7.320628773

Al – Rajhi Islamic Bank

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.20216427	0.23585	-0.137950	44.026070	-0.00573374	44.32040836
2008	0.09210576	0.10745	-0.043962	10.486149	0.01023195	10.65198096
2009	0.16384701	0.19115	0.0004704	11.875161	0.02315888	12.25379222
2010	0.14709327	0.17160	0.0017945	11.826523	0.02214994	12.16917001

Bank Mualamat

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.06409086	0.07477267	0.0153553	4.5404664	0.01920621	4.71389144
2008	0.058525174	0.068279369	0.002030379	4.130052	0.004671528	4.263558449
2009	0.098997412	0.115496981	0.008281049	4.55912658	0.006090356	4.787992377
2010	0.094707259	0.110491802	0.028048065	3.9560052	0.026281244	4.21553357

Maybank Islamic Bank

Year	X1= Working Capital/ Total Assets 1.2	X2= Retained Earnings / Total Assets 1.4	X3 = Earnings Before Interest and Taxes / Total Assets 3.3	X4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X5 = Sales / Total Assets 0.999	Z SCORE
2007	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!
2008	0.075091143	0.087606334	0.019092399	2.79844	0.012907177	2.993137053
2009	0.090228033	0.105266039	0.046124605	2.75789	0.024323603	3.023832281
2010	0.089607191	0.104541723	0.039832082	2.78445	0.021758576	3.040189572

Hong Leong Islamic Bank

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.11570187	0.112492991	0.43106362	1.07042004	0.22250468	1.95218321
2008	0.185269339	0.140000014	0.329967033	0.705547991	0.290047691	1.81023562
2009	0.065182037	0.129551919	0.200301047	0.593495255	0.162069361	1.9454421
2010	0.098811401	0.115047571	0.036902439	0.889632982	0.184706718	1.8442399

RHB Islamic Bank

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.105577674	0.123173952	0.063666592	1.7583233	0.032272778	2.083014296
2008	0.108017136	0.126019992	0.04029949	1.598788	0.025497286	1.898621905
2009	0.095895189	0.11187772	0.02550176	1.984476	0.021130052	2.238880721
2010	0.090117009	0.10513651	0.022808618	1.898333	0.017985218	2.134380356

HSBC AMANAH

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	Nil	Nil	Nil	Nil	Nil	0
2008	0.164661292	0.192104841	0.021100259	1.47402	0.014570213	1.866456605
2009	0.185443957	0.216351283	0.053313097	1.3332	0.041932905	1.830241241
2010	0.139394445	0.162626852	0.030919261	1.47534	0.03296538	1.841245937

Public Islamic Bank

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.6755	1.111	0.005394453	1.00458	0.001716599	2.798191052
2008	0.07181008	0.083778427	0.012925704	1.473892	0.005457137	1.647863348
2009	0.079499174	0.092749036	0.066757815	1.07833331	0.02699575	1.344335086
2010	0.092070335	0.10741539	0.07280398	1.0587932	0.029841665	1.360924571

Kuwait Finance House

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.143613434	1.23168632	0.019417872	0.533685853	0.022473916	1.950877394
2008	0.221531228	1.47786459	0.017261801	0.213757028	0.023489624	1.953904271
2009	0.237486787	1.5677781	0.009978172	0.163963296	0.0117404	1.990946756
2010	0.225748255	1.6995	-0.03562912	0.195543974	0.006367728	2.091530841

Alliance Islamic Bank

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.0885566	0.10331604	0.01885839	0.085514502	0.03490772	0.33115326
2008	0.1124637	0.13120771	0.05984905	0.09922489	0.03671906	0.43946447
2009	0.1042463	0.12162069	0.03143014	0.053982097	0.03308828	0.34436754
2010	0.11186395	0.130507947	0.042619751	0.571313775	0.03358601	0.88989143

Standard Chartered - Saadiq

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	#DIV/0!	0
2008	0.045273542	0.052819132	0.007103347	0	0.006538935	0.111734956
2009	0.07943327	0.092672148	0.012050821	0	0.016075931	0.200232169
2010	0.130307217	0.152025087	0.051705629	0	0.034256346	0.368294279

Affin Islamic Bank

Year	X_1= Working Capital/ Total Assets 1.2	X_2= Retained Earnings / Total Assets 1.4	X_3 = Earnings Before Interest and Taxes / Total Assets 3.3	X_4 = Market Value of Equity / Book Value of Total Liabilities 0.6	X_5 = Sales / Total Assets 0.999	Z SCORE
2007	0.04511365	0.052632588	0.030480247	0.383121846	0.016798338	0.528146667
2008	0.05193177	0.06058706	0.022487682	0.234695798	0.017832082	0.387534387
2009	0.07319983	0.085399805	0.023769842	0.368733819	0.018926255	0.570029554
2010	0.06883497	0.080307465	0.020322841	0.388971472	0.018143808	0.576580557

DETERMINANTS OF REVENUE EFFICIENCY IN THE MALAYSIAN ISLAMIC BANKING SECTOR

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Abstract

The objective of this study is to identify the existence of revenue efficiency in Malaysian Islamic banks over the periods 2006 to 2010 particularly on domestic Islamic banks in Malaysian banking sector. The study also examines the potential bank specific determinants that influence revenue efficiency in Malaysian domestic Islamic banks. To represent the Malaysian Islamic banking sector, a sample of 17 domestic and foreign banks in Malaysia were selected to participate in the study. The level of revenue efficiency was measured using Data Envelopment Analysis (DEA) method which applied the intermediation approach. The results showed that a level of revenue efficiency in Malaysian domestic banks was lower than foreign banks. The determinants that could improve the revenue efficiency in Malaysian domestic banks were identified using Multivariate Regression Analysis (MRA). Three bank specific determinants were found to influence the improvement of revenue efficiency: capitalisation, market power and liquidity.

Keywords: Malaysian domestic Islamic banks; Malaysian foreign Islamic banks; Revenue efficiency; Data envelopment analysis

1. Introduction

The Islamic banking system (IBS) is defined as a banking system of which principles underlying its operations and activities are founded on Islamic or Syariah principles. This means that all operations of an Islamic bank, that is, transactions involving either deposits or financing, must be based on Syariah principles. Such principles also cover other banking transactions such as money order transaction, letter of guarantee, letter of credit, foreign exchange, etc. The main factor that distinguishes Islamic banks from their conventional bank peers is that transactions are administered without involving elements of Riba'. Riba' is prohibited in Islam and is acknowledged by all Muslims. The prohibition of Riba' is clearly mentioned in the Quran, the Muslim's holy book and the traditions of Prophet Muhammad (Sunnah).

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It is commonly agreed that Riba' means an increase or growth. Some insist it is the increase imposed on the debtor at the maturity of the debt in case debtor fails to pay it and want to roll it over. Most scholars believes that it covers the interest stipulated at the time of the contract in case of loans as well as the subsequent increase in the case that the loan or the debt arising from sale on credit is rolled over because the debtor does not pay it at the time stipulated in the contract (Badawi, 1964). Technically it denotes in a loan transaction, any increase or premium advantage obtained by the lender as a condition of the loan. In essence, the business management of Islamic banks is governed by the concept of justice and fairness of societies' interests a whole.

Despite its humble beginning, Islamic banks have blossomed throughout the world. The Islamic banking system has become the most competitive to the conventional banking systems. At present, Islamic banks has presence in more than 75 countries, from Malaysia to Bahrain to Europe and the U.S. International Monetary Fund (2005) reported that the number of Islamic financial institutions has quadrupled to more than 300 institutions over the past three decades. Total assets of Islamic financial institutions are estimated to be US$250 billion and are estimated to be increasing at about 15 percent rate per year, three times the rate for conventional banks. According to Ghafour (2006), the size of the world Islamic banking industry assets is estimated to have grown in excess of $265 billion from merely hundreds of thousands of dollars in the 1970s.

Given the rapid development of the Islamic banking sector, it is reasonable to expect that the performance of Islamic banks has become the center of attention among Islamic bank managers, stakeholders, policymakers, and regulators. Berger and Humphrey (1997) point out that studies focusing on the efficiency of financial institutions have become an important part of banking literature since the early 1990s. Furthermore, Berger et al. (1993) suggests that if banks are efficient, they could expect improved profitability, better prices and service quality for consumers, and that greater amounts of funds would be intermediated.

However, little attention has been given on the efficiency of its operations. Within the context of the Malaysian Islamic banking sector, Sufian (2007) examines the efficiency of the domestic compared to the foreign Islamic banks. Sufian and Haron (2008) provide an assessment on the total factor productivity change in the Malaysia Islamic banking sector. On the other hand,

empirical examination covering all three efficiency concepts namely cost, revenue, and profit efficiency is completely missing from the literature.

This paper investigates whether the environment and internal factors determines the revenue efficiency of Islamic banks operating in the Malaysia. For that purpose, we employ the non- parametric Data Envelopment Analysis (DEA) method to analyze the cost, revenue, and profit efficiencies of the universe of Malaysian Islamic banks over the period of 2006 to 2010. The preferred method allows us to distinguish between three different types of efficiency, namely cost, revenue, and profit efficiencies. Furthermore, we perform a series of parametric (t-test) and non-parametric (Mann- Whitney [Wilcoxon] and Kruskall-Wallis) tests to examine whether the domestic and foreign Islamic banks are drawn from the same population. Finally, we employ a panel regression analysis framework to analyze the determinants of revenue efficiency Islamic banks in the sample.

The article begins with a brief overview of the Malaysian Islamic banking sector. This is followed by section 3, where we provide a review of related studies. Section 4 discusses on the methods employed in the study and variables employed in the panel regression analysis. We present the empirical findings in section 5. The article concludes and provides discussions on the policy implications in section 5.

2. Islamic Banking in Malaysia

As with other Muslim countries, Malaysia was affected by the Islamic resurgence movement among the intellectuals especially around the 1970s. There were calls from individuals and certain groups and agencies for the government to establish Islamic banks to cater to the needs of Muslims in Malaysia. During the Bumiputra Economic Congress in 1980, a resolution which required the government to allow the Pilgrimage Board (known as Lembaga Tabung Haji) to establish an Islamic bank for the purpose of collection and investing money owned by Muslims was passed. In 1981 at the National Seminar, government was urged to promulgate a special law which would allow the establishment of banks and financial bodies whose operations would be based on Islamic principles (Haron and Azmi, 2009).

In line with these requests, the government appointed a National Steering Committee on Islamic Banking on 30 July 1981 chaired by Tan Sri Raja Mohar Raja Badiozaman. The secretarial

functions were entrusted to the Pilgrimage Board. This committee studied the operations of Faisal Islamic Bank of Egypt and Faisal Islamic Bank of Sudan when preparing its report (Connors, 1988). The final report was submitted to the government on 5 July 1982 and the following recommendations were made by the committee:

I. An Islamic bank whose operations are in accordance with the Syariah principles should be established;
II. The Islamic bank shall be incorporated as a company under the auspices of the Companies Act 1965;
III. Since the Banking Act of 1973 is not applicable for the operations of Islamic banks, a new banking act, Islamic Banking Act 1982, must be introduced to license and supervise Islamic banks. The supervision and administration of this new Act shall be the responsibility of the Central Bank of Malaysia; and
IV. Islamic banks shall establish their own Syariah Supervisory Board whose function is to ensure that the operations of Islamic bank are in accordance with Syariah law.

Source: Bank Islam Malaysia Berhad (BIMB) 1984

In order to pave the way for the establishment of Islamic banks, the Islamic Banking Act 1983 was gazetted and came into effect on 7 April 1983. This Act outlines the rules which must be conformed to by Islamic banks that wish to operate in Malaysia, as well as the powers of the Central Bank of Malaysia in supervising and regulating Islamic banks in Malaysia. At the same time, the government also passed the Government Investment Act 1983 to empower the government to issue Government Investment Certificates based on Syariah principles (Haron and Azmi, 2009).

The legal basis for the establishment of Islamic banks was the Islamic Banking Act (IBA) which came into effect on 7 April 1983. The IBA provides Malaysian banking authority, BNM (Bank Negara Malaysia) with powers to supervise and regulate Islamic banks, similar to the case of other licensed banks. The Government Investment Act 1983 was also enacted at the same time to empower the Government of Malaysia to issue Government Investment Issue (GII), which are government securities issued based on Syariah principles. As the GII are regarded as liquid assets, the Islamic banks could invest in the GII to meet the prescribed liquidity requirements as well as to invent their surplus funds (Haron and Azmi, 2009).

The first Islamic bank established in the country was Bank Islam Malaysia Berhad (BIMB) which commenced operations on 1 July 1983. In line with its objectives, the banking activities of the bank are based on Syariah principles. After more than a decade in operations, BIMB has proved to be a viable banking institution with its activity expanding rapidly throughout the country with a network of 80 branches and 1,200 employees. The bank was listed on the Main Board of the Kuala Lumpur Stock Exchange on 17 January 1992 (Haron and Azmi, 2009).

In Malaysia, separate Islamic legislation and banking regulations exists side-by-side with those of the conventional banking system (Ling, 2009). The BNM introduce the 'Interest-Free Banking Scheme" in March 1993 that initiated the concept of Islamic window that allowed the existing conventional banks to produce the Islamic products and services. The IBS was established in 1999 that included the interest-free banking system and full-fledged Islamic banks involved in operating Islamic financial products and services. This dual banking system provides an interesting ground to investigate the efficiency of domestic and foreign banks.

On 1 October 1999, the second Islamic bank, namely Bank Muamalat Malaysia Berhad (BMMB) commenced operations. The vision of Bank Muamalat Malaysia Berhad is to be a strong, progressive, and modern Islamic bank offering innovative, quality and competitive product and services. Their mission is to build the bank into a modern, dynamic, and strong Islamic bank providing a viable alternative to the conventional system and contribute to the development of modern Malaysia. The establishment of BMMB was the effect of the spin-off following the merger between Bank Bumiputra Malaysia Berhad (BBMB) and Bank of Commerce (Malaysia) Berhad (BOCB). Under the merger arrangement, the Islamic banking assets and liabilities of BBMB, BOCB, and BBMB Kewangan Berhad (BBMBK) were transferred to BBMB, while the conventional operations of BBMB, BOCB, and BBMBK were transferred to BOCB accordingly. In addition, BMMB was given 40 branches of BBMB and BBMBK in various locations throughout Malaysia and a staff workforce of 1,000, migrated from BBMB, BOCB, and BBMBK (Overview of Islamic Banking).

During the year 2000, there were 2 full-fledged Islamic banks and 17 commercial banks offering Islamic window. Meanwhile there were 11 full-fledged Islamic banks, 8 commercial banks offering Islamic window, 4 Islamic investment banks and 5 development institutions offering Islamic banking products and services in July 2007. The liberalization in Malaysia had

increased the number of Malaysia Islamic bank participation and attracted the foreign banks to open their operation in Malaysia which were Kuwait Finance House, Al-Rajhi Banking & Investment, and Islamic Financial Consortium. The existing foreign banks also were also participating in IBS namely OCBC Bank Malaysia Berhad, Standard Chartered Bank Malaysia, and HSBC Bank Malaysia Berhad. The concept of Islamic banking subsidiary was also introduced by BNM to Hong Leong Islam Bank Berhad, RHB Islamic Bank, and Commerce Tijari Bank Berhad in order to be more comprehensive.

The Malaysian Islamic banking sector is currently (year of 2011) represented by 17 Islamic banking institutions comprised of 11 domestic and six foreign full-fledged Islamic banks. These Islamic banking institutions offer a comprehensive and broad range of Islamic financial products and services ranging from saving, current and investment deposit products to financing products such as property financing, working capital financing, project financing, plant and machinery financing, etc
(Sufian, 2007).

As at end-2010, assets that comply with Islam's ban on interest increased to RM350.8 billion ($116 billion) and accounted for 21 percent of the total banking system reported by BNM 2010 annual report. In term of profitability, Islamic banking institutions registered a steady and sustained income, thereby improving returns on assets and equity. The total income year-on-year of the banks increased from RM9.71 billion in 2009 to RM11.80 billion at December 2010. Similarly, net income (profit) increased from RM6.10 billion in 2009 to RM6.84 billion at end 2010.

3. Literature Review

Despite considerable developments in the Islamic banking sector, there have been very limited studies done focusing on the efficiency of Islamic banks. So far, there are a fair number of researches that studied banking efficiency in less developed countries (Bader et al. 2008). There are some documented studies that compare the performance of Islamic banks with their conventional counterparts. Nevertheless, those studies focus more on the profitability with the help of financial ratios and constrained by the time span and the number of Islamic banks (Samad and Hassan, 1999; Iqbal, 2001). The previous studies mostly concentrate on the technical, pure technical and scale efficiency in the Islamic banking sectors (Isik and Hassan, 2002; Hassan and Hussein, 2003; Yudistira, 2004). Despite the significant

importance of this area, documented studies that address on cost, revenue and profit efficiency of Islamic banks are limited (Yudistira, 2004; Hassan, 2005; Brown and Skully, 2005).

Technical, Pure Technical, and Scale Efficiency

The first study that used frontier non-parametric approach (DEA) to assess the efficiency of Islamic banks was conducted by Yudistira (2004). The study discovered new evidence on the performance of 18 Islamic banks over the period 1997-2000 where the Islamic banks suffer slight inefficiencies during the global crisis 1998-1999. Indeed, 1998 and 1999 were the period of turmoil that hit the global economy. The level of inefficiency in 1998 is more attributable to pure technical inefficiency rather than scale inefficiency.

Sufian et al. (2008) performs an analysis on the efficiency of Islamic Banks using empirical evidence from the MENA (Middle East and North Africa) and Asian Countries. By using the Data Envelopment Analysis (DEA) method, they estimate three different types of efficiency measures, namely technical, pure technical and scale efficiency. The result shows that PTIE outweighs SIE in the Islamic bank. Although the Islamic banks have been operating at a relatively optimal scale of operations, they were managerially inefficient to exploit their resources to the fullest.

On the other hand, Hassan and Hussein (2003) study the efficiency of the Sudanese banking system during the period of 1992 and 2000. They apply a variety of parametric and non-parametric DEA techniques to a panel of 17 Sudanese banks. They discover that the Sudanese banking system have exhibited 37% allocative efficiency (AE) and 60% technical efficiency (TE), suggesting that the overall cost inefficiency of the Sudanese Islamic banks were mainly due to the technical efficiency (managerially related) rather than allocative efficiency (regulatory).

According to Sufian (2007), the results from the DEA suggest that Malaysian Islamic banks efficiency declined in year 2002 to recover slightly in years 2003 and 2004. The domestic Islamic banks were more efficient compared to the foreign Islamic banks albeit marginally. The source of inefficiency of Malaysian Islamic banks in general has been scale, suggesting that Malaysian Islamic banks have been operating at the wrong scale of operations.

Cost, Revenue, and Profit Efficiency

There are many studies had conducted the cost and profit efficiency in the conventional banks rather than Islamic banks and discovered that the different levels between cost and profit efficiency are caused by the inefficiency from the revenue side (e.g. Chu and Lim, 1998; Rogers, 1998; Berger and Mester, 2003). Revenue can be defined as how effectively a bank sells its outputs. Maximum revenue is obtained as a result of producing the output bundle efficiently (Rogers, 1998). In fact, revenue efficiency is decomposed of technical and allocative efficiency which are related to managerial factors and is regularly associated with regulatory factors (Isik and Hassan, 2002). English et al. (1993) posits that in order to ascertain revenue efficiency, banks should focus on both technical efficiency (managerial operating on the production possibilities) and allocative efficiency (bank producing the revenue maximizing mix of outputs based on certain regulations).

Another way to improve the revenue efficiency proposed by several studies is for banks to produce higher quality services and charge higher prices and struggle to avoid any improper choice of inputs and outputs quantities and mis-pricing of outputs (Rogers, 1998). The revenue inefficiency could be well identified via the profit function because this function combines both the cost and revenue efficiency to evaluate the profit efficiency (Akhavein et al. 1997). The revenue efficiency would totally affect the efficiency of the profit even though the cost efficiency is high. In essence, the revenue efficiency would be the major factor that influences the efficiency on the profit efficiency. Berger and Humphrey (1997), Akhavein et al. (1997), and Bader et al. (2008) state that there have been limited studies done on revenue efficiency of banks. If these studies are narrowed down into the revenue efficiency on the Islamic banks industry, there are more paucity studies that looked into domestic and foreign Islamic banks.

The above literature reveals the following research gaps. First, the majority of these studies have mainly concentrated on the conventional banking sectors of the western and developed countries. Second, empirical evidence on the developing countries, particularly the Islamic banking sector, is scarce. Finally, virtually nothing has been published on the cost, revenue, and profit efficiency and its determinants in the Islamic banking sector. In the light of these knowledge gaps, the present paper seeks to provide new empirical evidence on the cost, revenue, and profit efficiency and its determinants in the Malaysian Islamic banking sector.

4. Research Method

The present study gathers data from all Malaysian Islamic banks from 2006 to 2010. The primary source of financial data is the BankScope database produced by the Bureau van Dijk which provides banks' balance sheets and income statements. Data are analyzed from banks which offer Islamic banking products and services under the Islamic Banking Scheme. We collect data from 17 Islamic banking institutions comprising of 11 domestic and six foreign full-fledged Islamic banks (see Table 1).

First Stage: Data Envelopment Analysis

The level of revenue efficiency is measured by using the Data Envelopment Analysis (DEA) method. The DEA method constructs a frontier of the observed input-output ratios by linear programming techniques. The linear substitution is possible between observed input combinations on an isoquant (the same quantity of output is produced while changing the quantities of two or more inputs) that was assumed by the DEA method. Charnes et al. (1978) were the first to introduce the term DEA to measure the efficiency of each decision making units (DMUs), obtained as a maximum of a ratio of weighted outputs to weighted inputs. The more the output produced from given inputs the more efficient is the production.

This study employs estimates efficiency under the assumption of variable returns to scale (VRS). The VRS assumption was proposed by Banker, Charnes and Cooper (1984). The BCC model (VRS) extended the CCR model that was proposed by Charnes, Cooper and Rhodes (1978) by relaxing the constant return to scale (CRS) assumption. The resulting BCC model was used to assess the efficiency of DMUs characterized by VRS assumption. The VRS assumption provides the measurement of pure technical efficiency (PTE). PTE measures the efficiency of DMUs without being contaminated by scale effects. Hence, results derived from the VRS assumption provide more reliable information on DMUs efficiency compared to the CRS assumption (Coelli et al. 1998).

The revenue, cost, and profit efficiency models are given in Equations (1) – (3) respectively. As can be seen, the revenue, cost, and profit efficiency scores are bounded within the 0 and 1 range.

Frontier Type	Revenue Efficiency	Cost Efficiency	Profit Efficiency

	(Eq. 1)	(Eq. 2)	(Eq. 3)
VRS	$max \sum_{r=1}^{s} q_r^o \tilde{y}_{ro}$ *subject to* $\sum_{j=1}^{n} \lambda_j x_{ij} \le \tilde{x}_{io} \quad i = 1,2,...,m;$ $\sum_{j=1}^{n} \lambda_j y_{rj} \ge \tilde{y}_{ro} \quad r = 1,2,...,s;$ $\lambda_j \tilde{y}_{ro} \ge 0$ $\sum_{j=1}^{n} \lambda_j = 1$	$min \sum_{i=1}^{m} p_i^o \tilde{x}_{io}$ *subject to* $\sum_{j=1}^{n} \lambda_j x_{ij} \le \tilde{x}_{io} \quad i = 1,2,...,m;$ $\sum_{j=1}^{n} \lambda_j y_{rj} \ge y_{ro} \quad r = 1,2,...,s;$ $\lambda_j, \tilde{x}_{io} \ge 0$ $\sum_{j=1}^{n} \lambda_j = 1$	$max \sum_{r=1}^{s} q_r^o \tilde{y}_{ro} - \sum_{i=1}^{m} p_i^o \tilde{x}_{io}$ *subject to* $\sum_{j=1}^{n} \lambda_j x_{ij} \le \tilde{x}_{io} \quad i = 1,2,...,m;$ $\sum_{j=1}^{n} \lambda_j y_{rj} \ge \tilde{y}_{ro} \quad r = 1,2,...,s;$ $\tilde{x}_{io} \le x_{io}, \tilde{y}_{ro} \ge y_{ro}$ $\lambda_j \ge 0$ $\sum_{j=1}^{n} \lambda_{j=1}$

Source: Zhu (2009)

where

s	is output observation
m	is input observation
r	is s^{th} output
i	is m^{th} input
q_r^o	is unit price of the output r of DMU0 (DMU0 represents one of the *n* DMUs)
p_i^o	is unit price of the input i of DMU0
$\tilde{y}_{ro}$	is r^{th} output that maximise revenue for DMU0
$\tilde{x}_{io}$	is i^{th} input that minimise cost for DMU0
y_{ro}	is r^{th} output for DMU0
x_{io}	is i^{th} input for DMU0
n	is DMU observation
j	is n^{th} DMU
λ_j	is non-negative scalars
y_{rj}	is s^{th} output for n^{th} DMU
x_{ij}	is m^{th} input for n^{th} DMU

By calculating the three efficiency measures (e.g. revenue, cost and profit), we will be able to observe a more robust result for the domestic and foreign in Malaysian Islamic banks over the period under study. However, the present study will give greater emphasize on the revenue efficiency measure compared to the other efficiency measures (e.g. cost and profit).

The Input and Output Variables in DEA

According to Cooper et al. (2002), there is a rule required to be complied with in order to select the number of inputs and outputs. A rough rule of thumb which could provide guidance can be given as:

$n \geq \max \{m \times s, 3 (m+s)\}$

where:

n is a number of DMUs
m is a number of inputs
s is a number of outputs

Given the underdevelopment of capital markets, the importance of banks as a financial intermediary are more prevalent in developing economies like Malaysia. Therefore, it is reasonable to assume that the efficiency of banks in terms of their intermediation functions is crucial as an effective channel for business funding. In this vein, Jaffry et al. (2007) points out that banks play an important economic role in providing financial intermediation by converting deposits into productive investments in developing countries. The banking sector of developing countries have also been shown to perform critical role in the intermediation process by influencing the level of money stock in the economy with their ability to create deposits (Mauri, 1983; Bhatt, 1989; Askari, 1991).

Following Bader et al. (2008), Isik and Hassan (2002), and Hassan (2005) among others, the present study employs the intermediation approach which views banks as an intermediary between savers and borrowers (see Sealey and Lindley, 1977). Accordingly, two inputs, two input prices, two outputs, and two output prices variables were chosen. The two input vector variables consist of x1: deposits and x2: labour. The input prices consist of w1: price of deposits and w2 price of labour. The two output vectors are y1: loans and y2: income. Meanwhile, two output prices consist of r1: price of loans and r2: price of investment. The summary of data used to construct the efficiency frontiers are given in Table 2.

Second Stage: Multivariate Regression Analysis

The next purpose of this study is to identify the potential bank specific and macroeconomic determinants which influence the Malaysian Islamic banking sector's revenue efficiency. To examine the relationship between the revenue efficiency of Malaysian Islamic banks and the

explanatory variables, we employ a panel regression analysis defined as follows for observation (bank) i (Coelli et al. 1998).

$$y_{it} = \beta x_{it} + \varepsilon_{it} \qquad i = 1,...,N, \tag{4}$$

Where:

y_{it}	is the efficiency (total, technical or allocative, as per case) of bank i at time t
x_{it}	is the matrix of the explanatory variables (determinant)
β	is the vector of coefficients
ε_{it}	is a random error term representing statistical noise
i	is a number of bank
t	is a year
N	is a number of observations in the data set

By using the revenue efficiency scores as dependent variable, we extend equation (4) and estimate the following regression model:

$$\begin{aligned}\theta_{jt} = \alpha_t + \beta_{jt}(& LNTA_{jt} + LLRGL_{jt} + ETA_{jt} + BDTD_{jt} + LOANSTA_{jt} + NIETA_{jt} \\ & + LNGDP_{jt} + INFL_{jt} + DOM_IB_{jt} + LNTA_{jt} * DOM_IB_{jt} + LLRGL_{jt} * DOM_IB_{jt} \\ & + ETA_{jt} * DOM_IB_{jt} + BDTD_{jt} * DOM_IB_{jt} + LOANSTA_{jt} * DOM_IB_{jt} \\ & + NIETA_{jt} * DOM_IB_{jt} + LNGDP_{jt} * DOM_IB_{jt} + INFL_{jt} * DOM_IB_{jt}) + \varepsilon_{jt}\end{aligned}$$

Where:

θ_{jt}	Revenue efficiency of the j-th bank in the period t obtained from the DEA Model.
LNTA	Log of total assets (size of bank)
LLRGL	Loan loss reserve to gross loan (asset quality)
ETA	Equity to total assets (capitalisation)
BDTD	Bank's deposit over total deposit (market power)
LOANSTA	Total loan over total assets (liquidity)
NIETA	Non-interest expense over total assets (management quality)
LNGDP	Log of gross domestic product (gross domestic product)
INFL	Customer prices index (inflation)
DOM_IB	Dummy domestic Islamic bank
j	Number of bank
t	Number of year
α	Constant term
β	Vector of coefficients

ε_{jt} Normally distributed disturbance term

The Generalized Least Square (GLS) is used in this study rather than the Ordinary Least Square (OLS) as method of estimation to estimate the panel data regression formed. The decision is made following Gujarati's (2002) suggestion that GLS may overcome the heteroscedasticity, resulted from utilizing financial data with differences in sizes. Due to the fact that the sample employed in this study consists of small and large banks, differences in sizes of the observations are expected to be observed.

The usual practice of econometrics modelling assumes that error is constant over all time periods and locations due to the existence of homoscedascity. Nevertheless, problems could arise which lead to heteroscedasticity issues as variance of the error term produced from regression tend not to be constant, which is caused by variations of sizes in the observation. Therefore, the estimates of the dependent variable will be less predictable (Gujarati, 2002).

Using OLS estimation will solve the problem since it adopts the minimizing sum of residual squares condition. The OLS allows all errors to receive equal importance no matter how close or how wide the individual error spread is from the sample regression function. On the other hand, GLS minimizes the weighted sum of residual squares. In GLS estimation, the weight consigned to each error term is relative to its variance of the error term. Error term that comes from a population with large variance of error term will get relatively large weight in minimizing residual sum of squares (RSS). Consequently, if a problem of non-constant error arises, GLS is able to produce estimators in Best Linear Unbiased Estimators (BLUE) version because it accounts for such a problem by assigning appropriate weight to different error terms, which in turn, produces an ideal constant variable (Gujarati, 2002).

We therefore adopt a step-wise regression model to avoid severe multicollinearity problems. Accordingly, 11 regression models are estimated to examine the relationship between Malaysian Islamic banks' revenue efficiency and the potential determinant variables.

Variables Description Used in the Panel Regression Models

Variable	Description	Note
Bank Specific		
LNTA	Natural logarithm of total assets	Proxy of size of bank. This positive coefficient of size indicates positive relationship between size of banks and revenue efficiency where the larger the size of banks, the higher the revenue efficiency. This regression outcome may suggest that the large bank size is able to become more efficient due to the benefits obtained such as increasing in revenue, service quality and higher leverage from financial capital (Akhavein et al,1997; Sufian, 2009; and Sufian and Habibullah, 2009).
LLRGL	Loan loss reserve over gross loan	Proxy of asset quality. LLRGL is predicted to have negative coefficient (Sufian, 2009; and Sufian and Habibullah, 2009). Kosmidou (2008) showed that the ratio of loan loss reserves to gross loans (LLRGL) indicates how much of the total portfolio has been provided for, but not charged off, and is used as a measure of bank's asset quality. The coefficient is expected to be negative because bad loans (non-performing loans) could reduce the bank's efficiency level. A better quality asset is described as having lower non-performing loans or ratio of LLRGL (Ismail et al., 2009 and Wang, 2003). In this direction, Miller and Noulas (1997) asserted that the greater financial institutions exposure to high risk loans, the higher the accumulation of unpaid loans, and this lowers the profitability. Therefore, the asset quality will be better if the coefficient is lower. A lower coefficient contributes to a higher asset quality which can increase the revenue of the banks.
ETA	Earning over total assets	Proxy of capitalisation. This coefficient is expected to be positive (Abreu and Mendes, 2001; Casu and Girardone, 2004; Carvallo and Kasman, 2005; Athanasoglou et al., 2008 and Sufian, 2009). The positive coefficient of capitalisation signifies the positive relationship between capitalisation and revenue efficiency where the larger the capitalisation of the banks, the higher the revenue efficiency. The regression result may show that the well- capitalised banks would increase banks' revenue and profitability due to the lower expected costs of financial distress, lower expected bankruptcy costs, and lower risk of portfolio and such advantages will then be translated into high profitability (Bourke, 1989; Berger, 1995; Angbazo, 1997 and Demirguc-Kunt and Huizinga, 1999).
BDTD	Bank's deposit over total deposit	Proxy of market power. this coefficient is expected to show positive sign (Group of Ten, 2001; Carletti et al., 2007 and Graeve et al., 2007). In this regard, the positive coefficient of market power shows the positive relationship between market power and revenue efficiency where the larger market power, the higher the revenue efficiency. The regression outcome suggests that the large market power contributes to the high bank concentration and therefore, changes both loan rates and market shares in imperfectly competitive loan markets and this will contribute to the tendency for banks to charge high loan mark-ups (Carletti et al., 2007 and Graeve et al., 2007).
LOANSTA	Total loan over total assets	Proxy of liquidity. Bank loans are assumed to be the main source of revenue and are expected to affect performance positively. Nevertheless, the coefficient could also be negative which indicates a negative relationship between liquidity and revenue efficiency because loan-performance relationship depends significantly on the expected change of the economy. While in a strong economy, only a small percentage of loans will default (lower percentage of unpaid loans). On the other hand, banks may be depressingly affected during a weak economy as borrowers are likely to default on their loans. Preferably, banks should capitalise on favourable economic environments and shield themselves during adverse conditions (Sufian, 2009a; Sufian, 2009 and Sufian and Habibullah, 2009).

NIETA	Non-interest expense over total assets	Proxy of management quality. NIETA is applied to provide the information on variation in operating costs across the financial system. It reflects employment, total amount of wages and salaries, as well as the cost of running branch office facilities. The lower or higher cost represents a good management quality. Bourke (1989) argued that reduced expenses tend to improve the profitability of the financial institutions. Therefore, a higher ratio of NIETA is assumed to affect performance negatively because efficient banks are expected to operate at lower costs. Moreover, the wages expenses (reduce labour) could be reduced due to the usage of the new technology such as automated teller machines (ATMs) and other automated means of delivering services. Nevertheless, Molyneux and Thornton (1992) showed a contradictory finding in which they observed a positive relationship, suggesting that higher profits earned by banks that are more efficient may be appropriated in the form of higher payroll expenditures paid to more productive human capital. Therefore, the expected coefficient could be negative and may have positive relationship with revenue efficiency. Among studies that employed the similar variables are Berger (1997), Berger and DeYoung (1997), Berger et al. (1999), Athanasoglou et al. (2008), Sufian (2009a), Sufian (2009) and Sufian and Habibullah (2009).
		Macroeconomics
LNGDP	Natural logarithm of gross domestic product	Proxy of gross domestic product. Sufian (2009), Sufian and Chong (2008) and Kosmidou (2008) suggested that the coefficient of the LNGDP is expected to be positive with the bank efficiency which shows that higher LNGDP leads to the higher revenue efficiency.
INFL	Inflation	Flamini et al. (2009) measured the INFL based on the current period of customer prices index (CPI) growth rate. Inflation may have direct effects such as an increase in the price of labour, and indirect effects such as changes in interest rates and asset prices on bank performance (Staikouras and Wood, 2003). Abreu and Mandes (2001) and Sufian and Chong (2008) suggested that inflation is negatively related to bank's profitability, implying that the higher inflation will contribute to the lower profit. However, Sufian (2009) found that the inflation has positive effects on bank's profit efficiency. Perry (1992) suggested that the effects of inflation on bank performance depend on whether the inflation is anticipated or unanticipated. In the anticipated case, the interest rates are adjusted accordingly, resulting in faster increase of bank revenues than costs and subsequently gives positive impact on bank performance. In the unanticipated case, banks may be slow in adjusting their interest rates, resulting in a faster increase of bank costs than revenue; consequently, gives negative effects on bank performance.
		Dummy Variable
DOM_IB	Dummy domestic Islamic bank	DOM_IB is a binary variable that takes a value of 1 for domestic Islamic bank, and it is 0 otherwise. As expected, this coefficient is to be in positive sign which indicates that the banking sector has been relatively more revenue efficient in Malaysian domestic Islamic banks.
		Interaction Variables
LNTA*DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0 otherwise.	LNTA*DOM_IB variable is expected to have positive coefficient that indicates positive relationship between size of banks and domestic Islamic banks. The positive relationship suggests that the larger the size of banks, the higher the revenue efficiency of the domestic Islamic banks.
LLRGL*DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0	LLRGL*DOM_IB variable is expected to be negative because bad loans (non-performing loans) could reduce the bank's efficiency level. Therefore, the asset quality in domestic Islamic bank will be better if the coefficient is lower. This could contribute to the higher asset quality and increase the revenue to the banking sector (Kosmidou, 2008; Cornett et al., 2006; Cornett and Tehranian, 1992).

	otherwise.	
BDTD*DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0 otherwise.	BDTD*DOM_IB is expected to have positive coefficient that indicates positive relationship between market power of bank and domestic Islamic bank. The positive relationship explains that larger market power of the banks will increase the revenue efficiency of the domestic Islamic banks(Carletti et al., 2007; Graeve et al., 2007; Berger, 1995)
LOANSTA *DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0 otherwise.	LOANSTA*DOM_IB is expected to have positive or negative coefficient that indicates positive or negative relationship between liquidity and domestic Islamic bank. The positive relationship explains that higher liquidity of the banks will increase the revenue efficiency of the domestic Islamic banking sector. The negative relationship indicates that the higher liquidity of the banks will reduce the revenue efficiency of the domestic Islamic banking sector (Pana et al., 2010; Diamond and Rajan, 2000; Diamond and Rajan, 2001).
NIETA*DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0 otherwise.	NIETA*DOM_IB variable is expected to be negative or positive because efficient banks are expected to operate at lower or higher costs that represent good quality management. The negative or positive coefficient indicates negative or positive relationship between the banks' cost management and domestic Islamic banks. Thus, lower expenses of banks will lead to higher revenue efficiency in the domestic Islamic banking sector (Sufian, 2009a; Sufian, 2009; Molyneux and Thornton, 1992; Pilloff, 1996; Berger et al., 1999, Berger, 1997).
LNGDP*DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0 otherwise.	*DOM_IB variable is expected to be positive with the bank efficiency. It shows that higher LNGDP leads to higher revenue efficiency in domestic Islamic banks.
INFL*DOM_IB	Binary variable that takes a value of 1 for the domestic Islamic bank, 0 otherwise.	INFL*DOM_IB is expected to be positive or negative with the bank efficiency which indicates that higher or lower inflation leads to higher or lower bank's revenue efficiency in domestic Islamic banks.

5. Empirical Results

Before proceeding with the DEA results, as suggested by Cooper et al. (2002), this study first test the rule of thumb on the selection of inputs and outputs variables. Since the total number of DMUs (17 banks) in this study is more than the number of input and output variables (2 inputs x 2 outputs @ 3 [2 inputs + 2 outputs]), the selection of variables is valid and allows the efficiencies of DMUs to be measured. By calculating the three efficiencies measures (e.g. revenue, cost and profit), we obtain robust results for both the domestic and foreign Islamic banks efficiency. Table 3 illustrates the revenue efficiency estimates along with the cost and profit efficiency measures for both the domestic and foreign Islamic banks.

Efficiency of Domestic Islamic Banks

Table 3 shows the mean cost, revenue, and profit efficiency for the Malaysian domestic Islamic banks of 74.5%, 71.2%, and 62.5% respectively. In other words, the domestic Malaysian Islamic banks have been inefficient in producing outputs by using the same input (revenue inefficiency) and by not fully using the inputs efficiently to produce the same outputs (cost inefficiency). Banks are said to have slacked if they fail to fully minimize the cost and maximize the revenue (profit inefficiency). The results indicate that levels of cost inefficiency, revenue inefficiency, and profit inefficiency are shown as 25.5%, 28.8%, and 37.5%.

For the cost efficiency, the results indicate that on average Malaysian domestic Islamic banks have utilized only 74.5% of the resources or inputs to produce the same level of outputs. In other words, on average, Malaysian domestic Islamic banks have wasted 25.5% of its inputs, or it could have saved 25.5% of its inputs to produce the same level of outputs. It is also worth noting that on average, Malaysian domestic Islamic banks have been more cost efficient in utilizing their inputs compared to their ability to generate revenues and profits. For revenue efficiency, the average Islamic bank could only generate 72.1% of revenues, less than what it was initially expected to generate. Hence, revenue is lost by 28.8%, indicating that the average Islamic bank loses an opportunity to receive 28.8% more revenues given the same amount of resources, or it could have produced 28.8% of its outputs given the same level of inputs.

Obviously, the inefficiency is on the revenue side, which is followed by the profits side. Similarly, the average Islamic bank could have earned 62.5% of what was available, and

lost the opportunity to make 37.5% more profits from the same level of inputs. Even though the cost efficiency is reportedly highest in the domestic Islamic banks, the revenue efficiency is found to be lower, and this led to higher revenue inefficiency. When both efficiency concepts (revenue and cost) are compared, the higher revenue inefficiency seems to have contributed to the higher profit inefficiency levels.

Efficiency of Foreign Islamic Banks

The empirical findings presented in Table 3 seem suggest that the Malaysian foreign Islamic banks have exhibited mean cost, revenue, and profit efficiency (inefficiency) of 79.9% (20.1%), 84.4% (15.6%), and 79.3% (20.7%) respectively. Furthermore, it is interesting to note that on average Malaysian foreign Islamic banks have been found to be more efficient compared to their domestic bank peers. For revenue efficiency, the average foreign Islamic bank could generate 84.4% of revenues than it was expected to generate. Hence, the average foreign Islamic bank lost an opportunity to receive 15.6% more revenue, given the same amount of resources.

As for the cost efficiency, the results seem to suggest that the average foreign Islamic bank have utilized only 79.9% of the resources or inputs in order to produce the same level of output. In other words, on average, foreign Islamic banks have wasted 20.1% of its inputs, or it could have saved 20.1% of its inputs to produce the same level of outputs. Therefore, there was substantial room for significant cost savings for the foreign Islamic banks if they employ their inputs efficiently. Noticeably, the highest level of inefficiency is on the cost side, followed by the profits side. Similarly, the average foreign Islamic bank could have earned 79.3% of what was available, and lost the opportunity to make 20.7% more profits when utilizing the same level of inputs.

In conclusion, the empirical findings from this study seem to suggest that the foreign Islamic banks have exhibited a higher efficiency levels for all three efficiency measures (e.g. cost efficiency (84.4% vs. 71.2%), revenue efficiency (79.9% vs. 74.5%), and profit efficiency (79.3% vs. 62.5%)). In essence, revenue efficiency seems to play the main factor leading to the lower or higher profit efficiency levels. Besides, results for the domestic Islamic banks shows that the level of cost efficiency is higher than profit efficiency due to the lower revenue efficiency level or higher inefficiency from the revenue side. Meanwhile, the level of cost efficiency is slightly higher than

profit efficiency due to the higher revenue efficiency level from the revenue side for the foreign Islamic banks.

Robustness Tests

After examining the results derived from the DEA method, the issue of interest now is whether the difference in the cost, revenue, and profit efficiency of the domestic and foreign Islamic banks is statistically significant. Coakes and Steed (2003) suggest that the Mann-Whitney [Wilcoxon] is a relevant test for two independent samples coming from populations having the same distribution. The most relevant reason is that the data violate the stringent assumptions of the independent group's t-test. In what follows, we perform the non-parametric Mann-Whitney [Wilcoxon] test along with a series of other parametric (t-test) and non-parametric Kruskall-Wallis tests to obtain robust results.

Table 4 shows the robustness tests. The results from the parametric t-test and non-parametric Mann-Whitney (Wilcoxon) test suggest that the Malaysian domestic Islamic banks have exhibited a lower mean cost efficiency level than their foreign Islamic bank peers (0.745 < 0.799). Likewise, the Malaysian domestic Islamic banks have also exhibited a lower mean profit efficiency level compared to their foreign Islamic banks (0.625 < 0.793). The results from the parametric t-test are further confirmed by the non- parametric Mann-Whitney (Wilcoxon) and Kruskall-Wallis tests. Similarly, the parametric t-test and non- parametric Mann-Whitney (Wilcoxon) and Kruskall-Wallis tests results indicate that the domestic Islamic banks have exhibited lower revenue efficiency level compared to the foreign Islamic banks (0.712 <0.844).

Based on most of the results presented in Table 4, we failed to reject the null hypothesis that the domestic and foreign Islamic banks come from the same population and have identical technologies since the revenue efficiency levels of the domestic Islamic banks is lower than foreign Islamic banks at the 0.01 levels of significance. The significant results on lower level of revenue efficiency in domestic Islamic banks indicate that, the revenue efficiency could influence the lower profitability of the banks due to the lower profit efficiency level. Therefore, the revenue efficiency represents the most important efficiency measure which in turn could lead to higher profit efficiency levels.

Determinants of Revenue Efficiency

In essence, the results from the first stage indicate that the revenue efficiency of the domestic Islamic banks has been lower compared to their foreign Islamic bank peers. In what follows, we proceed to identify the determinants which could improve the revenue efficiency in the Malaysian Islamic banking sector. To do so, we estimate 11 panel regression models which is presented in columns (1) to (11) of Table 5. For Model 1, which is the baseline regression model, the regression model includes all six basic bank specific determinant variables namely size of bank (LNTA), assets quality (LLRGL), capitalization (ETA), market power (BDTD), liquidity (LOANSTA), and management quality (NIETA).

Model 2 adds the macroeconomic control variables which are gross domestic product (GDP) and inflation (INFL), while the bank specific variables are kept in the regression model. In regression Model
3, we include a binary dummy variable (DOM_IB) to examine the relationship between revenue efficiency and the Malaysian domestic Islamic banks. Models 4 to 11 represent focused models adopted to identify the potential determinants of Malaysian domestic Islamic banks' revenue efficiency. All the bank specific and macroeconomic variables are retained in these models (Model 4 to Model 11). In addition, we include several interaction variables namely LNTA* DOM_IB, LLRGL* DOM_IB, ETA* DOM_IB, BDTD* DOM_IB, LOANSTA* DOM_IB, NIETA* DOM_IB, LNGDP* DOM_IB and INFL* DOM_IB to further examine the impact of the bank specific and macroeconomic factors on the revenue efficiency of the Malaysian domestic Islamic banks.

Table 5 shows the results from the panel regression models. The equations are based on 86 bank year observations during the period of 2006 to 2010. The results show that the relationship between revenue efficiency and bank size (LNTA) is positive (statistically significant at the 1% level). The results clearly indicate that the larger Islamic banks tend to exhibit a higher level of revenue efficiency. The result is consistent with Al-Sharkas et al. (2008), Cornett et al. (2006), and Akhavein et al. (1997) among others. The large banks tend to report improvements in profit efficiency rather compared to their small and medium bank peers because higher costs incurred tend to be compensated by higher revenues received via quality services. Besides, large banks appear to be better able to capitalize on revenue enhancement and to have better cost cutting opportunities compared to the small and medium sized banks.

On the other hand, we find that asset quality (LLRGL) and management quality (NIETA) exert negative and significant impact on the revenue efficiency of Malaysian Islamic banks. The results clearly indicate that the lower ratio of LLRGL may increase banks' asset quality leading to higher revenue efficiency. The result is consistent with previous studies by Sufian, (2009), Sufian and Habibullah (2009), and Kosmidou (2008), supporting the argument that banks with lower LLRGL tend to exhibit higher asset quality which contributes to higher efficiency levels. Likewise, the empirical findings seem to provide support to the bad management hypotheses of Berger and DeYoung (1997). A lower NIETA ratio represents good management quality attributed to efficient bank managers in managing expenses resulting in the improvement in profitability. Low measure of cost efficiency is a signal of poor senior management practices, which apply to input-usage and day-to-day operation.

The empirical findings presented in Table 5 indicate that market power (BDTD) has positive influence in influencing the revenue efficiency of Malaysian Islamic banks, but only when we control for macroeconomic factors in the regression model. We also find that the impact of capitalization (ETA) is only significant when we control for the domestic Islamic banks (DOM_IB) and market power (BDTD) in regression Models (3) and (7). During the period under study, we do not find statistically significant impact of liquidity (LOANSTA) on the revenue efficiency of Malaysian Islamic banks.

In regression Model (2), we include macroeconomic variables as additional control variables. The results show that the impact of gross domestic product (LNGDP) is significantly positive at the 1% level, supporting the argument on the association between economic growth and financial sector performance (Sufian, 2009). During the period under study, we find that inflation (INFL) exerts negative and significant influence on Malaysian Islamic banks' revenue efficiency levels. The result clearly indicates that lower inflation leads to higher revenue efficiency Malaysian Islamic banks. The empirical finding is consistent with the previous studies by among others Kosmidou (2008).

We include DOM_IB the variable (a dummy variable that takes a value of 1 for the domestic Islamic banks, 0 otherwise) in regression Model (3) to examine the impact of domestic Islamic banks on revenue efficiency in the Malaysian Islamic banking sector. The empirical findings in column 3 of Table 5 indicate that the coefficient of the DOM_IB variable entered the regression model with a negative sign (statistically significant at the 5% level). If anything could be infer, the

results seem to suggest that revenue efficiency is significantly lower for the Malaysian domestic Islamic banks compared to their foreign Islamic bank counterparts.

Robustness Checks: Controlling for Domestic Islamic Banks

The domestic and foreign Islamic banks may react differently to the same efficiency determinants. In what precedes, we seek to identify factors which influence the revenue efficiency of the Malaysian domestic Islamic banks. To do so, we include the interactions of all the bank specific and macroeconomic determinants against the DOM_IB variable. As a result, six new bank specific interaction variables namely LNTA* DOM_IB, LLRGL* DOM_IB, ETA* DOM_IB, BDTD* DOM_IB, LOANSTA* DOM_IB and NIETA* DOM_IB are introduced in regression Models 4 to 9 respectively. Besides, two new macroeconomic interaction variables namely LNGDP* DOM_IB and INFL* DOM_IB are included in regression Models 10 and 11 respectively.

The empirical findings in column 6 of Table 5 seem to suggest a positive coefficient of the ETA* DOM_IB variable (statistically significant at the 1% level) indicating that the relatively better capitalized domestic Islamic banks tend to exhibit a higher level of revenue efficiency. Most of the previous studies (e.g. Casu and Girardone, 2004; Carvallo and Kasman, 2005; Athanasoglou et al. 2008) have showed similar results where the well-capitalized banks were found to lead to the higher profitability. On the other hand, the empirical findings in column 7 of Table 5 clearly indicate that market power (BDTD* DOM_IB) has negative impact on the revenue efficiency of the domestic Islamic banks. The results seem to suggest that an increase in market power tend to decrease the revenue efficiency of the domestic Islamic banks. Ariss (2010) among others points out that a higher market power does not warrant higher profitability levels for Islamic banks because the theoretical predictions and empirical evidence from previous studies have reported that greater market power tend to result in a higher bank risk. Therefore, it could be argued that greater market power may lead to higher risk levels which consequently could result in lower revenues and profitability levels among the domestic Islamic banks.

In column 8 of Table 5 we report the LOANSTA* DOM_IB result. As observed, the empirical findings seem to suggest a negative coefficient of the LOANSTA* DOM_IB. The result seems to suggest a negative relationship between the level of liquidity and the domestic Islamic banks' revenue efficiency. Sufian (2009a), Sufian (2009), and Sufian and Habibullah (2009) suggest that the loan-performance relationship depends significantly on the expected change of the economy.

The revenue efficiency of the domestic Islamic banks tends to be negatively affected by borrowers which are likely to default on their loans during a weak economy environment.

6. Conclusions

The study was carried out with the main purpose to examine the revenue efficiency of the Malaysian Islamic banking sector over the period of 2006 to 2010. To date, the majority of researchers have focused more on cost and profit efficiency in banking sectors and only a few have looked on revenue efficiency. Furthermore, most of these studies are carried out on the conventional banking sectors, while empirical evidence on the Islamic banking sectors is relatively scarce. The non-parametric Data Envelopment Analysis (DEA) method is applied to distinguish between three different types of efficiency measures, namely cost, revenue, and profit. Additionally, we perform a series of parametric (t-test) and non-parametric (Mann-Whitney [Wilcoxon] and Kruskall-Wallis) tests to examine whether the domestic and foreign Islamic banks are drawn from the same population.

We find that there is a statistically significant difference between the domestic and foreign Islamic banks' revenue efficiency. The result of this study shows that the revenue efficiency of the domestic Islamic banks is relatively lower compared to their foreign peers due to the difference between the cost and profit efficiency levels. If anything could be infer, the empirical findings clearly indicate that better revenue efficiency could improve the level of profit efficiency and consequently contribute to a higher profit of Malaysian Islamic banks. The empirical findings from this study failed to reject the null hypothesis that the domestic banks and foreign banks come from the same population and have identical technologies since the revenue efficiency of the domestic Islamic banks is statistically significantly lower compared to the foreign Islamic banks.

We also extend the study to examine the potential determinants of revenue efficiency, particularly for the Malaysian domestic Islamic banks. To do so, we employ a panel regression analysis framework based on the Generalized Least Square (GLS) method comprising the Fixed Effect (FE) and Random Effect (RE) models. Six bank specific (internal) determinant variables are included in the regression models namely size, asset quality, capitalization, market share, liquidity, and management quality. In addition, gross domestic products and inflation rate are included in the regression models as external factors control variables. Furthermore, in order to obtain robust

results, all potential determinants are interacted with Malaysian domestic Islamic banks dummy variables.

During the period under study, we find that capitalization, market power, and liquidity have significant influence on the revenue efficiency of Malaysian domestic Islamic banks. The improvement of the revenue efficiency in Malaysian domestic Islamic banks was also influenced by the rate of inflation. However, the impact is not uniform across Islamic banks with different ownership. We find that the relatively better capitalized domestic Islamic banks tend to exhibit higher revenue efficiency levels. On the other hand, we find that market power and liquidity tend to exert negative influence on the domestic Islamic banks' revenue efficiency. We do not find any statistical significant impacts of macroeconomic conditions on the domestic Islamic banks revenue efficiency levels.

The findings of this study are expected to contribute significantly to the existing knowledge on the operating performance of the Malaysian Islamic banking sector. Nevertheless, the study has also provided further insights to the bank's specific management as well as the policymakers with regard to attaining optimal utilization of capacities, improvement in managerial expertise, efficient allocation of scarce resources, and the most productive scale of operation of Islamic banks operating in the Malaysian Islamic banking sector. This may also facilitate directions for sustainable competitiveness of the Malaysian Islamic banking sector operations in the future.

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Table 1: List of Malaysian Islamic Banks – 2006-2010

Domestic		Foreign	
No	**Bank**	**No**	**Bank**
1	Affin Islamic Bank Bhd	1	Al Rajhi Banking & Investment Bhd
2	Alliance Islamic Bank Bhd	2	Asian Finance Bank Bhd
3	AmIslamic Bank Bhd	3	HSBC Amanah Malaysia Bhd
4	Bank Islam Malaysia Bhd	4	Kuwait Finance House (Malaysia) Bhd
5	Bank Muamalat Malaysia Bhd	5	OCBC Al-Amin Bank Bhd
6	CIMB Islamic Bank Bhd	6	Standard Chartered Saadiq Bhd
7	EONCAP Islamic Bank Bhd		
8	Hong Leong Islamic Bank Bhd		
9	Maybank Islamic Bhd		
10	Public Islamic Bank Bhd		
11	RHB Islamic Bank Bhd		

Source: Bank Negara Malaysia and Sufian (2007).

Table 2: Descriptive Statistics for Inputs, Inputs Prices, Outputs, and Outputs Prices

Variables	Min	Max	Mean	Std. Dev.
	(RM mil.)	(RM mil.)	(RM mil.)	(RM mil.)
*x*1	41.862	35190.400	9018.061	7555.576
*x*2	0.600	431.000	49.027	73.043
*w*1	0.001	0.045	0.021	0.007
*w*2	0.000	2.272	0.043	0.248
*y*1	2.408	33410.200	6074.593	5981.695
*y*2	1.650	1855.600	472.455	410.672
*r*1	0.006	0.666	0.069	0.069
*r*2	0.001	15.161	0.474	1.629

Note:

x1: Deposits (deposits and short term funding), x2: Labour (personnel expenses), w1: Price of deposits (total interest expenses/ deposits), w2: Price of labour (personnel expenses/ total assets), y1: Loans (net loans and interbank lending), y2: Income (gross income), r1: Price of loans (income on loans and other income/ loans), r2: Price of income (other operating income/ income)

Table 3: Cost, Revenue, and Profit Efficiency of Domestic and Foreign Islamic Banks

Domestic Islamic Banks					Foreign Islamic Banks				
No.	Bank	VRS	VRS	VRS	No.	Bank	VRS	VRS	VRS
CE	RE PE				CE	RE PE			
1	Affin Islamic Bank	0.506	0.497	0.278	1	Al-Rajhi Bank	0.855	0.720	0.634
2	Alliance Islamic Bank	0.985	0.987	1.000	2	Asian Finance Bank	0.922	1.000	1.000
3	AmIslamic Bank	0.840	0.941	1.000	3	HSBC Amanah	0.956	0.935	0.919
4	Bank Islam Malaysia	0.697	0.501	0.410	4	Kuwait Finance House	0.701	0.643	0.506
5	Bank Muamalat	0.627	0.594	0.482	5	OCBC Islamic Bank	0.688	0.767	0.697
6	Commerce Tijari	0.632	0.516	0.423	6	Standard Chartered Bank	0.670	1.000	1.000
7	EON Islamic Bank	0.781	0.782	0.661					
8	Hong Leong Islamic Bank	0.600	0.586	0.358					
9	Maybank Islamic	1.000	1.000	1.000					
10	Public Bank Islamic	0.873	0.807	0.752					
11	RHB Islamic Bank	0.654	0.619	0.515					
Mean		**0.745**	**0.712**	**0.625**	**Mean**		**0.799**	**0.844**	**0.793**

Note:
CE: Cost Efficiency, RE: Revenue Efficiency, PE: Profit Efficiency

Table 4: Summary of Parametric and Non-Parametric Tests on Domestic and Foreign Islamic Banks

Test groups	Parametric test		Non-parametric tests			
Individual tests	t-test		Mann-Whitney [Wilcoxon Rank-Sum] test		Kruskall-Wallis Equality of Populations test	
Hypothesis			MedianDomestic = MedianForeign			
Test statistics		t(Prb>t)		z(Prb>z)		X^2 (Prb > X^2)
Mean	*t*	Mean Rank	z	Mean Rank	X^2	
Cost Efficiency						
Domestic Islamic banks	0.745	-1.131	41.09	-0.973	41.09	0.947
Foreign Islamic banks	0.799		46.50		46.50	
Revenue Efficiency						
Domestic Islamic banks	0.712	–2.726***	37.49	–2.827***	37.49	7.992***
Foreign Islamic banks	0.844		53.10		53.10	
Profit Efficiency						
Domestic Islamic banks	0.625	–2.551**	38.46	–2.352**	38.46	5.533**
Foreign Islamic banks	0.793		51.32		51.32	

Note:

*** and **, indicates significance at the 1% and 5% levels respectively.

Table 5: Panel Regression Analysis under Fixed Effect Model

Variable	Model (1)	Model (2)	Model (3)	Model (4)	Model (5)	Model (6)	Model (7)	Model (8)	Model (9)	Model (10)	Model (11)
CONSTANT	–3.92***	15.851***	10.055***	15.97***	9.827**	5.539**	8.361**	13.009***	17.389***	16.13***	15.268***
	(0.788)	(4.162)	(3.772)	(4.208)	(5.351)	(3.246)	(3.649)	(4.078)	(4.129)	(4.257)	(5.245)
Determinant Variables											
LNTA	0.766***	2.412***	1.857***	2.301***	1.815***	1.316***	1.537***	2.049***	2.522***	2.428***	2.374***
	(0.142)	(0.365)	(0.319)	(0.439)	(0.496)	(0.280)	(0.308)	(0.373)	(0.360)	(0.371)	(0.424)
LLRGL	–0.863***	–1.842***	–1.751***	–1.782***	–1.515***	–1.179***	–1.505***	–1.486***	–1.998***	–1.849***	–1.82***
	(0.167)	(0.336)	(0.311)	(0.363)	(0.379)	(0.291)	(0.315)	(0.346)	(0.337)	(0.340)	(0.360)
ETA	0.161	0.168	0.316***	0.186	0.189	0.068	0.269**	0.182	0.201	0.177	0.160
	(0.091)	(0.123)	(0.106)	(0.130)	(0.121)	(0.108)	(0.109)	(0.116)	(0.121)	(0.127)	(0.131)
BDTD	0.069	0.282***	0.166	0.331**	0.347***	0.287***	0.3558***	0.3000***	0.2702***	0.286***	0.267**
	(0.094)	(0.094)	(0.084)	(0.140)	(0.099)	(0.079)	(0.113)	(0.088)	(0.091)	(0.095)	(0.126)
LOANSTA	0.188	-0.010	-0.021	0.014	0.163	0.056	0.010	0.429	-0.054	-0.004	-0.007
	(0.146)	(0.164)	(0.144)	(0.173)	(0.189)	(0.129)	(0.145)	(0.232)	(0.161)	(0.166)	(0.167)
NIETA	–0.183**	–0.134	–0.204***	–0.137	–0.185**	–0.207***	–0.179**	–0.178**	–0.207**	-0.126	–0.135
	(0.079)	(0.079)	(0.072)	(0.080)	(0.083)	(0.065)	(0.074)	(0.076)	(0.086)	(0.082)	(0.080)
Macroeconomic Variables											
LNGDP		0.261***	0.167***	0.263***	0.176**	0.082	0.128**	0.224***	0.281***	0.287***	0.253***
		(0.066)	(0.059)	(0.067)	(0.081)	(0.052)	(0.058)	(0.064)	(0.065)	(0.091)	(0.079)
INFL		–4.697***	–3.283***	–4.705***	–3.161**	–2.047**	–2.74***	–3.915***	–5.02***	–4.755***	–4.426**
		(0.991)	(0.886)	(1.000)	(1.313)	(0.770)	(0.855)	(0.983)	(0.978)	(1.010)	(1.768)
DOM_IB			–0.227**								
			(0.094)								
Interaction Variables											
LNTA*				0.147							
DOM_IB				(0.313)							
LLRGL*				0.555							
DOM_IB				(0.320)							
ETA*				0.899***							
DOM_IB				(0.172)							
BDTD*							–0.367***				
DOM_IB							(0.128)				
LOANSTA*								–0.56**			
DOM_IB								(0.220)			
NIETA*									0.295		
DOM_IB									(0.158)		
LNGDP*										-0.033	
DOM_IB										(0.079)	
INFL*											-0.212
DOM_IB											(1.138)

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	Model 8	Model 9	Model 10	Model 11
R^2	0.405	0.885	0.511	0.886	0.893	0.626	0.528	0.901	0.894	0.886	0.885
Adj R^2	0.347	0.821	0.435	0.818	0.829	0.568	0.455	0.841	0.831	0.818	0.817
Durbin Watson	1.109	2.224	1.203	2.288	2.307	1.542	1.316	2.221	2.311	2.224	2.195
F-statistic	6.927***	13.835***	6.742***	13.049***	14.021***	10.773***	7.205***	15.22***	14.197***	13.032***	12.985***
Estimation technique	**REM**	**FEM**	**REM**	**FEM**	**FEM**	**REM**	**REM**	**FEM**	**FEM**	**FEM**	**FEM**

Note:
(1) ***, **, indicates significance at the 1% and 5% levels respectively.
(2) In parentheses are standard errors.

PROBLEMS FACED BY TAKAFUL FIRMS IN MALAYSIA: SOME INSIGHTS FROM TAKAFUL AGENCY LEADERS

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Abstract

As a business, takaful is increasingly been recognized and emphasized in the Malaysian economy. Despite the importance of the takaful business in the national economy, research emphasis on takaful firms remained limited and neglected in the local context. This study attempted to investigate the problems faced by takaful firmsand industry in Malaysia. The data for the study was collected from 196 Takaful Agency Leaders by using questionnaire. Based on the results of the analysed data, the study identified not only a variety of problems faced by the takaful firms but also found several problems in the takaful industry.

Keywords: *problems, takaful, Takaful Agency Leaders, takaful firms and industry*

1. Introduction

Since its introduction, takaful or Islamic insurance has gained much acceptance as well as experienced remarkable growth. The world takaful industry was estimated to be valued at US$2 billion (RM6 billion) in the year 2010. In terms of growth, it has been estimated that in recent years, the takaful industry has been growing at the rate of between 20 to 25 percentannually. It was projected that the globaltakaful market is expected to be worth US$11 billion (RM34 billion) by the year 2015 (New Straits Times, October 4, 2010).

In Malaysia, there are currently 12 takaful operators. It was reported recently that the takaful industry in the Malaysia grew by 24 percent in 2011 and the industry was valued at RM4.5 billion. This significant growth has made Malaysia the second largest takaful market in the world after Saudi Arabia. It has been projected that the takaful industry in Malaysia is expected to be worth RM7.64 billion in the year 2012 (Business Times, New Straits Times, July 17, 2012).

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Surprisingly, despite the importance of the takaful operators and industry in the Malaysian economy, as an area of research, takaful has not attracted much research emphasis. The literature reveals that past studies in this area of research are still relatively limited in scope, focus, and fragmented in nature. As a result, not much is known about the role and nature of the takaful firms. For instance, although the takaful firms play an important role in the national economy, little is still known about the takaful industry and the manner in which the firms within the industry operated.

Given the limited research and information concerning takaful firms, more focused research efforts are needed in this area of study. One such area of research would be to investigate the problems faced by the takaful firms in Malaysia. Knowing and understanding the problems faced by the takaful firms are of practical importance to those involved in the business and industry. For instance, in the case of policy makers, understanding the problems can assist them in formulating effective policies and developing assistance programs for the takaful firms. More significantly, awareness of these problems can assist owners and managers of takaful firms to acquire the necessary skills, knowledge and attitude to not only overcome the problems, but also to help improve the quality of their products and services.

This paper which is based on a larger study examined the problems faced by takaful firms. More specifically, the study identifies and provides some insights into the problems encountered by takaful firms in the Malaysian context.

2. Literature Review

According to the literature, takaful or Islamic insurance was first instituted in Sudan in the year of 1979. The introduction of takaful resulted from the demand to meet the growing needs and wants of Muslims for an insurance protection in accordance with the Islamic Law (*shariah*). Takaful is based on two main principles that include; joint and shared collaboration (*ta'awun*) and contribution (*tabarru*). On the basis of these two principles, the risk is commonly combined and shared willingly by a group of contributors or participants (Marina Hashim, 1996; Hedagha, 1995; and Annuar and Abu Bakar, 2010).

The concept or term “Takaful” originated from an Arabic expression which means “joint guarantee” or “guaranteeing each other” (Mahmood, 2008). The concept is commonly hold by a group of individuals who have similar concerns about the need to guarantee or shield one another from definite defined adversities such as early death, disability and property indemnity (Obaidulllah, 2005).

The takaful business was introduced in Malaysia in the 1980s. Similarly, its introduction came about as a result of increasing number of Muslim customers wanting a shariah (Islamic) compliance insurance scheme. In addition, the fatwa (decree) issued by the Malaysian National Fatwa Council may have also contributed to the introduction of takaful in Malaysia to a certain extent. The Malaysian National Fatwa Council had issued a fatwathat rejected the contract of conventional a life insurance due to the existence of constituents such as ambiguity, gambling and interest (Central Bank Report, 2005).

In Malaysia, the legal definition of takaful has been provided in the Takaful Act 1984 (Act 312) and regulations.According to the Takaful Act 1984, the term takaful means *a scheme based on brotherhood, solidarity and mutual assistance which provides for mutual financial aid and assistance to the participants in case of need whereby the participants mutually agree to contribute for that purpose.*

The Act further defined takaful business as *business of takaful whose aims and operations do not involve any element which is not approved by the Syariah.* In addition, the Act refers to takaful operator, international takaful operator, takaful agent and takaful broker as a person who carries on takaful business as takaful operator, international takaful operator, takaful agent and takaful broker respectively.
At the same time, as an industry that is still at its infancy stage, takaful encounters various challenges and organizational problems. All business firms face problems, and takaful firms enjoy no special immunity. In general, organizational problems have been defined as those related to human relations, technical issues, organizational inputs and outputs, strategic and operational issues. For instance, the family takaful business in Malaysia started in the urban market with the middle income group as their major clients. However, the demographyof the country indicates that majority of

Muslimsare located in the rural areas. Hence, there is also a need for the takaful firms to market their products and services in the rural areas (Huang and Brown, 1999).

The literature also suggests that takaful firms lack knowledgeable and qualified people. Although there are increasing numbers of educational institutions providing training in Islamic finance, the major problem among the takaful firms has been to hire those who have the capabilities to join their firms.

Although the review of past studies have indicated attempts made to propose and develop framework for classifying problems encountered by entrepreneurs, the literature review reveals there has beenlimited studies conducted on the types of problems encountered by takaful firms, particularly in the local context (Huang and Brown, 1999).

Prior research has also shown that in general, people do not know and understand the need to insured themselves, their family, properties, and their businesses. Findings of past studies have provided evidence that suggested there is still lacked of awareness of the concept of assurance among the general public. For instance, the study conducted by the Survey Research Malaysia indicated that 45% of the participants were found to have only trivial knowledge about the subject of life insurance (Asia Insurance Review, 1997). Another study conducted by Maysami and Low (1998) in Singapore also showed that respondents lacked information and knowledge concerning the need and the importance of insurance.

3. Research Methodology

The data for the study was collected from Takaful Agency Leaders that were employed by the takaful firms in Malaysia. As listed in Table 1, there are currently 12 takaful firms orperators in the country. This study used the directory obtained from the takaful firms as its target population. The directory consisted of 1,000 agency leaders that fulfilled the criteria of Takaful Agency Leader as established by the respective Takaful operators.

Based on the identification criteria, this study selected the 1,000 Takaful Agency Leaders as its sample. The data was gathered from the Agency Leaders by using questionnaire. A total of one thousand questionnaires were posted to the selected Takaful Agency Leaders. Of the 1,000 questionnaires mailed, 196 Takaful Agency Leaders completed and returned the questionnaires. This resulted in a response rate of 19.6%. In the questionnaire, two semi-structure items were used to gather the information on the problems faced by the takaful firms and industry. The respondents were requested to list the three most pressing problems faced by their firms. In addition, the Agency Leaders were also asked to indicate the three most critical problems confronted by the Takaful industry in Malaysia.

Table 1: Takaful Firms in Malaysia

Takaful Firm	Shareholders / Parent Company	Year Incorporated
1. Syarikat Takaful Malaysia Berhad	BIMB Holdings Berhad	1985
2. Takaful IkhlasSdnBhd	MNRB Holdings Berhad	2003
3. CIMB Aviva Takaful Berhad	CIMB Group and Aviva PLC	2006
4. Hong Leong Tokio Marine Takaful Berhad	Hong Leong Group Tokio Marine & Nichido Fire Insurance Co. Ltd.	2006
5. HSBC Amanah Takaful (Malaysia) SdnBhd	HSBC Insurance (Asia Pacific) Jerneh Asia Berhad Employees Provident Board of Malaysia (EPF)	2006
6. MAA Takaful Berhad	MAA Holdings Solidarity of Bahrain	2006
7. Prudential BSN Takaful Berhad	Prudential Plc Bank SimpananNasional (BSN)	2006
8. Etiqa Takaful Berhad	MaybankFortiss	2007
9. GE Takaful	GE Holdings Limited KoperasiAngkatanTentera Malaysia Berhad	2010
10. Am Takaful Berhad	AMMB Holdings Berhad	2010
11. AIA Takaful	AIA Berhad	2010
12. ING Takaful	ING Insurance Berhad Public Bank Berhad	2010

Source: Malaysian International Islamic Financial Center, 2011

4. The Results

Problems Faced by the Takaful Firms

The results of the analyzed data indicate that the takaful firms encountered various problems. The responses recorded from the respondents suggest that these firms faced numerous difficulties related to their business operations and activities.A total of 177 responses from the 196 Takaful Agency Leaderswere included in the analysis. The problems reported by the takaful firms wer eanalyzed and categorized by using descriptive analyses. The results of the analyses indicated that the takaful firms in the study faced ten types of problems. Table 2 lists the ten areas of problems confronted by the takaful firms as reported by the Takaful Agency Leaders that participated in this study.

As shown in Table 2, of the total of 177 responses recorded in the study, 60 (33.9%) responses were found to be related to the poor attitude of agents. The other 42 (23.8%) responses were associated with the employment of part-time agents. Another 33 (18.7%) responses identified in the study indicated that the takaful firms were having difficulty in recruiting new employees. This is followed by 15 (8.1%) responses linked to training, 10 (5.7%) responses indicated poor performance of agents and another seven (4.0%) responses were linked to lack of coaching. The 10 least frequently responses reported problems in the study involved management support (5 responses), competition (3 responses), product (1 response) and poor fund performance (1 response).

Table 2: Problems Faced by the Takaful Firms

No.	Problems	Frequency	Percentage (%)
1.	Poor attitude of agents	60	33.9
2.	Part-time agent	42	23.8
3.	Recruiting	33	18.7
4.	Training	15	8.1
5.	Poor performance	10	5.7
6.	Coaching	7	4.0
7.	Management support	5	2.9
8.	Competition	3	1.7
9.	Product	1	0.6
10.	Poor fund performance	1	0.6
	Total	**177**	**100**

The details of the 177 responses as classified in the ten areas of problems are presented in the following section. The lists, frequencies and percentages of the 10 problems identified in the study Table 3 through Table 11.

Poor Attitude of Takaful Agents

Of the ten major problems found in the study, the concern with poor attitude of the takaful agents has been identified as the most frequently problem confronted by the Takaful Agency Leaders. Poor attitude of the takaful agents represented 33.9%(60) of the total of 177 responses recorded in the study. More specifically, the issues related to the poor attitude among the agents include; poor commitment (45%), not attending meetings (21%), poor discipline (7%), lazy agents (3%), and no confidence (2%). Table 3 lists the issues related to the poor attitude of the takaful agents as found in the study.

Table 3: Poor Attitude of Takaful Agents

No.	Problems	Frequency	Percentage (%)
1.	Poor commitment	27	45
2.	Not attending meetings	21	35
3.	Poor discipline	7	12
4.	Lazy agents	3	5
5.	No confidence	2	3
	Total	**60**	**100**

Part-Time Agents

In this study, 42 responses associated to the problem of employment of part-time agents were recorded from the respondents. The difficulty with employing part-time agents accounted for 23.8% of the total problems identified in the study. The respondents reported various issues related to the use of part-time agents in their firms. Among the issues raised by the respondents concerning the part-time agents included; no commitment among the part-time agents (50%), low productivity (28.5%), not attending trainings (16.5%) and two respondents specifically considered the part-time agents as inactive or “sleeping agents” (5%). The breakdown of the issues related to part-time agents is presented in Table 4.

Table 4: Part-Time Agents

No.	Problems	Frequency	Percentage (%)
1.	No commitment	21	50
2.	Low productivity	12	28.5
3.	Not attending trainings	7	16.5
4.	"Sleeping agents"	2	5
	Total	**42**	**100**

Recruiting

The respondents indicated that recruiting as the third most frequently problem faced by the takaful firms that participated in this study. The figures in Table 2 indicated that 33 (18.7%) of the total of 177 responses were associated to the recruitment of agents in the takaful firms. Table 5 presents the specific issues related to recruiting as reported by the respondents. As shown in Table 5, of the total of 33 responses identified in the study, 67% (22) of the issues were related to poor recruiting, difficulty to recruit qualified agents represented 21% (7) of the total issues, and the remaining 12% (4) were linked to poor selection process in the recruitment of the agents employed by the takaful firms.

Table 5: Recruiting

No.	Problems	Frequency	Percentage (%)
1.	Poor recruiting	22	67
2.	Difficult to recruit qualified agents	7	21
3.	Poor selection in recruiting	4	12
	Total	**33**	**100**

Training

In total, 15 responses (8.1%) indicated concern with the training of the takaful agents. Among the specific issues associated to training as highlighted by the respondents included; no systematic training provided to the takaful agents (47%), not attending training programs organized by the agencies (33%) and lack of knowledge among agents. Table 6 shows the breakdownof theissues that were related to the problem of inadequate trainingamong the agents of the takaful firms.

Table 6: Training

No	Problems	Frequency	Percentage (%)
1.	No systematic training	7	47
2.	Not attending training	5	33
3.	Lack of knowledge	3	20
	Total	**15**	**100**

Performance of Agents

In the study, poor performance of agents was also considered as a difficulty encountered by the takaful firms. The poor performance of agents accounted for 5.7% (10) of the total responsesreported in the study.More specifically, the respondents indicated low productivity (50%), inconsistent performance (30%) and poor persistency (20%) as the three major issues that contributed to the poor performance of takaful agents. Table 7 shows the issues related to the problem of poor performance among the agents.

Table 7: Performance of Agents

No.	Problems	Frequency	Percentage (%)
1.	Low productivity	5	50
2.	Inconsistent performance	3	30
3.	Poor persistency	2	20
	Total	**10**	**100**

Coaching

The respondents identified coaching as another problem faced by the takaful firms. The problem with coaching amounted to 4.7% (7) of the total responses in the study. The Takaful Agency Leaders reported two major issues associated to the problem of coaching the agents in the takaful firms. As shown in Table 8, the two issues involved no coaching given to the agents (57%) and the takaful firms having poor coaching system (43%).

Table 8: Coaching

No.	Problems	Frequency	Percentage (%)
1.	No coaching given to agents	4	57
2.	Poor coaching system	3	43
	Total	**7**	**100**

Inadequate Management Support

The other problem reported in the study was concerned with inadequate management support.This problem amounted to 2.9% (5) of the total responses in the study. The respondents indicated that the agents working in the takaful firms were not receiving enough management support to carry out their jobs satisfactorily. Table 9 presents the two issues related to this problem. The two issues included poor support from the headquarters of the takaful firms (60%) and lack of support from the branches of the takaful firms (40%).

Table 9: Management Support

No.	Problems	Frequency	Percentage (%)
1.	Poor support from headquarter	3	60
2.	Lack of support by branches	2	40
	Total	**5**	**100**

Competition

Competition had also been indicated as a problem encountered by the takaful firms in the study. However, competition was ranked as the eighth of the 10 problems identified in the study. The information in Table 10 indicates that the firms in the study faced competition not only from the other takaful firms but also from the conventional insurance firms.

Table 10: Competition

No.	Problems	Frequency	Percentage (%)
1.	Competition from other takaful firms	2	75
2.	Competition from conventional insurance firms	1	25
	Total	**3**	**100**

Product

The results presented in Table 11 indicate that the problem with takaful products not being competitive as one of the two least frequentlyreported problems identified in the study

Table 11: Product

No.	Problems	Frequency	Percentage (%)
1.	Products were not competitive	1	100
	Total	**1**	**100**

Poor Performance of Funds

As shown in Table 12, results of the study show that poor performance of fund as the other least frequently reported problem encountered by the takaful firms.

Table 12: Poor Performance of Funds

No.	Problems	Frequency	Percentage (%)
1.	Poor performance of fund	1	100
	Total	**1**	**100**

Problems in Takaful Industry

In addition to examining the problems faced by takaful firms, this study also attempted to investigate the types of problems that existed in the takaful industry. In the study, the respondents were also asked to provide information regarding the problems found in the takaful industry.

With regards to the information on the problems in the takaful industry, the study was able to obtain a total of 138 responses from the 196 respondents. By using descriptive analysis, eight major problems were determined from the 138 responses. The eight major problems identified from the analyseddata are summarized in Table 13.

As shown in Table 13, the results of the study indicated that there are eight main problems occurring in the takaful industry in Malaysia. Of the eight problems

identified, competition among takaful operators (24%) has been found to be the most prevalent problem in the takaful industry. The second most frequently reported problem in the industryis concern with the lack of awareness of the takaful business (20%).Following this, problems related to takaful products (15%) and takaful agents (15%) were indicated as the other two major problems occurring in the industry. In addition, the results of the study also showed that the takaful industry faced problem with regard to the claims (12%) made in the industry. The remaining three problems singled out in the takaful industry included; poor support system (8%), lack of company support (4%) and inadequate capital (2%).

Table 13: Problems in the Takaful Industry

No.	Problems	Frequency	Percentage (%)
1.	Competition in the industry	33	24
2.	Lack of awareness of takaful business	27	20
3.	Takaful products	21	15
4.	Takaful agents	21	15
5.	Claims	17	12
6.	Poor support system	11	8
7.	Lack of company support	5	4
8.	Inadequate capital	3	2
	Total	**138**	**100**

Competition

The most frequently recorded problem in the takaful industry is concern with competition.Of the total of 33 responses obtained from the respondents, 21 responses (64%) indicated that competition in industry resulted from rivalry among the existing takaful operators. In addition, another seven responses (21%) suggested that the competition in the industry was caused by too many takaful operators in the industry. The remaining five responses (15%)specifically claimed the existence of product competition in the industry.

Table 14: Competition

No.	Problems	Frequency	Percentage (%)
1.	Competition among takaful operators	21	64
2.	Too many takaful operators	7	21
3.	Product competition	5	15
	Total	**33**	**100**

Problems with Agents

Apart from the competition in the industry, the results of the study show that the industry faced problems related to the takaful agents. In total, the problems related to takaful agents amounted to 15% (21) of the 138 responses recorded in the study. More specifically, the information in Table 15 indicate that the problems related to the takaful agents involved issues such as poor commitment from agents (57%), part-time agents (33%), and unethical agents (10%).

Table 15: Problems Related to Agents

No.	Problems	Frequency	Percentage (%)
1.	Poor commitment from agents	12	57
2.	Part-time agents	7	33
3.	Unethical agents	2	10
	Total	**21**	**100**

Claims

In the study, insurance claims had been identified as another problem in the takaful industry. Claims as a problem represented 12% (17 responses) of the total of 138 responses provided in the study. Of the 17 responses related to claims, 14 responses indicated that there had been delay in claims. The remaining three responses pointed out that there had been too many procedures in the claim process. Table 16 presents the two issues related to claims.

Table 16: Claims

No.	Problems	Frequency	Percentage (%)
1.	Delayed claims	14	85
2.	Too many procedures in the claim process	3	15
	Total	**17**	**100**

Support System

The information in Table 19 shows that 11 responses suggested support system as a problem in the takaful industry. As shown in Table 17, of the 11 responses recorded,

seven responses indicated poor support systems and the other four responses reported old-fashioned systems being adopted in the Takaful industry.

Table 17: Support System

No.	Problems	Frequency	Percentage (%)
1.	Poor support systems	7	64
2.	Old-fashioned systems	4	36
	Total	**11**	**100**

Company Support

The need for company support had been identified as another problem in the takaful industry. As presented in Table 18, four of the five responses concerning company support suggested lack of support from the company. In addition, only one response indicated poor support provided by the branches of the company.

Table 18: Company Support

No.	Problems	Frequency	Percentage (%)
1.	Lack of support from the company	4	80
2.	Poor support from the branches of the company	1	20
	Total	**5**	**100**

Capital

As shown in Table 19, the least frequently reported problem in the takaful industry is concerned with capital. Of the total of 138 responses, only three responses indicated that the takaful industry lacked capital.

Table 19: Capital

No.	Problems	Frequency	Percentage (%)
1.	Lack of capital	3	100
	Total	**3**	**100**

5. Discussions and Conclusions

This study represents an attempt to examine the problems faced by the takaful firms and industry in Malaysia. From the analysed data collected from the 196 Takaful Agency Leaders, the study managed to identify a total of 18 common problems. More

specifically, the results indicate that of the total of 18 problems discovered in the study, the takaful firms confronted 10 problems. The other eight problems were found to be dominant in the takaful industry.

The identification and understanding of these problems identified in this study provide the first step toward positive management of the takaful firms. For the takaful operators and managers, knowing and understanding the problems would be helpful in terms of not only becoming more aware of what needs to be done, but also would be useful to assist them in identifying the right talents, skills, knowledge, and attitudesneeded to enhance the professionalism as well as improve the productivity, efficiency and effectiveness of their firms.

Additionally, the regulators and service providers such as the Bank Negara Malaysia (BNM) and the Malaysian Takaful Association (MTA) could use this information to develop and implement more appropriate, focused and effective assistance programs, in particular training programs. Lastly, since this study mainly focused on describing and reporting the problematic areas faced by the takaful firms and industry, future research should attempt to move toward investigating organizational and environmental factors that can help to sustain the operations and success of the takaful firms in the country.

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INVESTIGATING AWARENESS ABOUT *FARAID* AMONG UNIVERSITY STUDENTS: THE CASE OF INTERNATIONAL ISLAMIC UNIVERSITY MALAYSIA

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Abstract

The purpose of the study is threefold i.e. to examine the level of *faraid* awareness among university students, as well as the factors that may influence it. Furthermore, the study attempts to investigate whether there is any difference between the various groups of respondents based on gender, education level, age and origin. The study uses three main statistical techniques to analyse the data, namely, one sample t-test, MANOVA and multiple regression. The data was gathered by distributing the questionnaire to 150 students of International Islamic University Malaysia. The findings indicate that overall the students have good knowledge about *faraid*. Nevertheless, the students were found to have a misconception and misunderstanding regarding the female share in inheritance in Islam. In addition, the findings show that there is significant education level difference in *faraid* awareness. Finally, the findings conclude that among the variables initially included in the study, only facilitating conditions is significantly influencing the level of awareness of the university students.

Keywords: *Faraid*, Awareness, Malaysia, University.

1. INTRODUCTION

Islam is a religion that covers all aspects of the life, regarding this life itself as well as behaviour that impacts the hereafter. Nafed (2009) stated that *faraid* is one of the most important elements of *shari'ah* law. It provides a set of clear rules that were outlined in Surah Al-Nisa verses 11, 12 and176. During the pre-Islam period (*al-jahiliya*), children, women and old relatives had no right to inherit. Only strong brothers and uncles of the deceased, especially those that are capable of fighting potential enemies, would impose themselves and take the whole wealth. However, as the Quran was gradually revealed,

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these evils were corrected (Hussaini, 2008). Therefore, Islam has established a fair and just system for wealth distribution among heirs without discrimination against gender or particular classes of age.

In the early days of Islam, *faraid* became an independent and crucial branch in Islamic law. Subsequently, it was further expanded and developed in Jurisprudence books. This is due to the fact that *faraid* knowledge is based on two important components, namely, *Fiqh al-mawarith* and Math knowledge; therefore scholars have distinguished *faraid* knowledge from the remaining fields of knowledge and gave it special attention (Al-shami, 1997).

The prophet s.a.w emphasised the importance of *faraid* and the great need to acquire it when he divided *shari'ah* Knowledge into three categories, namely, a precise verse, or an established *sunnah* (practice), or a firm obligatory duty, which is *faraid*. Therefore *faraid* becomes one third of the *shari'ah* Knowledge (Al-Suhailie, 1984).

In another *hadith*, the prophet s.a.w has encouraged his *ummah* to learn the *faraid* and to teach it to others. This is what Abu Hurairah reported that the Prophet said: "O Abu Hurairah, learn *faraid* and teach it to them. Indeed it is half of the knowledge and it is the first thing that has been taken from my *ummah*". In this *hadith*, the prophet has stated that *faraid* is half of *shari'ah* knowledge. This is because *faraid* knowledge is related to the situation where a Muslim passes away, which is one of the two elements of the human being i.e. life and death, while the rest of knowledge is concerned with the present one only i.e. life (Al-Fasie, 2003).

The above *hadith* clearly indicates the importance of *faraid* and its position in Islamic knowledge. Hence, it is of great importance to examine the level of awareness of *faraid* among Muslims. The population chosen is university students, particularly International Islamic University Malaysia (IIUM) Students. This is due to the nature and vision of the university as well as the syllabus offered in all the faculties, which encourages the Islamic aspect of knowledge. Furthermore, the IIUM students' community is a panacea of

international students from more than 100 countries. This makes the sample studied inclusive of respondents from majority of the Muslim countries, as well as countries with minority Muslim citizens.

Thus, the objective of the study is threefold. First, the study attempts to examine the level of awareness of *faraid* among university students, particularly in the case of Malaysia. Secondly, to investigate the possible differences in *faraid* awareness between genders, education levels, age categories as well as origin of the students. Thirdly and lastly, to identify the factors that may influence the level of *faraid* awareness among the students.

The rest of the paper is organised as follows: section two provides an overview on the principles of *faraid*, as well as a review of the main factors that generally influence the level of awareness. Section three discusses the methodology employed in the study, section four discusses the main findings of the study, and finally, section five provides the implications of the study, and its limitations as well as the recommendations for the future studies.

2. LITERATURE REVIEW

2.1. Overview on Faraid

Faraid is wealth distribution knowledge toward those who have a right to inherit. The main aim of *faraid* is to make sure that heirs receive a fair share from deceased relatives. The sources of *fariad* are grouped into three categories, which are: Quran, *sunnah*, and the scholar's *ijtihad*. Moreover, Allah has explained in more details the portion and the share of beneficiaries regarding the distribution in the following three verses in Surah Al-Nisa:

> *Allah (thus) directs you as regards your Children's (Inheritance): to the male, a portion equal to that of two females: if only daughters, two or more, their share is two-thirds of the inheritance; if only one, her share is a half. For parents, a sixth share of the inheritance to each, if the*

deceased left children; if no children, and the parents are the (only) heirs, the mother has a third; if the deceased Left brothers (or sisters) the mother has a sixth. (The distribution in all cases ('s) after the payment of legacies and debts. Ye know not whether your parents or your children are nearest to you in benefit. These are settled portions ordained by Allah. And Allah is All-knowing, All-wise (Ali: Surah Al-Nisa 4: 11).

In what your wives leave, your share is a half, if they leave no child; but if they leave a child, ye get a fourth; after payment of legacies and debts. In what ye leave, their share is a fourth, if ye leave no child; but if ye leave a child, they get an eighth; after payment of legacies and debts. If the man or woman whose inheritance is in question, has left neither ascendants nor descendants, but has left a brother or a sister, each one of the two gets a sixth; but if more than two, they share in a third; after payment of legacies and debts; so that no loss is caused (to any one). Thus is it ordained by Allah. and Allah is All-knowing, Most Forbearing (Ali: Surah Al-Nisa 4: 12).

They ask thee for a legal decision. Say: Allah directs (thus) about those who leave no descendants or ascendants as heirs. If it is a man that dies, leaving a sister but no child, she shall have half the inheritance: If (such a deceased was) a woman, who left no child, Her brother takes her inheritance: If there are two sisters, they shall have two-thirds of the inheritance (between them): if there are brothers and sisters, (they share), the male having twice the share of the female. Thus doth Allah make clear to you (His law), lest ye err. And Allah hath knowledge of all things. (Ali: Surah Al-Nisa 4: 176).

Based on Shalabie (1978), the heirs have to meet at least one of the following three reasons to be eligible to inheritance, namely, blood relationship, marriage relationship or

wala' and Islam. *Al-Irth* is the transfer of property or ownership from the deceased to the living. This transfer depends on three fundamental conditions i.e. the death of al-mawruth, the survival of an heir and the absence of inheritance obstruction such as murder, slavery and differences in religion (Coulson, 1971).

Al-Sabuni (2002) further states that wealth distribution will not take place unless the payment of the following priorities and responsibilities is made: the funeral rites and expenses, debt settlement of the deceased whether debt to Allah s.w.t. or debt to other human beings and prioritisation of the will that was made by the deceased.

According to Shalabie (1978), beneficiaries can be categorised into three groups, namely, *ashab al-furud*, *asabah* and *dhawi al-arham*. A*shab al-furud* beneficiaries are those who have designated portions or shares in the distribution of inheritance according to the Quran, the *sunnah* and the consensus such as daughter, wife and husband. They are the most important individuals of the beneficiaries and they come first in the wealth distribution compared to the *asabah* and *dhawi al-arham* beneficiaries.

While *asabah* beneficiaries are those who are not entitled clearly defined shares in the Quran or the *sunnah*. In some cases, they receive all of the wealth; while the others are just entitled the balance and in the worse case, they do not receive any portion of the estate. This is due to the fact that wealth has been fully spent by *ashab al-furud* beneficiaries.

Dhawi al-arham is a beneficiary who has blood relationship with the deceased, other than *ashab al-furud* beneficiaries and *asabah*. However, the scholars are in disagreement whether *dhawi al-arham* have a right to inherit or not, but in general they agreed that *dhawi al-arham* do not have right in the presence of *ashab al-furud* and *asabah* (Awang, 2008).

2.2. Awareness Factors

Awareness has been extensively explored in the previous studies. These studies have covered different areas, including banking services (Kangis and Passa, 1997; Abdullah and Abdul Rahman, 2007; Rammal and Zurbruegg, 2006; Bley and Kuehn, 2003; Khattak and Rehman, 2010), mobile phone services (Kowalski and Goldstein, 2006), *waqf* (Muhammad, 2010). The findings of these studies have shown contradicting results, for instance, Kowalski and Goldstein (2006) found that respondents were unaware of any security functionality of mobile phones. On the other hand, Abdullah and Abdul Rahman (2007) found that bank managers possess good knowledge of the general principles of Islamic banking and finance. These findings can be explained by the nature of the subject studied and its complicacy or simplicity.

The sources of information have been classified into two main types, namely, explicit sources and implicit sources; a third source that is considered depending on the field is the official sources (Rhem, 2001; Koc and Ceylan, 2009). The explicit sources are a combination of newspapers, magazines, books, and journal articles. The implicit sources cover friends, family, television and radio. Finally, the official sources are comprised of official authorities and nongovernmental organisations. Furthermore, the traditional sources are also relevant in the area of *faraid* awareness and knowledge; this includes Islamic traditional studies, *halaqah,* as well as *shari'ah* courts.

In addition to these sources, facilitating conditions were also considered as one of the factors that determine the level of awareness (Taylor and Todd, 1995; Tan and Teo, 2000). Facilitating conditions include technological and financial resources, government support, as well as environmental support. It is assumed that facilitating conditions have a positive influence on the awareness level. This is supported by the findings of Gu, Lee and Suh (2009). Nevertheless, these results contradicts with those of Puschel, Mazzon and Hernandez (2010), whom have found that resource facilitating conditions do not have any influence on behaviour. This may be due to the nature of the subject studied as above mentioned.

3. METHODOLOGY

The current study is focused on the Malaysian context. Particularly, the target population is the university students' population in International Islamic University Malaysia (IIUM). The questionnaire was distributed to 150 students of the university. Out of the distributed questionnaires, 110 were returned and properly filled, making a response rate of 73.3 %, which is an acceptable rate as suggested by several studies e.g. Dusuki and Abdullah (2007).

The questionnaire was constructed of three main parts. The first part was meant to examine the level of awareness of the respondents with regards to the *faraid* concept and practice. The second part collected information on the factors that may lead to the awareness of the respondents, this was measured based on Rhem (2001), Koc and Ceylan (2009), Taylor and Todd (1995), Tan and Teo (2000), Gu *et al*. (2009) as well as Puschel et al. (2010). The measurement for these two section was made on a five points likert scale (1 = Strongly Disagree and 5 = Strongly Agree). The last section gathered the demographic information of the respondents for subsequent comparative analysis. The questionnaire was made in English and was distributed as such, since English the second language in the country and most Malaysian people can speak English. Furthermore, the sample is taken from IIUM students, which use English as the main medium of study.

The data analysis was done through descriptive analysis, one sample t-test, Multiple Analysis Of Variance (MANOVA), factor analysis as well as multiple regression analysis. It is worth mentioning that the analysis was done through SPSS 18 software.

The demographic data shown in Table 1 below indicates that 60.9 per cent of the respondents are female, while 39.1 per cent are male. With regards to the age distribution, 57.3 per cent are between 20 and 30 years old, 21.8 per cent are between 31 and 40, 10 per cent are below 20 years old, 8.2 per cent are between 41 and 50, and finally 1.9 per cent of the respondents are above 50 years old. In terms of level of education, 58.2 per cent of the respondents are undergraduate students while 41.8 per cent are postgraduate

students. Finally, 55.5 per cent of the respondents are international students, while 44.5 per cent are local students.

Table 1: Descriptive statistics

		Percent
Gender	Male	39.1
	Female	60.9
Age	Below 20	10
	20-30	57.3
	31-40	21.8
	41-50	8.2
	Above 50	2.7
Education level	Undergraduate	58.2
	Postgraduate	41.8
Origin	Local	44.5
	International	55.5

4. RESULTS

4.1. One Sample T-Test

In accordance with the first objective, the level of awareness about *faraid* is tested using one sample t-test. Since the measurement scale used is 5-points likert scale, the neutral point is 3, hence the test value used is 3. The deviation from this value allows identifying whether the respondents have sufficient knowledge of *faraid* in the context of the study.

The results in Table 2 indicate that with the exception of item 12, all the other items are significantly greater than the test value, this includes the overall awareness. This shows that the respondents have sufficient awareness of *faraid* concept. With regards to item 12 referring to “In some cases under Islamic law, the woman earns more than the man”, the results show that there is still a misconception about male and female shares in Islam. Most of the people are aware that male inherits double the share of female heirs, however, few people are aware that there are cases where male and female earn equal share, and some other cases where female earns more than the share of male. This misconception might be due to the misleading information provided by the different types

of media, particularly the western media, in addition to the international women rights' movements and organisations, which are also western based.

Table 2: One Sample t-test

	Test Value = 3					
					95% Confidence Interval of the Difference	
	t	df	Sig. (2-tailed)	Mean Difference	Lower	Upper
Awareness	15.343	103	.000	.95742	.8337	1.0812
Q1	11.615	108	.000	1.08257	.8978	1.2673
Q2	11.150	108	.000	.88073	.7242	1.0373
Q3	12.550	108	.000	1.09174	.9193	1.2642
Q4	9.706	108	.000	.86239	.6863	1.0385
Q5	4.570	109	.000	.50000	.2832	.7168
Q6	6.801	106	.000	.61682	.4370	.7966
Q7	6.775	109	.000	.67273	.4759	.8695
Q8	11.983	107	.000	1.05556	.8809	1.2302
Q9	5.517	106	.000	.60748	.3892	.8258
Q10	4.021	106	.000	.42056	.2132	.6279
Q11	7.277	107	.000	.58333	.4244	.7422
Q12	-.319	108	.750	-.03670	-.2648	.1914
Q13	2.302	109	.023	.24545	.0341	.4568
Q14	9.525	108	.000	.92661	.7338	1.1194

4.2. MANOVA

In order to examine the possible differences of awareness in the four demographic variables i.e. gender, age, education level, and origin, Multivariate Analysis Of Variance (MANOVA) is employed. The multivariate results in Table 3 show that the difference is significant in the *faraid* awareness, and this significance is in terms of the one categorical variable. These differences are further detailed further in Table 4.

Table 3: MANOVA Output

Effect		Value	F	Hypothesis df	Error df	Sig.
Gender	Pillai's Trace	.166	.935[a]	14.000	66.000	.527
	Wilks' Lambda	.834	.935[a]	14.000	66.000	.527
	Hotelling's Trace	.198	.935[a]	14.000	66.000	.527
	Roy's Largest Root	.198	.935[a]	14.000	66.000	.527
Age	Pillai's Trace	.488	.684	56.000	276.000	.956
	Wilks' Lambda	.591	.669	56.000	258.899	.964
	Hotelling's Trace	.569	.655	56.000	258.000	.971
	Roy's Largest Root	.223	1.099[b]	14.000	69.000	.375
Education level	Pillai's Trace	.689	2.516	28.000	134.000	.000
	Wilks' Lambda	.420	2.560[a]	28.000	132.000	.000
	Hotelling's Trace	1.121	2.602	28.000	130.000	.000
	Roy's Largest Root	.794	3.798[b]	14.000	67.000	.000
Origin	Pillai's Trace	.134	.732[a]	14.000	66.000	.735
	Wilks' Lambda	.866	.732[a]	14.000	66.000	.735
	Hotelling's Trace	.155	.732[a]	14.000	66.000	.735
	Roy's Largest Root	.155	.732[a]	14.000	66.000	.735

In terms of gender and age and origin comparisons, there is no significant difference in *faraid* awareness. However, there is significant difference if *faraid* awareness regarding education level, particularly items 2, 6, 7, 8, 10, 11, 12 and 13, as well as the overall awareness. It is noteworthy that the postgraduate students have shown a higher level of understanding of *faraid* compared to undergraduate students. This can be due to the "maturity" and seriousness in knowledge seeking which distinguishes between both groups. This finding is in line with the argument of Venkadesh and Morris (2000) as well as Minton and Schneider (1980).

Table 4: Detailed Comparisons

Source	Dependent Variable	Type III Sum of Squares	df	Mean Square	F	Sig.
Gender	Q1	2.142	1	2.142	2.250	.138
	Q2	1.223	1	1.223	1.814	.182
	Q3	3.878E-7	1	3.878E-7	.000	.999
	Q4	.279	1	.279	.364	.548
	Q5	.095	1	.095	.073	.788
	Q6	.193	1	.193	.219	.641
	Q7	.902	1	.902	1.142	.288
	Q8	1.087	1	1.087	1.837	.179
	Q9	.053	1	.053	.037	.848
	Q10	.623	1	.623	.527	.470
	Q11	.787	1	.787	1.196	.277
	Q12	2.913	1	2.913	2.290	.134
	Q13	.002	1	.002	.002	.967
	Q14	.133	1	.133	.146	.704
	Awareness	.011	1	.011	.039	.844
Age	Q1	2.724	4	.681	.715	.584
	Q2	4.639	4	1.160	1.721	.154
	Q3	4.020	4	1.005	1.173	.329
	Q4	3.063	4	.766	.998	.414
	Q5	1.906	4	.476	.364	.833
	Q6	3.104	4	.776	.881	.479
	Q7	2.290	4	.572	.725	.577
	Q8	1.946	4	.487	.822	.515
	Q9	3.166	4	.792	.548	.701
	Q10	1.931	4	.483	.409	.802
	Q11	1.380	4	.345	.524	.718
	Q12	4.274	4	1.068	.840	.504
	Q13	2.282	4	.570	.527	.716
	Q14	8.935	4	2.234	2.453	.053
	Awareness	2.856	4	.714	2.488	.050
Education level	Q1	1.058	2	.529	.556	.576
	Q2	7.345	2	3.672	5.450	.006
	Q3	3.557	2	1.778	2.076	.132
	Q4	.807	2	.404	.526	.593
	Q5	4.922	2	2.461	1.882	.159
	Q6	8.828	2	4.414	5.010	.009
	Q7	7.449	2	3.725	4.718	.012
	Q8	4.723	2	2.361	3.991	.022
	Q9	8.992	2	4.496	3.113	.050
	Q10	8.377	2	4.189	3.546	.034
	Q11	4.219	2	2.109	3.206	.046
	Q12	8.073	2	4.036	3.173	.047

	Q13	14.049	2	7.025	6.493	.002
	Q14	5.631	2	2.815	3.091	.051
	Awareness	3.787	2	1.894	6.600	.002
Origin	Q1	.763	1	.763	.801	.373
	Q2	.064	1	.064	.094	.760
	Q3	.066	1	.066	.077	.783
	Q4	.003	1	.003	.005	.947
	Q5	.774	1	.774	.592	.444
	Q6	.849	1	.849	.964	.329
	Q7	2.843	1	2.843	3.601	.061
	Q8	1.031	1	1.031	1.743	.191
	Q9	.231	1	.231	.160	.690
	Q10	1.908	1	1.908	1.615	.207
	Q11	.715	1	.715	1.087	.300
	Q12	.420	1	.420	.330	.567
	Q13	.051	1	.051	.047	.829
	Q14	.002	1	.002	.002	.965
	Awareness	.035	1	.035	.121	.729

4.3. Multiple Regression

Multiple regression was subsequently used in order to determine the factors that influence the awareness of the university students about *faraid*. As such, the dependent variable is the awareness level, while the independents variables are facilitating conditions, access to explicit and implicit information, access to information coming from official sources, as well as the access to traditional sources of knowledge.

Table 5: Overall Model Fit

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	10.098	5	2.020	6.646	.000
	Residual	28.567	94	.304		
	Total	38.665	99			

The results in Table 5 indicate that the overall model is valid with a significance level of 0.000. This model excluded four of the independent variables i.e. access to explicit and implicit information, official information as well as the information coming from traditional sources, because these variables were found to be non significant. While “facilitating conditions” was found to be significant as it is shown in Table 6 and it was able to explain 26.1% of the variation in the awareness level of the dependent variable i.e.

R square equals to 26.1%. This result is compatible with that of Taylor and Todd (1995), Tan and Teo (2000), and Gu et al. (2009) that have found a positive relationship between facilitating conditions and behaviour. Nevertheless, these results contradict with those of Puschel et al. (2010). It is worth mentioning that facilitating conditions are a combination of financial and technological resources and environmental support such as family, friends, etc. It also includes government's support. As such, the availability of these conditions will boost the *faraid* awareness among Muslims.

Table 6: Regression coefficients

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.
		B	Std. Error	Beta		
1	(Constant)	3.045	.353		8.620	.000
	F_Cond	.368	.070	.508	5.224	.000
	Explicit	.065	.087	.081	.744	.459
	Official	.041	.068	.061	.602	.549
	Traditional	.034	.070	.046	.480	.633
	Implicit	.171	.086	.224	1.984	.050

5. CONCLUSION

The main of the study was threefold i.e. to examine the awareness level about *faraid* among the university students in Malaysia i.e. IIUM, to test whether there is any difference in *faraid* awareness in terms of age, gender, education level, and origin, and finally to inspect the factors that influence the *faraid* awareness among IIUM students. The findings indicate that the latter have good knowledge about *faraid*. Nevertheless, the students were found to have a misconception and misunderstanding regarding the female share in inheritance in Islam. At this level, the University students appeared unaware of the various cases of females' shares entitlement in Islamic inheritance. In addition, the findings show that overall; there is significant education level difference in *faraid* awareness, however, there is no significant difference between the various age, origin as well as gender groups. Finally, the findings conclude that among the variables initially included in the study, only facilitating conditions is significantly influencing the level of awareness of the university students in Malaysia.

These findings have great implications for the body of knowledge as well as for the practitioners and decision makers. In fact, this study provides a basic measurement of the *faraid* awareness which can be used in the future to conduct studies in this area. The study also provides hindsight on the possible factors to influence the level of awareness, not only in the case of *faraid*, but also with regards to awareness in general. This study is the first to study *faraid* awareness which will seriously enrich the literature on this topic.

For the decision makers and practitioners, the study provides insights on the level of *faraid* awareness and the factors that influence it. This will assist the practitioners to enhance and develop instruments to enhance the awareness of *faraid*.

In a final note, it is worth mentioning that the Muslim scholars, practitioners, stakeholders, policy makers, etc. should put their efforts together to enlighten the future generations on *faraid* and its importance. Particularly, the fairness of Islam with regards to the male and female shares entitlements should be emphasised by countering the western arguments on this matter, so that the truth can prevail.

Nevertheless, the current study has a number of limitations that should be taken into account in the future studies undertaken in this area. The main of which is the sample studied which is 150 respondents taken from university students in IIUM only. This means that future studies should take a larger number of respondents to be taken from different Muslim countries, and not particularly students but various socio-categorical groups. Furthermore, only one of the variables initially included in the study was found to be a significant predictor of *faraid* awareness, which means that future studies should attempt to find the other variables that may explain the variation in *faraid* awareness.

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ISSUES ON CORPORATE WAQF

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Abstract

Traditionally waqf revenues are most frequently spent on mosques. This includes salaries of the Imam, teachers of Islamic studies, and maintenance of the mosque properties. Since the beginning of Islam, education has been financed by waqf and through voluntary contributions. Waqf financing of education usually covers libraries, books, salaries of teachers and other staff. Another section that receives waqf financing or the third largest beneficiary of waqf is the needy those with very low income, needy orphans, person with disabilities and the elderly. However, the present situations of waqf institutions generally, are undoubtedly unsatisfactory. They can be fairly said that in many areas there has been a calamitous collapse of waqf. The institutions are not given proper attention and therefore, vast waqf properties are ill-managed. Since deteriorating situation of the institution of waqf needs urgent attention and should not be left to go further backward, therefore, it makes sense to look in the opposite direction forward and to rethink the situation particularly in respect of the use of existing waqf assets. Indeed the current reappraisal of the role of the waqf offers opportunities to learn from the mistakes of the past and to move for managing the waqf assets in the professional way within a modern administrative framework. Corporate waqf is an innovative adaptation of the Islamic waqf institution that can be made a key organisational strategy to translate the business jihad energy into real and sustainable business and economic success. It is a creative and innovative act to use the waqf concept and apply it to achieve business and corporate objectives. A corporate waqf is therefore envisioned to have a distinct and unique advantage compared with a conventional waqf, in that it allows access to and thus can benefit from all the dynamics of corporate driven businesses.

Keywords: Corporate Waqf, Awareness on Waqf

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1. INTRODUCTION

The nature of the economic system of Islam is determined by following goals and values (Chapra, 2008):

1. Economic well-being within the framework of the moral norms of Islam;
2. Universal brotherhood and justice;
3. Equitable distribution of income; and
4. Freedom of the individual within the context of social welfare.

All economic activities have to be designed and structured to meet above goals. Those should also lead society in formulate any types of transactions and organizations to enable them to operate their economic activities.

The first goal to achieve economic well-being gives simultaneous stress on both the material and the spiritual aspects of life that make Islamic economy unique from other system.

As to second goal, Islam aims at establishing a social order where all individuals are united by bonds of brotherhood and affection like members of one single family. This brotherhood is universal and not parochial or geographical divided. A natural corollary of the concept of universal brotherhood is mutual co-operation and help, which should be able to be translated into operation and institution of Islamic economy.

Meanwhile justice should encompass both social justice and economic justice. The essence of social justice is equal treatment to all without discrimination by the rich and the poor, the high and the low or the white and black. Economic justice happens when everyone gets his due for his contribution to society or to the social product and that there is no exploitation of one individual by another.

The Islamic program for equitable distribution income consists of three parts:

a. Providing gainful employment
b. The payment of zakat for redistributing income from the rich to the poor
c. Division of the estate of a deceased person in accordance with a given formula.

With regard to fourth goal, to set into a proper perspective the rights of the individual vis-à-vis other individuals and society, the jurists have agreed upon the following basic principles:

1. The larger interest of society takes precedence over the interest of the individual.
2. Relieving hardship takes precedence over promoting benefit.
3. A bigger loss cannot be inflicted to relieve a smaller loss or a bigger benefit cannot be sacrificed for a smaller one. Conversely, a smaller harm can be inflicted to avoid a bigger harm or a smaller benefit can be sacrificed for a larger benefit.

This article discusses introducing and developing corporate waqf concept to be one of mainstream tools in the effort to achieve Islamic economics goals and values as described above by Chapra.

2. INTRODUCTION TO WAQF

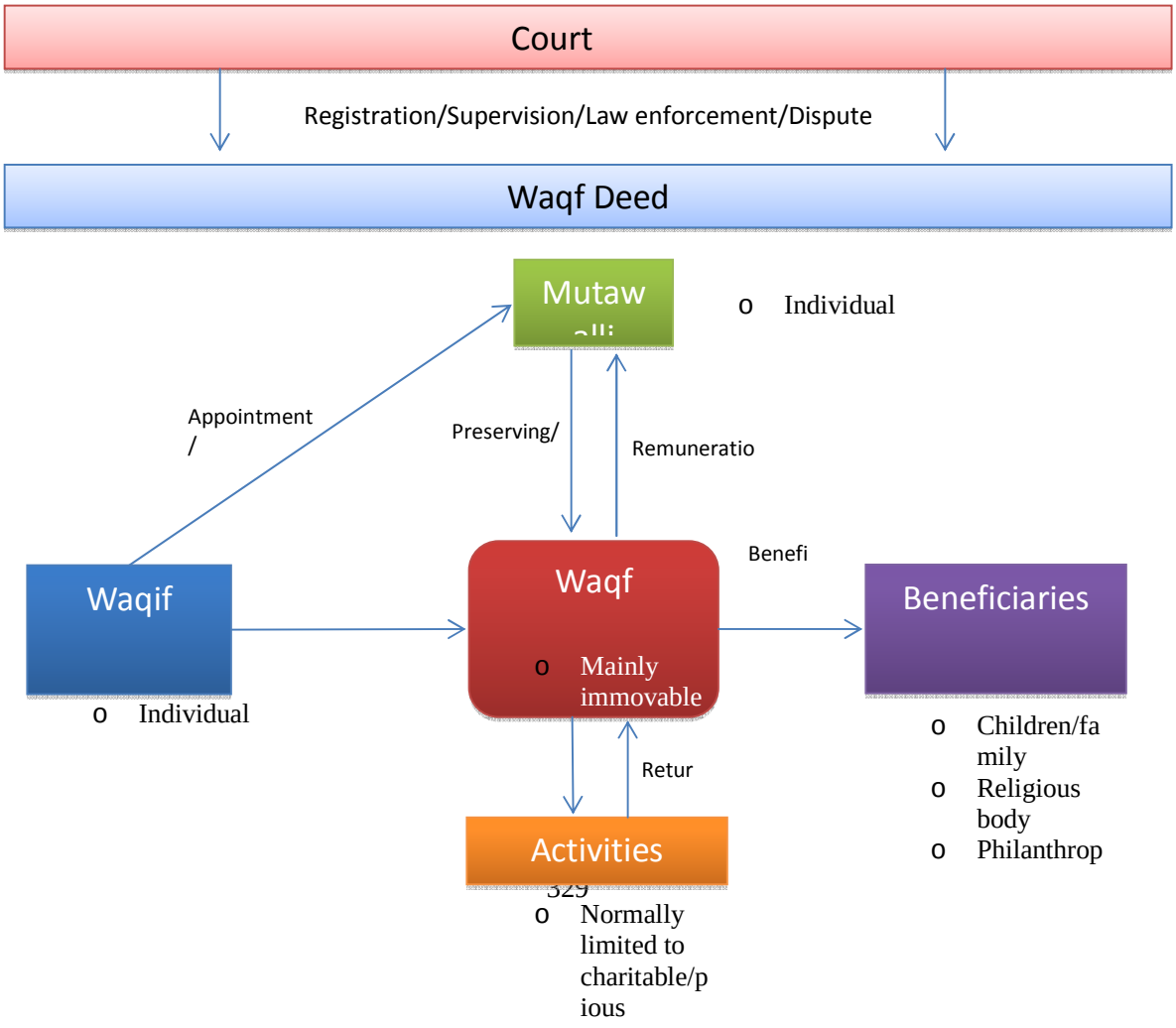
The term waqf literally means to prevent or restrain. In legal terms it means to protect a thing or to prevent it from becoming the property of a third person. Waqf could be defined as the permanent dedication by a Muslim of the corpus of a valuable property to the ownership of Allah SWT with a declaration of dedicating its usufruct perpetually for religious, charitable and or pious purposes as recognized by Shariah (Saleem, 2012).

Waqf is inalienable or made in perpetuity. The corpus of the property made the subject of waqf cannot be sold, mortgaged, donated or alienated even by inheritance.

Waqf is considered a juristic person. It is represented by the administrator (*mutawalli* or *nazir*) who is merely a manager of a waqf, but not the owner. The mutawalli represents the waqf both as a plaintiff and as a defendant. His duty is to do everything necessary and proper for the protection of the waqf property and for its administration. A mutawalli is appointed to carry on management of waqf for the benefit of those in whose favour the waqf has been created. He is responsible for the distribution of proceeds of the waqf amongst the beneficiaries.

A mutawalli may be appointed by the founder of the waqf (*waqif*) or by the court. The waqif may authorize the mutawalli and his successors to take a fixed remuneration out of the income of the waqf property. If no remuneration has been fixed in the waqf deed, the court may on the application of the mutawalli fix his remuneration and authorizes him to realize the same out of the income of the waqf property.

The operation of waqf can be described in graph below:



Sources: proposed by this article authors

The institution of Waqf has played an important role throughout Islamic history, from the time of the Holy Prophet (pbuh) to the beginning of the 19th century (Mohsen). Although this institution survived before the coming of Islam, yet, Islam was the first religion to build up its legal framework and to legalize and regulate it. Thus, it became one of the devices created by the Muslims to fulfill many services that are today financed by the state or the government, such as education, health care, national security, transportation facilities, the basic infrastructure, food, shelter and jobs for many communities. Its role was like a network, which penetrated many service sectors whenever it found a need to promote that sector.

A.M. Sadeq (2005) stated that Waqf is considered an important institution in an Islamic Economic System. It plays an important and precious role along the Islamic history, especially in time of Othoman Khalifate. There were various institutions, organizations, and even some infrastructure facilities which were built by use of proceeds from Waqf properties.

Nowadays, the problem that we are facing now, all over the vast Islamic world, from the Atlantic to the Pacific, magnificent works of architecture as well as myriad of services vitally important for the society have been financed and maintained for centuries through this system. The resilience of the system is, indeed, remarkable. It has been shown that many awqaf had survived for considerably longer than half a millennium and some even for more than a millennium (Crecelius).

Despite these overwhelming achievements, the history of awqaf is a turbulent one. For centuries the fate of this institution was closely linked to the fates of the states under which they functioned. Consequently, they experienced dramatic ups and downs. The period of establishment and growth was often followed by one of decline and neglect and with a new state emerging, a renewal and prosperity once against prevailed. Nowhere in this long history of fluctuations, however, did the awqaf experience the universal and

deliberate destruction that was inflicted upon them during the 19th and 20th centuries, a fact which pinpoints, of course, to western imperialism as the culprit. Yet, the greatest destruction took place not in a region colonized by the great powers, but in Turkey, an Islamic country which was not colonized (Cizakca, 2011).

3. WAQF AS PART OF ISLAMIC VOLUNTARY SECTOR

Islamic concept on production instruct every single individual to be able to fulfill his/her needs in this world by encouraging him/her to work or to produce something which gives benefit to him/herself or and others, so that he/she might be able to achieve his/her self-fulfilling ability and not dependent on others. Islamic Teachings have a clear character in this regards, that there is an injunction that man should be able to manage their wealth and economic resources endowed by Allah SWT in a just manner to facilitate the improvement of all human welfare. The wealth and economic resources should not circulate only among a few people. They should be distributed equitably among all people so that they will enable people to achieve a prosperous society.

"……In order that wealth or property (merely) may not make a circuit between the wealthy among you……" (Qur'an 59:7)

This implies one important question on how to distribute the wealth and economic resources in a just and more equitable way. In this respect, Islamic Economic System recognizes two mechanisms in the distribution of income and wealth (AHM Sadeq, 2005), *first*, functional distribution of income and wealth and *second* income (re)distribution through transfer payment institutions both obligatory and voluntary. The first mechanism conducts the distribution through market mechanism, while the second one implements the distribution through various instruments such as *Zakah*, *Infaq*, *Shadaqah*, and *Waqf*.

The importance of voluntary activities can be understood under the context that Islam is significantly stressing altruistic aspect in the social life. This is implied from the

existence of two types of obligation attached to every Moslem individual, first is obligation for each individual which is irreplaceable or non-transferable, (*fardlu 'ain*). Second is communal obligation (*fardlu kifayah*). Voluntary activities are conducted by Muslim individuals as a reflection of altruism characteristic of human being in Islam. These activities might provide many benefits for the community in the form of public services be made available, such as educational services, orphanage shelters, medical clinic facilities and so on. These kinds of services basically should have been provided by government at the basic level, however, there are always plenty of rooms for members of community to provide similar community's needs due to the limitation of government budget to cover the whole package of such public services.

At this point, voluntary sector's existence being felt very important by community members, because it helps improving the welfare of the community by providing public services deeply needed by them. The activities in this sector are highly motivated by Islamic injunctions under communal obligation for each Muslim individual. As it is believed by Muslim personality, that the best person would be those who capable of providing benefits and helps to others as much as possible. This kind of attitude will drive positively to the community welfare.

4. CORPORATE WAQF

Corporate waqf, on the other hand, is a creative and innovative act to use the waqf concept and apply it to achieve business and corporate objectives. It involves applying modern corporation mechanism and efficiency to optimize achievement of objectives of waqf (Hashim, 2009).

Just like conventional waqf, corporate waqf can be established through voluntary and pious acts of Islamic charity, generosity and selflessness involving the endowment of one's property or asset for the benefit of chosen beneficiaries and the long-term interest of the larger community. It can also be established by governments transferring their

corporate interests, for example, in government linked companies (GLCs), to a corporate waqf body established for that purpose.

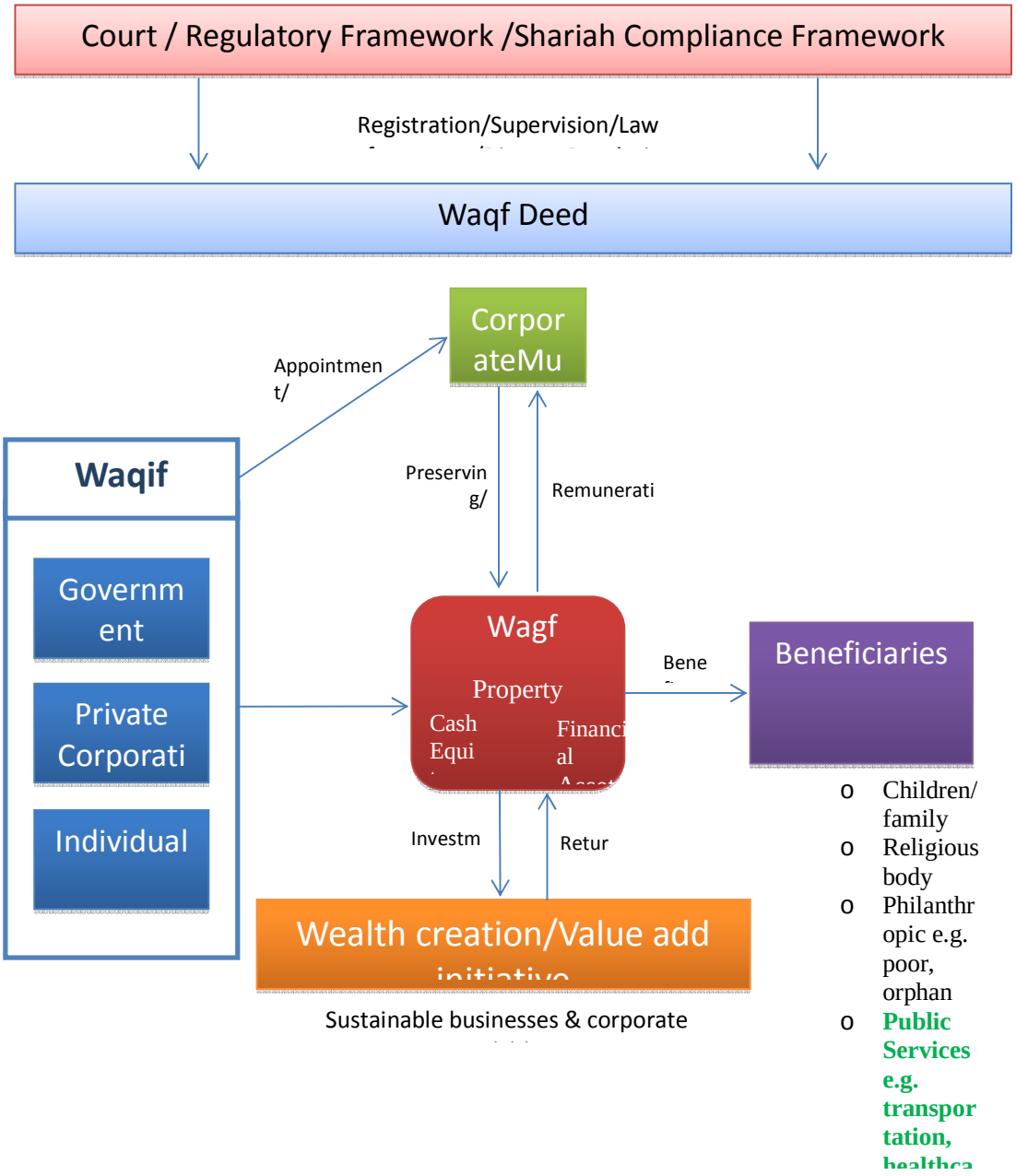
A conventional waqf is more often associated with vesting in waqf the physical assets and property such as land, buildings, physical infrastructures, public utilities and such. In practice, conventional waqf may also involve the waqf of cash, shares, and equity, though these are less prominent.

Corporate waqf, however, goes beyond the waqf entity being just institutional owners having passive possession over shares and equity, and using the earnings or dividend payouts from these shares and equity for the good of the intended beneficiaries. The corporate waqf concept involves an institutional entity - that is, a waqf corporation - by giving it full Mutawwali status (or official management-trustee status) by the relevant Islamic religious authorities.

The corporate waqf also has to have the ability to autonomously act (within the provision of the trust or waqf deed) and exercise discretionary managerial powers. In practice, however, it is wise to subject these discretionary powers to a corporate decision-making structure. Such a structure can be adapted from a managerial and decision-making framework normally adopted and practised by business corporations.

In any event, an effective corporate waqf must successfully move towards a position of corporate control of its investments, if not across the board, at least in selected, key strategic businesses. Such controlling ownership or influential voting power will grant the waqf corporation real, active control over all assets – tangible or intangible - as well as the use of these assets. In this manner, it can influence the impact created from business to ensure that maximum benefit will accrue to its targeted beneficiaries as defined by the trust deeds of the waqf. This adapted version can include, for example, the appointment of CEOs, who are made answerable to a supervising board of directors.

Following graph explain the concept of corporate waqf:



Source: proposed by this article authors.

As can be seen on the above graph, corporate waqf differs from conventional waqf in any of following ways:

1. Under conventional waqf, waqif is mostly individual. In corporate waqf, not only individual can found the waqf, private corporation or government link companies can be part of the waqif.
2. The subject matter of conventional waqf normally immovable property. Under corporate waqf, subject matter can be extended to the other types of property such as cash, equity and financial asset.
3. Mutawalli in conventional waqf is mainly individual appointed by the waqif or the court. Under corporate waqf, mutawalli can be a company.
4. In terms of activites, conventional waqf usually limit itself within charitable or pious activities or limited businesses. On the other hand, corporate waqf with resources in its disposal may spread its wing to venture to sustainable business and corporate activities.
5. With effective and efficient corporate-style of management, waqf may have better chance to produce high and sustainable return to beneficiaries.

In short, corporate waqf is an effort to revive waqf role by inserting the efficiency of corporate mechanism.

5. ISSUES ON CORPORATE WAQF MODELS

Issues may arise in reviving waqf as mainstream part of Islamic economy through introduction and development of corporate waqf can be viewed from following perspectives:

1) Awareness on Waqf

2) Management/Mutawalli

3) Subject Matter/Mauquf

4) Distribution

5.1 Awareness on Waqf: How to Motivate People or Organization to Contribute in Waqf

Community participation is a key part of the philosophy of many institutions especially businesses. Charitable donations in particular by way of Waqf are one way that individual, companies, owners and employees give back. Fundraising brings workers together in support of a common cause and helps raise a business' community profile. Knowing what motivates people and businesses (institution) to contribute in voluntary and charitable activities including Waqf will help us to set our policy in order to ensure that this idea is successful.

Based on several studies conducted, there are many reasons why people or organization contributes in charitable activities. For instance, it can be further deliberated as follows (Kooser):

Personal Motivations

A lot of people donate to organizations where they have personal ties. For example, someone with a family member afflicted by cancer may get involved with a charity such as Cancer Society and others. Further survey by the *Mutawalli* can be conducted to classify which sector of charities they support. These opportunities can be used to identify such sectors or types of beneficiaries where the people or organization will then support this Waqf scheme.

Building Morale

Employees of the companies will feel good when they know that their employers care about giving back to the community especially by way of doing Waqf. Holding an office charity performance is way to build companionship among workers and boost morale. Set fundraising goals and turn it into a friendly

competition. Matching funds are another way to get involved with employee charities and allows employees to know that the organization is care about their lives outside of the office.

Community Involvement

A business is only as strong as the community that surrounds and supports it. Healthy communities feed into healthy businesses. Your monetary donations can go to causes that promote better health, fund medical research, stock food banks or support organizations that fight poverty. Investing in charities is like making an investment towards a better future for employees and for the business itself. Therefore, today's Corporate Waqf should have a very specific target in term of its distribution towards beneficiaries and charitable activities in order to motivate community involvement.

Marketing

Promoting the business is a positive side effect of being active in community organizations and charitable giving especially in Corporate Waqf. Sponsoring events with banners, t-shirts or other giveaways gets the business name out in the community. In addition, working with a non-profit allows the organization to promote itself through press releases or postings on their website. The organization therefore, can consider focusing part of their marketing budget into charitable giving.

Tax Deductions

The Income Tax Department allows individual and businesses to deduct certain charitable contributions. These monetary donations need to be made to a registered non-profit organization. The authorities e.g. Majlis Agama have to find

a way to ensure that the Corporate Waqf's organizer is registered as one of the institutions that will eligible for this tax deduction incentive.

5.1.1 Proposed Solution to Motivate Participation in Waqf

Moving forward, in order to solve this awareness issues on Waqf especially Corporate Waqf, we are suggesting the following:

1. To develop a clear, concise, compelling request for the objectives of introducing this Corporate Waqf. People and organization will contribute because they believe in the mission of the institution and also trust that the Waqf Institution to be good stewards of their gift. It can be done via connecting them with a clearly crafted letter, email, website or event.

2. To create apparent what is in it for the contribution. Tell them what they will get back from donating money to this institution. For instance, it could be the satisfaction of knowing that a child in charity house will be fed and clothed for a month. It could be that they will be recognized in the newsletter, with a plaque, or at an event for their gift. It could be that they will receive some item in return.

3. To give details how the contributors will be able to track what happens to the money they give to the Waqf institution. Donors want to make the most of their charitable dollars and need to know that the Mutawalli is transparent, accountable and honest. They especially want to make sure that the money they give goes to the purpose for which they designated it. Besides, the law safe-guards the donor's right to designate how the Mutawalli will use their gift.

4. To thank the contributors within reasonable time frame for example, of receiving their contribution. When the Mutawalli operates its program of donor relations according to a regular set of procedures and policies, donors become more

motivated to give subsequent gifts. Many donors test an institution's ‘customer service’ with a very small first gift, so that they can determine how the institution treats and values its donors. Then, if they feel embraced, they may become more seriously committed and motivated to donate more.

5. The present corporate Mutawalli have to become more creative such as active in social network online communities like Twitter, FaceBook and etc. Individual like younger people tend to respond better to online giving campaigns than to direct mail appeals. While the first online gift may be small and motivated by impulse and mercy if the institution services these smaller online donors well, thanking them genuinely, and providing them with opportunities to join your conversation, you are likely to make friends. As Hal Colston of Good News Garage in Burlington, Vermont, is fond of saying: *"Friend-raise and the funds will follow."* (Barker)

5.2 Mutawalli

One of the key elements in our corporate waqf is Mutawalli. Monzer Kahf (Kahf, 2011) used it as a waqf manager and his/her responsibility is to administer that waqf property to the best interest of the beneficiaries and then to maximize the revenues of the beneficiaries. Based on this definition, a mutawalli will monitor a waqf property in a proper way to ensure the continuity of the existence of the assets and the beneficiaries will continue gain the ‘manfaah’ of the said property. The second part of the definition given by Monzer Kahf catered for the latest corporate waqf concept in which a mutawalli is not only a waqf keeper but he is also responsible to act in a corporate style in order to increase the value of the assets and to enhance the cash inflow of the institution and thus will maximize the revenues of the beneficiaries.

In Islam, the function and position of Mutawallis are clearly defined. His role is as a manager to manage the waqf properties is crystal clear and it is totally different compared to the other religion’s trustee concept which the role and position are not clear.

While these individuals were the ones who actually preserved the Islamic architectural heritage through the centuries and enabled many waqf to survive, it was also they who ended up being accused ruthlessly and held responsible for the demise of the system (Cizakca, 2011). In another words, Mutawallis are the nucleus in the waqf system, the success of the system is partly contributed by this center. However, the opponent of the waqf system would propagate that the failure of the system was due to the failure of the Mutawallis. Since then, the mutawallis can be considered as a captain of a ship or a pilot of a flight which the destination of a journey will safely arrive. Hiccups in a journey will first reflecting a pilot skills even it is totally caused by the weather condition.

In Malaysia, Majlis is a sole trustee or a mutawalli in any waqf arrangement. Majlis refers to the body constituted under the provisions of the Islamic Administrative legislation of each state as passed by their respective Legislative Assemblies and for the Federal Territories of Kuala Lumpur , Labuan and Putrajaya by the Parliament (Mahamood, 2011). Majlis is an authority body in every state assigned by the Rulers of the states (called as Sultan) respectively to govern a religious related matters. Since waqf is under religious matter of the states, therefore, for the purpose of standardization and uniformity of the operation, the role of trustee or Mutawallis is totally parked under the custodian of the Majlis.

Based on earlier identify function for mutawalli which is relatively related to the business function, therefore a mutawalli needs to have a creative and business skill. Generally, a religious body likes Majlis consists of parties who have a meticulous understanding of Islamic religious but lack in business and administrative soft skill. It is directly reflected into the performance of the waqf assets. It is proven that the continuity and permanence of the waqf assets are being materialized but not in growing and developing the said assets in order to boost up the value and increase the ‘manfaah’ and thus distributable to the beneficiaries. This trigger a point which the right of the mutawalli should not be restricted to the Majlis only but need to be closely monitored by them.

Under the State of Selangor, Part IVof the Administration of Muslim Law Enactment, 1952, No. 3 of 1952 (Mahamood, 2011) stated that Majlis has a power to appoint officers and servants in helping them in properly manage and administer these assets. The same provision has being made available in *Wakaf* (Negeri Sembilan) Enactment 2005 under Part VII: Management of Wakaf, item 34: Majlis shall ensure person or agent performs obligations. Based on these provisions, it shows that the authority has identified the above problem and proposed this mechanism as a tool to curb it.

The writer would propose within the restriction of Majlis as a sole trustee, a list of requirements which will guide the selection of the agents. These requirements will work as a guideline toward corporate identity which later will translate in management quality and appreciation of waqf assets value.

The suggested requirements for a competent person to be a corporate mutawalli are:-

(a) An expert Muslims with a good business sense and a well understanding of Islamic principles.
(b) He must be well understanding of local ‘uruf’ and customs, and have a good relation with local societies and related parties to waqf.
(c) He must possess at least a Bachelor Degree in a business related study.
(d) He must have a minimum of 10 – 15 years experience in related industry.

The above lists are the basic requirements need to be satisfied and the other corporate requirements in hiring the top management need to be maintained. Furthermore any additional or modification to the requirements in order to fit the situation and condition are allowed.

These suggestions are very difficult to be implemented especially in Malaysia since there are a lot of conflicts between state and federal authorities in term of power sharing, standardization of laws, the problems of squabble among Islamic jurists and scholars and boundaries problem. In order to satisfy this problem, a suggestion in standardizing the

laws of waqf needs to be materialized. In order to do this, the same implementation which has being done for Islamic Banking in Malaysia in almost three decades ago i.e. the establishment of Islamic Banking Act 1983, could be proposed. Waqf Act should be established using the same mechanism and thus a single act across all the states in Malaysia which will standardize the waqf laws can be happened.

The last part to be discussed under the corporate mutawalli is the governance issue. A waqf property will be managed by mutawalli who will act as an agent. In this arrangement, the same agency problem may arise since an agent is a human in nature and will normally act at least not to jeopardize his own benefit. In order to control this problem, a modified corporate governance concept needs to be implemented in bridging the asymmetry gap between the contributors, agents and beneficiaries.

A shariah advisory board needs to be appointed in order to ensure, that the operation will be in a correct lane at all time. This board will review all the reports, procedures and policies of the operation periodically and will take corrective and preventive action in their efforts. Finally, a standardized reporting and auditing statements which can cater the Islamic and waqf perspective need to be established and at the same time the performance of waqf is 'evaluate-able'.

5.3 Subject Matter of Waqf

In traditional practice, the subject matter of waqf is in certain form of assets which normally have a characteristic of immovable property. There is ulama' who opine that the mauquf needs to be in immovable property only. At the same time, In Indonesia for example , the constraint in introducing cash waqf and making it acceptable by Muslim in Indonesia is that they still believe that waqf must be in the form fixed assets, not in the form of money (Dewi, 2011). This condition leads to the controversy of a few mauquf types which suitable to be implemented in a corporate waqf structure.

On the other hand, Murat Cizakca (2011) discussed in thorough about cash waqf which has being implemented in earlier century. He stated that 'the earliest origins of the cash waqf may be traced back to eight century, when Imam Zufar was asked how such waqf should function. He had replied that the corpus (mauquf) of the waqf should be entrusted to the entrepreneur in the form of mudarabah (Cizakca, 2011)'. This statement shows that, the mauquf should not be limited to immovable property only.

The allowable of this mauquf gives a wider prospect for all parties to involve in waqf endowment. For the contributor, it will attract many parties to create waqf because an initial capital outlay is not in a big lump sum amount compared to the waqf immovable properties. The more the parties involve the bigger the size of the fund. As the size of the fund increasing, it will create a pool of cash which later will create flexibility for the mutawallis to manage this fund but with the stated and given instruction of the fund contributor. A mutawalli needs to grab this flexibility and liquidity in generating extra revenue for the benefits of the beneficiaries. This implementation can be done in a proper way through a corporate structure and business operation.

A second mauquf for corporate waqf is stock. A founder may purchase or allocate a certain units of shares for the purpose of waqf. The proceeds or dividends from these shares are directed to the beneficiaries (after deducting the operational cost).

Part VI of the Administration of Muslim Law Enactment, 1952, State of Selangor (ammended 23rd December 1999) (Mahamood, 2011) discussed about Istibdal and development of mawquf. In istibdal, the mauquf is allowable to be replaced by another property provided the replacement is at the equivalent value. This condition will cater the issues of liquidity when the dealing is related to the traded stock.

On the other hand, property investments or any business related investment can be used as a mauquf in generating more inflow for the waqf which later to be channeled to the beneficiaries. However this situation needs new ijtihad and fatwa which can be based on the doctrine of permissibility i.e. everything related to muamalah is allowable except

those mentioned and categorized under haram transactions. Hossein Pirasteh and Hojjatoullah Abdolmaleki have listed down a few principles which known as prohibitive principles which regulate trade and economic activity to be mentioned as follows (Abdolmaleki, 2011):-

(i) Act of Batil

The first kind of prohibition is doing some act as Batil. According to ayah 29 of Surah An-Nisa; : "Do not consume your wealth among yourselves unduly (bil-batil) except by trade and mutual agreement". Batil is anything which violates the rights of Allah, and transacting parties as well as third parties

(ii) Illegal Act

The second acts of prohibition are those activities which are declared 'illegal' by the Islamic State.

(iii) Wealth Accumulation by Violating Other's Rights

The third acts of prohibition are ways of creating wealth that violates the right of third parties. This covers all negative externalities.

All of the above prohibitive principles can be used as a general guideline in determining the 'allow-ability' of the mauquf and thus will open a big floodgate which later will flourish the evolvement of waqf.

5.4 Distribution of Waqf

The importance of Waqf relies on the form of property being donated and it can be distributed to the various types of interest or necessities (i.e. public or ummah interests) (Tohirin, 2010). Meanwhile, in Bangladesh Education Sector recorded merely more than 8,000 educational institutions established based on Waqf. In addition, 123,000 mosques were built based on Waqf, most of which have education institutions (A.M. Sadeq, 2005). The following illustrations also indicate the important roles played by Waqf institutions for the countries (M. Boudjellal, 2005):

1. Three-quarters (3/4) of all Arab land in the former Ottoman Empire belonged to ‘awqaf.
2. In Algeria, under French occupation, Waqf comprised half (1/2) of the lands of the country in the middle of the nineteenth century.
3. For the same period, Waqf comprised one third (1/3) of the land in Tunisia.
4. In Egypt in 1949, about one eighth (1/8) of the agricultural land belonged to this category.

Further historical notes stated that in this Waqf sector, there was interesting record on the proportion of Waqf forms being donated by Muslim *Ummah* as revealed in a study by Ruth Roded during six centuries period (1340-1947). It covered 104 Waqf institutions (endowment foundations) in Egypt, Syria, Palestine, Turkey, and Anatolia, and resulted in the following (M. Boudjellal, 2005):

1. Fifty eight (58) percent properties were concentrated in big cities and were comprised of commercial shops, roadhouses, flat and houses.
2. Thirty five (35) percent were concentrated in small villages and countryside and comprised of agricultural lands, farms and gardens.
3. Other types of ‘awqaf represented seven (7) percent where five point five (5.5) percent were in the form of money.

Based on the above explanation, it can be concluded that Waqf has significant potential to contribute to community development. It might play very crucial role in alleviating poverty as it can be targeted to low income groups. Managing whatever types of Waqf especially this Corporate Waqf requires many important aspects to take into account. Corporate Waqf might play an important role as a mode of transferring wealth. The issues arise today is that, it has been seen that the distribution of currently practiced Waqf is redundant with the targeted groups which can handled by *Zakah* which was mainly distributed to eight (8) categories of the beneficiaries (*Asnaf*) listed in the Qur'an. This kind of redundancy is to be resolved swiftly as Waqf can be extensively distributed for

religious and charitable activities. It is then expected that the Waqf should do better in term of distribution.

5.4.1 Proposed Solution on Distribution of Waqf

Related to this distribution, it is crucial to understand what are the main objectives in proposing this Corporate Waqf then to follow the purposes of its targeted distribution program. Therefore, it is strongly recommended that the distribution of generated income from Waqf might be targeted for the following purposes:

1. Reduction in Government Expenditure

   We are looking forward that the Corporate Waqf system would be confused by the fact that a numerous of essential services such as health, education, municipal, etc., were provided in history at no cost whatsoever to the government. Therefore, assuming that the efficiency problems are solved, the Waqf system can significantly contribute towards that ultimate goal of every modern economist; massive reduction in government expenditure, which leads to a reduction in the budget deficit, which lowers the need for government borrowing thus curbing the "crowding-out effect" and leads to a reduction in the rate of interest consequently reining a basic obstruction for private investment and growth.

2. Reduction in the Rate of Interest

   From the point of view of Islamic economics, the most important item in the above mentioned agenda is, obviously, the reduction in the rate of interest. The Waqf can, indeed, lower the interest rate by providing the most essential social services without any cost to the government. This important contribution of the Waqf system towards the gradual elimination of *riba* is not yet recognized by the Islamic economists. [2] It will be proposed here that it should be. Put differently,

[2] The most recent survey of Islamic economics is totally unaware of the importance or even the existence of endowments. See Mohamed Aslam Haneef, (1995). The linkage with *riba* was also not raised in the proceedings of the Jeddah conference of Islamic economists on awqaf. See IRTI, (1987), *Management and Development of Awqaf Properties*, Jeddah: IRTI/IDB.

are-establishment and revitalization of the Waqf system should be considered as a vital step in the struggle to eliminate *riba*.

3. Social Service Function

   Distribution of this type is aimed to fulfill the needs of those who are unprivileged. Waqf is a foundation, which aims at social service by various services provided by it. But when the historical process is taken into consideration, this social service fulfils a duty beyond the struggle of poverty to help to poor people. It will then contributes to upliftment of humanity and betterment of life and provides a life level which is proper with human dignity.

4. Empowerment

   Segment of this target is persons or group of people who have prospective business ventures but having difficulties to access financial capital. Empowerment here is aimed to provide means of production, i.e. financial capital so that this group of small business enterprise for example, might enhance their business ventures further. In assisting this group, various types of contracts in line with Shariah might be utilized, such as *mudharabah*, *musharakah* or *murabahah*, etc.

5. Human Investment

   This type of human investment is targeted to provide education, through scholarship program, or training to improve the quality of human being by enhancing the level of skills of labor or entrepreneurs. In the end, it is expected that productivity of this group of people will improve and positive effect on the level of output might be resulted.

6. Infrastructure Investment

   It is meant to assist providing physical facilities such as buildings for schools, medical facilities, and so on, which will help improving community's welfare.

Waqf plays an important role in protection environment and improvement of city and villages, has underlying role in transportations between cities (road, bridge, castle, caravansary, trade road, channel); plays an important role in municipality, agriculture and development such as road, water channel, bridge, school, hospital, library etc.

As a conclusion, Corporate Waqf as a relatively new method in Islamic voluntary activities might be considered as an important avenue to contribute to the development of a more productive Waqf property's management, which ultimately capable of producing various public services needed by community. It can be implemented side by side to assist other types of Waqf properties, especially buildings or lands, to enhance their productivity. It also can be implemented separately as independent Waqf property directed to achieve similar purposes in the area of public services. In short, its public benefit or *maslahah* that being taken care of most.

6. CONCLUSION

Traditionally waqf revenues are most frequently spent on mosques. This includes salaries of the Imam, teachers of Islamic studies, and maintenance of the mosque properties. Since the beginning of Islam, education has been financed by waqf and through voluntary contributions.

Waqf financing of education usually covers libraries, books, salaries of teachers and other staff. Another section that receives waqf financing or the third largest beneficiary of waqf is the needy those with very low income, needy orphans, person with disabilities and the elderly.

However, the present situations of waqf institutions generally, are undoubtedly unsatisfactory. They can be fairly said that in many areas there has been a calamitous collapse of waqf. The institutions are not given proper attention and therefore, vast waqf properties are ill-managed. Since deteriorating situation of the institution of waqf needs

urgent attention and should not be left to go further backward, therefore, it makes sense to look in the opposite direction forward and to rethink the situation particularly in respect of the use of existing waqf assets. Indeed the current reappraisal of the role of the waqf offers opportunities to learn from the mistakes of the past and to move for managing the waqf assets in the professional way within a modern administrative framework.

Expressing its economics contents the waqf can be explained as diverting resources from consumptions and investing them in productive assets that provide either usufruct or revenues for future consumption by individuals or groups of individuals. The surplus income of waqf can be put into operation that combines the act of saving with the act of investment together. It consists of taking certain resources off consumption and simultaneously putting them in the form of productive assets that increase the accumulation of capital in the economy for the purposes of increasing future output of services and incomes.

A waqf asset is considered a trust asset, where the role of the trustee is to look after the asset and ensure is perpetuity for the beneficiaries. All the fixed waqf assets have the potential to generate benefits for the public and contribute towards wealth and prosperity. Furthermore, the establishment of an Islamic waqf is very close to the establishment of a business corporation whose life span is unlimited. Therefore the waqf is a developmental process by virtue of its definition as it involves the accumulation of productive wealth through present investment that favours future generations since the waqf gives its beneficiaries future benefits in cash or kind without any fee or charge.

The waqf need to be privatised by returning their assets to private management by creating waqf boards of trustees. They will help managing the assets of waqf in a professional manner. Apart from that, there is also a need a complete revitalization of the management of waqf especially, immovable assets of waqf, in order to fulfil two objectives: (i) to increase the efficiency and productivity of the waqf properties; and (ii) to minimize fraudulous practices and corruption by the mutawalli/waqf managers.

Furhermore, there is also a need to provide a new style of management that suits the waqf instututions, keeping in mind that their properties are not owned by those who manage them.

On the aspect of solving today unemployment problems, if the waqf institutions are managed professionally by implementing the revitalization schemes, establishments like waqf will provide employment opportunities for the people and will contribute to the economy. Improving the waqf institution by adopting modern business management techniques will make the waqf institutions into transparent and responsive institution.

For professionalising the management of the waqf, there is a need to introduce stakeholders' principles into the body of the waqf institutions. Introducing stakeholders' theory into system of waqf will undoubtedly create many positive opportunities for quality improvement of the waqf institutions and internal delegation of responsibility.

Corporate waqf is an innovative adaptation of the Islamic waqf institution that can be made a key organisational strategy to translate the business jihad energy into real and sustainable business and economic success. It is a creative and innovative act to use the waqf concept and apply it to achieve business and corporate objectives.

A corporate waqf is therefore envisioned to have a distinct and unique advantage compared with a conventional waqf, in that it allows access to and thus can benefit from all the dynamics of corporate driven businesses.

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ROLE OF THE WAQF INSTITUTION IN POVERTY ALLEVIATION AND THE ESTABLISHMENT OF ECONOMIC AND FINANCIAL JUSTICE

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Abstract

As an attempt to address the issue of poverty and the current economic and social conditions of the Muslim societies, this paper discusses the important role waqf plays in poverty alleviation for individuals and groups, as well as driving of the society towards the achievement of fair and just economic and financial system. The paper gives an overview of the waqf institution as addressed in the holy Qur'an and implemented in the tradition of the Prophet Muhammad (S.A.W.) to show how great and important the position of waqf is in the Islamic teachings. The paper also gives practical evidences from the history on how waqf was used as a tool for the establishment and sustenance of sound economic and financial systems. The paper also explains various types of traditional Waqaf properties as well as modern items which can be considered as potential Waqaf Properties. Further the paper discusses some of the Shariah and Legal challenges faced by waqaf institutions in the course of their existence and development. In order to portray the practicality and the effectiveness of waqf institution in poverty alleviation and building of better mechanism for sustainable and just economic and financial systems, this paper identifies four workable frameworks through which waqf could be better understood and recognized as the best tool for the attainment of true and sustainable economic, financial and social justice. First: Establishment and enhancement of the relevant waqf authorities. Second: Mobilization of the waqf mechanism among the people. Third: Creation of waqf awareness mechanisms for the individuals and groups. Fourth: Use of the modern communication technology in carrying out the various waqf management tasks and roles.

Keywords: Waqf, financial justice, social, economic, sustainable.

1. Introduction to Waqf

Waqf is a religious endowment highly promoted by the virtues of Islamic tradition and maintained by the state for the achievement of various socio economic objectives.

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It is a voluntarily obligation, but it is highly inspired and motivated by the believers to its fulfilment if the needs arises for collective good. The rewards on such philanthropy are manifolds on the individual who contributed enhance self-development and an opportunity for achieving Allah's pleasure and reward in the hereafter. On the other hand, the perpetual benefit of the usufruct of property by the beneficiaries will also create a way towards combating socio economic justice in all walks of life, which has significant impacts for the development of the society. Thus it can be said that creation of such endowment is the best way for enjoying the continuing rewards from Allah even after the death as the perpetual benefit of the waqf is being maintained even after his death.

It is also one of the unique socio economic Islamic Institution which has contributed long lasting impact throughout the history since from its early creation by the prophet Mohammed (peace be upon him) to the modern world. Throughout this arena of time and space the institution of waqf has been revived and discussed legally, economically by the Islamic jurist of the periods and thus accorded a special reference in the branch of Islamic jurisprudence for its separate rules and regulation for creation, administration and perpetual succession. It is so well recognised in the classical Islamic jurist to the extent that they have different opinion on the validity of waqf, its creation and existence, Rights of Mutawalli, waqif and Beneficiary. Hence, most jurists differ in the interpretation of its definition and rules related to it. However, such divergences of opinion are the result of circumstances and the environment they accompanied with. However, the legal or shariah extent it is highly regulated rules and regulation and thus had been in establishment accordingly but the operational side we can see some loophole with regards to its management and distribution only with the exception of the few Awqaf. The condition of mismanagement is mainly because of interfering by the Monarch, respective governments for their own political and economic benefit.

Nevertheless, Muslims have created such voluntary act with great inculcation which is evident in the present state of Waqf throughout the world. To just give an example, India alone has 350000 waqf properties under Awqaf[3].

[3] Report ofJoint Parliamentaryt Committee on waqf Rajya abha Secretariat New delhi 2008

Thus to note there are various historical consideration and facts relevant towards the creation of the institution of waqf and hence Islamic jurists of the time, has been revived this institution according to the time and space throughout the history. Today in modern world, what the western academician propose and gave important emphasis on the creation of philanthropy institution called in economic terms as third sector and afterword given special name by Bill Clinton and Barack Obama in 2006 called "Philanthro-capitalism" as a solution to correct and balance economic disparity within the framework of capitalism. such importance and recognition of the institution is well maintained and got its establishment early in the period of prophet Mohd (PBHU), and has been continued till now as an integral part of Islamic economic system.

It is also well recognised fact that this institution had played a significant role in the society whether in terms of economy or various social realm of life. During the era of Muslim glory, we acknowledge how element of waqf has played a big role to develop and spread Islam to the people.Even in the periods of so called monarchy it is established that the monarch had given much emphasis on the development of these institution. It is also seen in the classical islamic fiqh literature that many of the early fuqaha had contributed much in this subject and come up with the different ruling unique to the creation existence, development and abandonment of the waqf institution. Thus it is evident in our time that such institution in various parts of world still exist and continue to be exist if it is given utmost important like the other private and public institution.

This kind of voluntarily institution which has got potential to correct the social and economic imbalances, disparity of rich and poor among society, eradication of poverty, and emancipation of education in Muslim Umma. But the present situation of this institution reflects a bad picture as to its own sustenance becoming a burden to the relevant authorities (Government, Religious Organisation). It is only because of the status provided by the state and individual in the society and negligence in respect of its development that has created many problems as to the maintenance, management and in some lesser extent legal problems. On above of all, the major problem is the operational issue that has not received much emphasis and thus the situation remains intact with the concerned authorities resulting into the private

benefit than the public benefit, which is the very purpose of the creation of Waqf Institution.

Nowadays, we can admit that people has accepted the performing of waqf as part of our responsibilities as Muslim. But more than that, we can see that people still do not have a deep understanding on how waqf can play an important role as one of the means to generate the economy in the country like what have been done in the past Islamic history.

Therefore, this paper will briefly explore briefly its origin, definition, basic principles, historical consideration, and move towards developmental strategies in order to complements and sustain waqf institution in order to play an effective role as an voluntarily sector in the development of socio economic life of the Muslim societies(Maqasid Al shariah) in particular and different faith in general. The study also look into the various tool of its establishment according to the sahariah consideration in order to suit the needs of the contemporary realities and gave recommendation is as to its revivalism.

2. Meaning and Definition

There are many definitions of waqf; however, we are going to look at only a few of them. *Waqf* is an Arabic word, its plural Awqaf derived from the related verb Waqafa literally means *habs* ('detention') prevent or restrain and in Islamic Shar'ia law means 'keeping the property (surrendering the title) for separate use for a particular purpose'.[4] Raissouni (2001, p. 13) explains that from a linguistic point of view, *Waqf* means forbidding movement, transport or exchange of something.

Bewley (2001, p.62) also explains that in the Arabic language, the word *Waqf* literally means 'confinement or prohibition'. In legal usage it means the non-negotiability of

[4] *Habs al-asl wa tasbil al-samarehi* [keeping the principle and using the benefit (for the way of Allah)]: Sheikh Sayyed Sahbeq, *Fiqh al-Sunna* [Sunni Jurisprudence] vol. 3, Dar al-Fiker, Beirut, 2nd ed., 1998, 267. and same by (Ibn Manzur, n.d.: 9/359, al-Jawhari, 1978: 4/1440).

property ownership which is of employable value, and the direction of its benefits to a certain charitable purpose, once and for all.

Belkhoja (p. 7) defines: “It’s when an owner gives beneficiary whatever he likes from his revenue, fruits, crops or real estate so that the yield, tax and benefits thereof follow the course he schemed willingly. That is one way of seeking God’s favour. Legal claim is in this case mortmain and meant neither to be sold nor granted and never inherited no matter how much remains thereof.”

Sheikh Abū Zahra defines waqf as “the non-negotiability of property ownership which is of employable value, and the directions of its benefits to a certain charitable purpose, once and for all”.[5]Another classical definition by Qadī Abu Yusuf, which has been adopted by a vast majority of Hanafi fuqahā’ (fiqh scholars) regards waqf as “taking the corpus of any property, out of the ownership of oneself, transferring it permanently to the ownership of Allah (s.w.t.), and dedicating its usufruct to others” (Hashmi, 1984).

Meanwhile, according to Kahf (1998), waqf may be generally defined as “the holding of an asset (Māl) and preventing its consumption for the purpose of re-extracting its usufructs for certain righteous benefit as predetermined by the waqf founder (waqif)”.

Now we look into definition accorded by some of the modern waqf authorities.

“*Waqf*” means the dedication of any property from which its usufruct or benefit be used for any charitable purpose whether as *wakaf am* or *wakaf khas* but it does not include a trust which is defined under Trustee Act 1914.[6]

Waqf as defined under Singapore ‘s Administration of Muslim Law Act or AMLA, is the permanent dedication by a Muslim of any movable or immovable property for any purpose recognised by the Muslim Law as pious, religious and charitable.

[5] [5]Mufti Abdalhaqq Sayf Al-Ilm Bewley, Zakah The Fallen Pillar Of Islam, Dar al-Hijrah, Cape Town, South Africa, 2001, p. 62

[6] Wakaf (State of Selangor) Enactment 1999

According to the definition given in the Mussalman Waqf Validating Act 1913[7] in India, waqf means the permanent endowment by a Muslim of any of his property for a purpose recognized by the Muslim Law as 'religious, pious or charitable.

In summary, waqf means primarily to protect a thing so that it does not become the property of third person. It signifies the appropriation or dedication of a property to charitable purposes. The creation of Waqf by individual or by group inculcates not only spiritual, social economic impact, social justice, but also collective good deeds which has long lasting benefit for the future generation to come. The properties may be utilized by the public, especially the poor. According to the majority of scholars, *waqf* has four pillars; the founder, the property, the beneficiaries, and the intention or expression. All of these pillars have their own conditions that need to be fulfilled (Saleem 2010)[8].

One of the unique Characteristic of the waqf is the nature of the subject matter being endowed must be of perpetual existence and henceforth perpetual benefits arising out of its corpus which cannot be irrecoverable and even inalienable. Thus such feature of permanent existence of waqf property such as buildings, houses, lands and other real estate property accrue greater benefits to the economic condition of the people if it is maintained properly as this will going to be last for near future generation. Therefore, we find everywhere in the world where Muslim have ruled or settled even has the legacy of the creation of waqf.

3. Provision of Waqf in Quran, Sunnah

There is no specific injunction in the Quran as for its legitimacy in the conclusive form but the institution of waqf owes its origin to various traditions of the prophet

[7] http://www.helplinelaw.com/docs/THE%20MUSSALMAN%20WAQF%20VALIDATING%20ACT,%201913

[8] Saleem, M. Y. (2010). An Introduction to the Theoretical Foundations of Islamic Transactions, Ilmiah Publishers.

(peace be upon him) himself[9]. Although there is no mention of this in the Quran, yet Quranic repeated exhortation at a number of places and in different ways and context to render voluntary economic assistance to the fellow-beings and the poor for the welfare of society endorses its importance in the Islamic economy.

There are many Qur'an verses that in general inspire believers to devote some portion of their wealth, time and service to the cause of Allah on charity basis.

As Allah Says in Quran:
"Establish regular prayer and give regular charity; and loan to Allah a beautiful loan. And whatever good ye send forth for your souls, ye shall find it in Allah's presence- ye better and greater reward. And seek ye the grace of Allah; for Allah is oft forgiving and most merciful "(LXX 111:20).

On the interpretation of this verse some regards giving loan to Allah means to disposition of his property as waqf with the only intention to receive pleasure from god.

Another verse is the one in*Surah Al* [*Imran* which reads: "By no means shall you attain *al-birr* (virtue, righteousness), unless you spend (in Allah's cause) of that which you love; and whatever of good you spend, Allah knows it well." (Qur'an, 3:92) When this verse was revealed, one of the Companions of the Prophet (peace be upon him), Abu Talhah approached the Prophet (peace be upon him) about giving his beloved orchard of date-palms called *Bayraha*'.The Prophet (peace be upon him) then said: "… It is a profitable property.

I have heard what you have said and I recommend that you distribute this amongst your relatives." On that, Abu Talhah replied: "O Messenger of Allah! I will do [so]." So he then distributed that orchard amongst his relatives and cousins (al-Bukhari, 1987: 2/814).

[9] [9] Sheikh Sayyed Sahbeq, *Fiqh al-Sunna* [Sunni Jurisprudence] vol. 3, Dar al-Fiker, Beirut, 2nd ed., 1998, p. 268.

The similar sentiments have been expressed in various other verses in the Quran. It is one of the ways by which voluntary economic assistance can be provided to the community as a whole and to the poor in particular on a permanent basis.

There are various other specific prophetic traditions with regards to the validity of the creation of waqf by his saying as well as by deeds. To cite some of the famous hadith Charitable Waqf initiated with the practice of Prophet Muhammad (uwbp) himself. Mukhairiq, a jewish man created a will to prophet Muhammad (uwbp) saying that his seven orchards in Madinah will be inherited by him. In the 4th Hijrah, the man passed away and the Prophet, uwbp, acquired the orchards and made it as a charitable Waqf . (Kahf 'a' undated, p. 2)

One of them is narrated by Ibn [Umar that [Umar bin al-Khattab obtained some land in Khaybar and went to the Prophet (peace be upon him) to consult him about it. [Umar said: "O Messenger of Allah, I obtained some land in Khaybar better than which I have ever had, what I should do with it?" The Prophet [pbuh], said: "If you like you can give the land as waqf and give its fruit in charity." [Umar then gave it in charity (as waqf) on the condition that it would not be sold nor given to anybody as a gift and not inherited, but its yield would be given in charity for the poor, for kith and kin, for freeing slaves, for Allah's cause, for the travellers and guests; and that there would be no harm if the guardian of the waqf ate from it according to his need with good intention, and fed others without storing it for the future (al-Bukhari, 1987: 2/982).

According to Othman (May Allah be pleased with him), once city of Madinah had shortfall with the availability of drinking water except the water of Bi'r Ruma (Ruma Well). The Prophet (uwbp) arrived in Madinah and realized the same and asked: "Who will purchase Bi'r Ruma to equally share the water drawn therefrom with his fellow Muslims and shall be rewarded with a better well in the Garden (of Eden)?" Then I bought it from my own money. At-Tirmizhi[10]

[10] Mohd imtiaz ali

In another tradition the Prophet (peace be upon him) said, "When a person dies, all his good deeds cease except for three: an ongoing continuous act of charity, beneficial knowledge and a righteous son who prays for him.[11]"

With respect to the beginning of the waqf being created it is observed that in primary sayings of the Prophet (*hadiths*) what is now known as *waqf* is referred to as the '*sadaqato jariyeh* [continuous charity]'.[12] During the time of the Prophet, properties such as mosques, water bores, land and horses were made *waqf* for charitable purposes.[13] According to Islamic jurisprudence texts, and leading *hadith* scholars,[14] real property was the first incident of *waqf* in Islam, made by the second Caliph on the order of the Prophet.

Apart from all these proofs from the Qur'an and the traditions of the Prophet (peace be upon him), the validity of waqf has also been confirmed by the consensus (ijma[) of the Companions of the Prophet (peace be upon him) (al-Qurtubi, n.d.: 6/339).

4. Practical Evidences from the Islamic History on Waqf Importance in Economy

The history of Awqaf dates back to the advent of Islam. As seen above, the Quran exhortation and prophet inculcation for doing well to society is such penetrated in the believers that everyone inclined to offer their properties as waqf as well. As the waqf got potential to cater beyond the basics needs of society it has been always associated with the property and ownership distribution in an economy. The significant point which could be derived from this is that it always one of the active players in the

[11] narrated by al-Bukhari and Muslim

[12] It is narrated from the Prophet Muhammad (by Moslem, Abu Daoud, Al-Termadhi and Al-Nisai) that 'When a person dies, they are survived by three things: *sadaqato jariyeh* [continuous charity]', knowledge that benefits society, and their children of good character.' It has been said that *sadaqato jariyeh* means *al-waqf*. See Sheikh Sayyed Sahbeq, *Fiqh al-Sunna* [Sunni Jurisprudence] vol. 3, Dar al-Fiker, Beirut, 2nd ed., 1998, 268

[13] Sheikh Sayyed Sahbeq, *Fiqh al-Sunna* [Sunni Jurisprudence] vol. 3, Dar al-Fiker, Beirut, 2nd ed., 1998, 268-269.

[14] Termadhi says that this *hadith* has been narrated from many scholars and companions of the Prophet, and he knows no one who has raised doubt about this *hadith* and that this was the first incident of *waqf* in Islam. Sheikh Sayyed Sahbeq, *Fiqh al-Sunna* [Sunni Jurisprudence] vol. 3, Dar al-Fiker, Beirut, 2nd ed., 1998, 270.

economy beyond public and private sector and connected to political domain of the society. Thus, Waqf presence had a formidable community development approach in the process of organized Islamic economic living being a third sector economic institution established purely based on social welfare.

Back to history, we find especially period of Umar bin Alkhattab and Umar bin Abdul Aziz waqf institution establish and organized properly and hence had seen a pivotal role in an Islamic living economy[15]. Both of these two caliphate period we had reports that Absolute Poverty is able to vanish from the economy because of proper management of zakat, waqf and other philanthropy system[16]. The later periods of history on awqaf best describes how the ruler signifies an importance to this institution and had played crucial role in socio economic and political life of Muslim. To any economy to prosper there should always start with the community building approach and thereby uplifting the weaker section to have presence in the economy. The Ottoman Empire waqf system has applied the same approach towards building up society through development rather than serving the society as beggars and needy forever. Here, I mean to say the developmental approach of people rather than giving token amount of money. They materializes the waqf for asset generating income and use the proceed for the same to weaker section of society by way of providing education, health care, Research and development, Infrastructural development and so on which brings real value in the economy. The whole approach leads the society towards one common goal that everyone right to prosper in the society given the resources in the economy. In other words, it will bring a better distribution of income through redistributive measure. Thus same could be seen to be applied in that period so as to say will not exaggerate the condition that "Thanks to the *Waqfs* that flourished during the Ottoman Empire, a person would have been born into a *Waqf* house, slept in a *Waqf* cradle, eaten and drunk from *Waqf* properties, read *Waqf* books, been taught in a *Waqf* school, received his salary from a *Waqf* administration, and when he died, placed in a *Waqf* coffin and buried in a *Waqf* cemetery."[17] Hence, government of the

[15] kahf

[16] Role-of-zakah-and-awqaf-in-poverty-allevation : IRTI Pg 31

[17] (Baskan 2002, p. 18)

period were able to eventual caters all the mentioned service alone through waqf system with the reduction in government expenditure. Waqf supplemented the government in provisioning of public goods through all these myriad of services being offered or financed. Thereby the social welfare was achieved by redistribution mechanism through Restriction on concentration of wealth and widespread circulation of goods, services in the economy. The ownership patterns were changed due to the waqf trends being established by Muslim societies during the periods. For Instance: Zubaidah, the wife of Caliph Harun al-Rashid, made waqf of all her wealth for the purpose of a road from Baghdad to Makah. The same goes for many Muslim rulers..Hence, In overall the historical experience of waqf institution give us a background picture how it played a dynamic role in ensuring well-being of society by transferring the wealth, education, skills and even public needs such as defence and security.

Role of Waqf in Poverty Alleviation

In Islam, waqf is one of the principle means to alleviate the poverty problem in the society besides zakat (compulsory charity) and sadaqah (optional charity). Among the Islamic principles which are also contributing the poverty alleviation programme through various means it is the only waqf institution which resembles permanency and stability of the asset for the use to generation. It is because of this feature with social welfare motive, the development and sustenance of this institution can be integrated with the different models of incorporating business. This can be achieved by through creation of firms and companies based on waqf whether employed for takafuk or privately owned institution. Hence, waqf places an important institution with regards to maintain socio economic balance and narrowing the gap of income disparity. It can be a best mechanism through which equitable growth can be achieved as well as development in very balanced manner.

We have seen above the actual role of waqf used to play by the application of efficient and effective waqf institution in particular and other means of contribution. To see the impacts been created by this institution in history we find that it has been an integral part of socio economic and political system of Muslim empires. The varied existence of waqf institution and large widespread waqf presence everywhere the Muslim had ruled proved the existence of Islamic civilization.

Basically, there were major awqaf for religious purpose such as mosques, Cemetery etc. which constitute major part of waqf assets. Waqf can ensure poverty alleviation through various means by way of 1. Provision of basic necessities to all members of society through the mechanism of assisting them for employment through education, training, enhancement of specific skills, financing the purchase of asset generating income which are needed by the business of any profile, Leasing of waqf properties at the medium rate of rentals- all is to serve and give back up to the earning capacity of an individual in a society, 2. If the basic necessities of life are not able to cover up by an economic agent then an assurance mechanism at least through waqf should be developed so that destitute, old survivors, physically and mentally handicapped or obsolescence are protected through such system.3. The occupational hazards or natural calamities which will erode the society at large- waqf needs to give an immediate relief to the affected people as a social security. 4. On the social level, Awqaf institutions contributed for development in the weaker section of society especially poor, widows, handicapped and old people. On top of these, wqaf being also created for the purpose of education, research, health and for financing in the later period of Muslim rulers. Likewise during the Ottoman Period in turkey Awqaf helped also in providing job opportunities for the jobless; for example, in Turkey 1931, the Turkish Awqaf hired over 13% of the working power in the country. To encompass all needs of society various kinds of awqaf were established including the cash Waqf, Awqaf for public utilities, education and research, and health care[18]. There was awqaf available also to provide loans to persons who need financing and providing services and supplementary income to low income people.

5. Types of waqf Properties

The objective of Waqf may be for individual needs or family concerns or nthe society at large. It broadly encompass to provide the provision of religious services, socio-economic relief to the needy, the poor, education, and environmental, scientific, and other puposes. This kind of Waqf is traditionally characterized as philanthropic (khiri) or public (‘amm). In case of a fimily (ahli) private (khass) waqf, the objective is related to the family and descendants of the founder or another specific person. A

[18] Kahf

combined/mixed Waqf (waqf mushtarak) has dual objectives of serving partly the family/descendants and partly the public.

There are two major types of *waqf* properties such as *waqf al-khairi* and *waqf al-zuri*. The former is created for charitable purposes for the sake of Allah which may be subdivided into public and quasi-public. The latter is initially created to serve their children but ultimately for charitable purposes.

Waqf revenues are most frequently spent on mosques. This includes salaries of the Imam, teachers of Islamic studies, and maintenance of the mosque property.

Education in general is the second largest recipient of waqf revenues. Since the beginning of Islam, education has been financed by waqf and voluntary contributions. Waqf financing of education usually covers libraries, books, salaries of teachers and other staff. The third largest beneficiary of waqf is the needy: those with very low income, needy orphans, persons with disabilities, the elderly and so on. The good examples of what could be donated as waqaf are hospital and schools or land, and even money to build these infrastructures for the benefit of needy, orphans, wayfarers, and others in the society.

Cash Waqf

Traditionally, the corpus of waqf has been in the form of land and real estate. As pointed out, one of the reasons that prevent the creation of waqf is that land has become very scarce and expensive. This enables only the very rich to form waqf properties. In order to revitalize the institution of waqf, there is a need to develop alternative ways that would enable people of all means to contribute to the creation of awqaf. In this respect, cash waqf is an old concept that needs to be revived. Cizakca (2004) proposes the revival of cash waqf that flourished in an Islamic empire starting from the medieval times was continuing to the Ottoman period. Waqf were established in the form of cash for a charitable purpose. The cash was invested in the form of mudarabah or credit and the revenue generated from the investments were used for charitable purposes

6. Discussion on Some of the Shariah and Legal Challenges Faced by Waqaf Institutions in the Course of Their Existence and Development

The main factor upsetting the development of new Awqaf institutions is the absence of sound legal shield to protect the Awqaf institution in many countries. The legal system of ensuring property rights in many Muslim countries is not only pathetic but also not properly enforceable as well. This faintness in the system of property rights are disadvantageous to the development of private sector as well as with awqaf institution.

7. Framework towards Achieving Just Economic Order

The present assets of *Awqaf* in most Muslim countries characterize a massive volume of community treasure that can be advanced to yield a proper allocation of social services, ensuring at least the provision of basic necessities of the public. Since the beginning of the 1990s, government in several Muslim countries have taken bold steps to change the style of administering Waqf properties and activities by establishing some agency to take charge of Waqf (Ahmed,2004) . Also, religious and other voluntary organisations, especially in Non-Islamic Muslim majority and minority countries are taking steps to revitalise the institution of Waqf. According to Khan (2007), the current state of Awqaf has the following two remarkable features: firstly, there is a huge stock of Awqaf property lying in various parts of the world (Muslim as well as non-Muslim) which have been abandoned and are no more operative. Secondly, not only that considerable number of Awqaf properties inherited from the past is lying idle, but also the new Awqaf are not coming up particularly to alleviate hardships faced by the poor despite potential capacity among the wealthier population in Muslim countries and communities. The main factor thwarting the emergence of new Awqaf institutions is the absence of legal protection to the Awqaf property.

Awqaf at the Present Time

After the fall of Ottoman Empire waqf in many part of the world come under the power of British colonization which is one of the peril of the destruction and fade of this institution. They didn’t give much emphasis on the management and

development of waqf. After onslaught of disintegration and freedom from colonization, Muslim countries began to enact and preserve the Waqf properties and concerned for the development of this institution. Many Islamic countries particularly Sudan, Malaysia Saudi Arabia, and Pakistan have enacted specific legislation whereby the development of this institution is of prime concern. For In Saudi Arabia, a special Ministry of endowments affairs, called "Ministry of Endowments and Islamic Affairs, Advocacy and Guidance" has been established to manage the waqf &Islamic affairs. The revival of this institution can be seen from this perspective being accorded a legal jurisdiction to prosper this institution to bear fruit through development. The expansion of Islamic banking sector also paves the process of waqf development through structuring of various product based on Islamic financing products. The waqf model is being employed in takaful industry as an alternative to modern insurance[19]. Such varied exposure of waqf application epitomizes the significance accorded by the authorities in present times in various field. Hence the revival process is under way to realize the actual results of waqf which were used to be played in history.

Establishment and Enhancement of waqf institution

It is commonly observed that after the colonisation period of most of the Islamic countries, the protection and promotion of existing and future awaqf is stagnant or being under developed due to the lack of supportive legal framework and management operations through which the real purpose of this institution can be able to play its significant role in economy. Most of the countries aftermath of colonisation followed the same the practices of the colonial period in terms of institutions, laws, and policies. hence we find in some countries state control over the management and administration of Waqf properties whereas in some other counties it is still a privately managed institution. Rather than modernise the endowment (waqf) institution, most post-colonial Muslim States sought its abolition or nationalisation. The countries like Malaysia, Sudan, Pakistan, Saudi Arabia and Libya have legislated special enactment for the protection and promotion of this institution under the government which authorises concerned bodies to be the sole and legitimate power for its due collection and Management. Kuwait has been the leader among States interested in supporting

[19] http://www.pktcl.com/waklawaqfmodel.aspx

both the reform of existing endowment (waqf) and its expansion. They enacted new laws of Awqaf which helped in recovering, preserving and developing the property of Awqaf and encouraged people to create new Waqf in these countries. These countries have given the institutional and legal framework of waqf institution by making its separate enactment and different provisions in law. for example, In Malaysia Zakat and awqaf is being administered by "Islamic religious council"(SIRC) Hence, every state has its own law for administration of zakat and awqaf headed by "State Islamic religious Council" or prerogative of the rulers (Sultan) except in case of federal territory Kuala lumpur.Nik Hassan, N.M. (1991). Another important aspect with regard to Waqf endowment is that the success of Waqf is largely dependent on the appointment and efficiency of the Mutawalli. While, having state control ensures some sort of security over the mismanagement and corruption of Waqf, at times it is also affected by lack of resources, inefficiency and bureaucracy. Another observation is that waqf administrator in most of the countries like in India and Malaysia faced problem in the registration of waqf land title and therefore it could not be identified and registered. In order to preserve waqf property in accordance with the law, all waqf lands should be registered in the name of the Islamic Religious Council. Without the land title, it is hard to the authorities to develop waqf land. In fact, regardless of information system that implemented by some states, it is found that the Islamic Religious Council does not have comprehensive and reliable data on waqf land which cause some of unregistered waqf lands undeveloped. The problem of unregistered waqf land could be settled with the implementation of the GIS system in waqf administration. This sophisticated computerized system provides an effective

8. Types of the Challenges which Facing Waqf in the World

Political challenges

Waqf in most Muslim countries faced a political challenges and problems as we mentioned before also as the politician in the whole Muslim when they receive any pressure from western countries they fast come to the Islamic institution to monitor and deal with it as guardian to small child especially after 11th of September when USA asked whole Islamic countries to fight terrorism and to have the money laundry laws and those governments issued the money laundry laws with the Islamic non-government charitable institution for Example in 2009 the Egyptian has stopped

Islamic waqf to build Hospitals for poor people and the reason was the fighting terrorism as it was under the Islamic medical association (one of the Muslim brotherhood's projects).

Social challenges

Westernization in Islamic countries and its results affected the Muslims societies in a negative way and it leads their behavior and lifestyle a way of Islam and Islamic concepts and from these concepts the Waqf. Waqf and sometime not believing in or accepting any Islamic tools like Waqf which is affected the number of the people who are participating Waqf or trusting Waqf, as Dr. Monzer kahf said24 "Waqf has a strong relations with When the Muslim culture as when our it was active, effective and well developed and we was seeking for building good future in this period the awqaf was huge and it was in all over the Islamic world".

Economical challenges

Poverty this is the common word in most of our Islamic countries and common part of Muslims life this one of the economical challenges that facing Waqf now a days for example the Muslim countries now a days we can find in the last 50 years the increasing in the amounts of the rich Muslims wealth side by side with the decreasing of the new waqf numbers in the Muslim countries as Dr. Monzer kahf said 25 "When the Muslims came down their Awqaf also came down and when the western raised their Awqaf also raised, now a days in America there are a huge organizations, the best Universities are the Waqf Universities as if I‟m going to give you the list of the first ten Universities in the world all of them they will be fully financed be Waqf ".

Mobilization of Waqf among the people

One of the basic problems towards the mobilization of waqf can be seen as the administration of the waqf, being onslaught of development hence gives negative alarm to the general public. There are various methods that can be employed to suit the current socio economic needs of the society and hence can mobilize the waqf through gradual processes of development. Once it is being able to become success stories in the economy, then every paid off may at least think of devoting his property and assures the satisfaction that he contribute to the development of society and the reward forever.

The same time the revivification of waqf land should began, if unproductive, through suitable method employed like Istibdal an exchange of piece of land or instead selling the waqf land in order to purchase with the same proceed with the commercial land.

The modern Islamic banking or finance in particular has also its role in structuring the various financing facility based on the capital of the waqf estate on the basis of P & L sharing arrangement. The various structures mentioned by Kahf 2000 can also suitably be designed to accommodate such arrangement through legal and managerial practice. Hence in this respect cash waqf can play a bigger role in mobilization lesser amount to the large group of people. Thus working capital of these institution can be strengthen beyond its permanent role in the economy.

Creation of Waqf Awareness Using Modern Technology

Historically, *waqf* tremendously contributed to the welfare and educational development of the Muslim societies. It was a successful model for supporting Islamic charitable and educational institutions. It financed and sustained mosques, schools, universities, hospitals and other public utility charitable institutions in the fields of education, healthcare, and even infrastructural works such as road, water canals and bridges. However, with the falling of several parts of the Muslim world to the military and cultural colonization during the nineteen century the institution of waqf has suffered a setback and its significant role in the human beings life has been slipped from the Muslim. Therefore, it is an inevitable requisite to create awareness of the importance of the waqf institution among the Muslim to restore it is position in the day-today life. It is necessary on both levels; firstly, high-net worth people to encourage them to establish waqf because there won't be any incentive for them to do so if they are ignorant of what the prophet (p.b.u.h) has said about such a holy pursuit for instance the prophet said. Secondly, lack of awareness may cause poor people not come to solve their problem.

Nevertheless, to create awareness among Muslims towards the need for the establishment of awqaf and the benefits few strategies are being proposed:

i. People should be told of the virtues of donations, especially waqf , in Friday sermons, Islamic conferences and other religious sermons.
ii. Students should be thought the institution of waqf in schools and universities

as a part of their curriculum.

iii. Wide scale marketing and awareness campaign, for instance, conducting workshops and the like.

The Waqf Properties are spread out all over the world and registered with respective Waqf Boards under their jurisdictions.. some of them are registered under the govt of each respective country by enactment or parliamentary order, Some of them are in illegal possession, encroached and few may under litigations. These properties are not being properly utilized for generating optimum revenue that could be used for more welfare activities.

Old documents pertaining to these properties are deteriorating day by day and therefore their digital archiving is very much needed in order to have clear title & to plead effectively in those cases which are under litigations in different courts.

For example in India, for monitoring process of the Waqf Properties, Ministry of Minority Affairs (MoMA) intends to develop a web based Waqf Management System that shall be ruled-out across all the State Waqf Boards. As a first step it is required to study the existing system at five strategic locations across India with a view to have a clear picture of the different systems followed by all the Waqf Boards and to prepare a Detailed Project Report.

Hence, the primary objective of Indian Waqf board should be to introduce Management processes and prepare a Detailed Project Report with a view to streamline and computerize the various functions/processes of the Waqf Boards.

On the Management side, the use of computerised system will be the helpful in easy access of information and control towards waqf management and administration. There is a need to have an integrated database of the zakat and waqf recipients as to collect the information about their particulars including the issues related to their problem which entitled them to be deserving category. The database is also for reporting of zakat payment accordingly over the period and effective management of fund through frequent checks on repetitive payment of zakat to the one class of family for longer periods. All these organising issues like reporting of zakat collection and

distributional list, the lack of efficiency in management especially in the maintenance of administration cost and limited availability of reports publication can be solved by designing such a system.

Hence on the public side One of the approaches towards is by educating the public, their duty and responsibility as a Muslim to perform this obligation. To this cause, it can achieve through education by means of personal contacts, Friday sermons, publication of pamphlets and booklets, advertisements in new papers, posters, Radio, TV, Internet and many more recent tools of Network based websites. The Modern Services like Zakat Counter, Bank Counter, Post (Cheque, Bank Draft, Money order) Deducting from salary, Phone-banking and Internet Banking should be provided in order to get Quality services for payer. This kind of services make easy for individual to channelled out zakat and thus to maximize the customer satisfaction through services offered by the institution.

9. Conclusion

The application of communication technological tools like internet, website, E-mail should be used for advancement of zakat institution. These are modern tools of communication which helps to reach out to the millions of public worldwide for providing information and its promotion. For ex: Zakat Foundation of America (http://www.zakat.org) which is an international charitable foundation depends extensively on internet as a means for collection and distribution. The zakat and other donation where donated through credit card using the Authorize.net software and through use of electronic mail. Moreover they even use the SMS service as a means to provide information and to collect zakat through zakat alert SMS service. There website is also communicated in a social network websites like Facebook, Twitter and YouTube portal. other services in the system can be included like “Ask Scholar” through e mail or either by arranging the time for “live chat” by using Skype , Google plus etc. So such a well communicated direct access of information about the waqf collection and their various programs of disbursement will definitely create awareness and encourage the donor of waqf and feels a satisfaction towards his generous donation. Thus the introduction of such online media based website of respective

waqaf institution can disseminate information quickly and thus enhance the overall Management and status of the waqaf institution.

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THE VALIDITY OF *HIBAH* TAKAFUL BENEFITS IN ISLAMIC ESTATE PLANNING : A CASE STUDY AT WASIYYAH SHOPPE SDN. BHD. (WSSB)

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Abstract

The Takaful industry in Malaysia has grown rapidly while Islamic estate planning industry is still at the infant stage. Various improvement and product innovations have been carried out by all the parties involved in both industries. The latest development shows there have been efforts to combine the contract of *hibah* in Takaful product to meet the objectives of Islamic estate planning, which is called as *hibah* Takaful benefit. Nevertheless, there are some issues that need to be reassessed. The objective of this study is to investigate the structure and implementation of *hibah* Takaful benefit offered by Wasiyyah Shoppe Sdn Bhd. The data is collected through semi-structured interview. The study finds that there are several issues related to operational structure of the *hibah* Takaful benefit and its validity that need to be refined. It also verifies that *hibah* Takaful benefit is not developed with the intention to avoid *faraid*. This study also provides recommendations to the stakeholders in terms of product development.

Keywords: *hibah*, Takaful, Islamic estate planning, marketability

1. INTRODUCTION

Malaysia was the pioneer of Islamic insurance with the establishment of Takaful Malaysia Sdn. Bhd. in 1985 (Ab. Ghani, 1999). To date in Malaysia, there are 12 Takaful operators which consists of nine local and three international Takaful operators (Bank Negara Malaysia, 2012). The escalating number of the Takaful operators indicates that the demand for Islamic insurance service is increasing and it becomes an alternative to

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the conventional insurance. A variety of efforts has been made by Takaful operators in terms of product innovation and development in order to ensure the product is more competitive. Viewing Takaful as a product of Islamic financial planning and wealth management, engaging *hibah* into Takaful product is the current mechanism employed in order to make the Takaful product a viable means of estate distribution. This approach has been adopted by Etiqa Takaful Bhd., Syarikat Takaful Malaysia Bhd., MAA Takaful Bhd., Takaful Ikhlas Sdn. Bhd. and HSBC Amanah Takaful (Malaysia) Bhd. (Nor Muhamad, 2010; Abdullah and Abdul Aziz, 2010). *Hibah* Takaful benefit is a mean of estate disposal in which a Takaful participant gives away his/her Takaful benefit as *hibah* to a single or more beneficiaries. To date, WSSB is the only Islamic estate planning company in Malaysia that offers the same product. The present state of affairs in regard to the estate problem in Malaysia, the current value of the frozen estate is now valued at RM42 billion (Baharin, 2011). Thus, there are numerous product innovations have been developed particularly to help the Malaysian Muslims in expedite the estate settlement and distribution. *Hibah* Takaful benefit is perceived as one of the solutions that an individual can opt to.

Most of the previous studies are conducted by focusing the implementation of *hibah* Takaful benefit among Takaful operators in Malaysia. The discussions mostly cover the Islamic jurisprudence of *hibah* within the contextual form of Islamic estate planning. However, the study of the Islamic estate planning industry is still relatively unexplored. The study concerning the implementation of *hibah* Takaful Benefit at WSSB is not yet conducted. It is the objective of this study to give a new sight of the *hibah* Takaful benefit in which it investigates the types and modus operandi offered by WSSB – an Islamic estate planning company. In addition, this paper extends the discussion on the validity of *hibah* based on *ruqba* principle and the extent to which the implementation of *hibah* used to avoid the distribution deceased's estate to legal heirs according *faraid*.

This paper is divided into seven sections. It begins with an introduction containing a brief discussion of the paper. Second section is the literature review and section three discusses *hibah* in terms of the Shariah jurisprudence. Research methodology and data collection employed in this study is in section four. Data analysis and discussion are in fifth section,

implication and recommendation are in the penultimate section and section seven concludes the paper.

2. LITERATURE REVIEW

Various studies has been carried out regarding *hibah* Takaful benefit and they raise the following issues: ownership of Takaful benefits, heritability of Takaful benefit, nomination, the validity of *hibah* Takaful benefit, the extent to which Takaful benefit can be given away as *hibah*, revocation of *hibah* and modus operandi among Takaful operators.

The extent to which the legitimacy of the ownership of the Takaful benefit is established justifies whether the money paid by the operator upon the death of the participant constitutes the participant's estate and clarifies whether Takaful benefit can be given away as *hibah*. Mohd Noor and Abdullah (2009: 40) argue that Takaful benefit is considered a property (*mal*) and the establishment of ownership of Takaful benefit according them is a result of the effort of the policyholder to enter a contract which generates the benefits and based on the fact that one's effort becomes a justification for ownership. Nevertheless, the extent to which the ownership of Takaful benefit established is somewhat questionable. They accept the clause given in Sec.2 Takaful Act 1984 which states that Takaful benefit includes any benefit, pecuniary or not which is secured by a Takaful's certificate, and "pay" and other expressions, where used in relation to Takaful benefit, shall be construed accordingly. However, they come up with an interesting point to ponder in which they say that the clause does not differentiate between participant personal account which represent his savings and investment, and participant special account which aims at making donation. They also observe that the clause does not segregate between the participant's savings and death benefit (contribution from other participants to cover the sum insured/scheme) (Mohd. Noor and Abdullah, 2009:37). Ismail (2009:4) views that the Takaful benefit from investment account is part of the participant's property. However there are differing opinion on the status of *tabarru'* portion. This divergence of opinion has implication on the heritability

of Takaful benefit upon the death of the participant which is discussed in the succeeding paragraph.

Under the Takaful plan, the contributions paid by the participants in Family Takaful are channeled to the Family Takaful Fund, which goes into different accounts, mainly known as Participant's Special Account (PSA) and Participant's Account (PA). The Takaful benefit which is to be paid by the Takaful operator to the nominee of the participant consist of the balance from the PA prior to the death of the participant and the unpaid amount of Takaful contribution from the date of the participant's death until the date of maturity of the Takaful certificate from the PSA (Abdullah and Abdul Aziz, 2010:71). Mohd. Noor and Abdullah (2009:39) find that there is no question regarding the heritability of money in the PA as it is part of the deceased's estate. However, with regard to the money payable by the Takaful operator taken from the PSA for the death benefit is still questionable. We therefore can conclude that Takaful benefit is considered as the participant's property but there is no consensus that benefits from *tabarru'* account should be treated as participant's property as well.

Nomination is a crucial issue in Takaful since it affects the heritability of the Takaful benefit. Nomination is a process whereby a policyholder who purchases the insurance policy should name someone to benefits from the policy in the event of the policyholder's death. The practice of nomination in Family Takaful aims to distribute the Takaful benefit to the beneficiaries promptly without going through the lengthy administrative delays of estate administration as it is not subject to the Probate and Administration Act, 1959 and the Will Act 1959 (Abdullah and Abdul Aziz, 2010: 72). Scholars and Takaful practitioners are of the opinion that money from the PA is considered as inheritance whereby the nominee is responsible to distribute it according to the Islamic law of inheritance (*faraid*) since this money is the right of the participant during his life. On the other hand, money from the PSA (*Tabarru'* account) which is considered as Takaful benefit, is not part of the inheritance since it is not the right of the participant during his life.

Abdullah and Abdul Aziz (2010) go further by examining the status of nominees for Muslim participants and non-Muslim participants in Family Takaful as stipulated in the

Takaful nomination form and the application of *hibah* in Takaful industry as part of the mechanism of estate management. This study look into the status of nomination applied in reality in Malaysia and the relevance of *hibah* in the Takaful industry by document review method. Their study indicates that the content of the nomination form of all Takaful operators is not standardized and they believe the standardization process of the nomination practice in the Takaful industry calls for an urgent action.

Even though Mohd. Noor and Abdullah (2009:41) agree that the money paid by the Takaful operator is included in the estate of the participant upon the death of the participants and must be distributed under *faraid* law, but they perceive this practice is contrary of the objective of participant's contributions in the Takaful account in which it is meant to provide financial help and assistance for the purpose of easing the burden of the participants' dependent. Even Ismail (2009:5) also agrees that the objective of participating Takaful will not be achieved if the appointed nominee distributes the money among legal heirs. Therefore, at present, a mechanism known as '*hibah* Takaful benefit' has been introduced for the purpose of distribution of Takaful benefit to a particular or sole beneficiary.

However, the validity of *hibah* Takaful benefit is still debatable. Firstly, *hibah* Takaful benefit involves the gift of something which not yet realized (Mohd. Noor and Abdullah, 2009:54; Ismail, 2009:4; Abdul Razak and Ahmad. 2008:213). In fact, there will be no death benefit if the policy holder is alive until the maturity of the policy. As a result, the *hibah* contract is void according to the Islamic jurisdiction. Secondly, there is a problem of the existence of *Al-Qabdh.* Thirdlyl, *hibah* Takaful benefit could be regarded as a death-bed gift which is subject to *wasiyyah* rules and finally is there any recognition from the existing law. Abdullah and Abdul Aziz (2010:96) contend that the application of *hibah* in Family Takaful seems to violate the nature of Islamic law of *hibah* because such *hibah* as presently practiced is given to the recipients upon the death of participant.

Ismail (2009:4) question whether participants can give away the Takaful benefit as *hibah*. We observe that the answer to this question is related to the answer whether PA or SPA is the participant's property and participant's estate upon his death. Ismail (2009:4) states that the Takaful benefit from the investment account may be given away as *hibah* as it is

the property of the participant, but there are differing opinions on status of the *Tabarru'* portion. He adds that some Takaful operators do not allow Takaful benefit in general to be given as *hibah* and participants do not have this option and one possible argument for this that the Takaful benefit is non-existent at the time when the *hibah* is executed. The next issue is whether Takaful benefit is revocable without the consent of the nominee or the trustee. In this respect there seems to be a divergence of opinions on the revocation of gifts. This is so due to the different opinion on the grade of the *Al-Hadith*[3] relating to gifts and differences in extracting the rules thereof (Ismail. 2009:11).

Nor Muhamad (2010) investigate how the divergence of opinion regarding *hibah* Takaful benefit shapes the variation of applications of the product between Etiqa Takaful Bhd. and Takaful Ikhlas Sdn. Bhd. by means of interviewing the authoritative persons at the Shariah Division Bank Negara Malaysia, the Shariah Compliant Department at Etiqa Takaful Bhd. and the Takaful Ikhlas Sdn. Bhd. He finds that *hibah* principles are used in various products of Family Takaful that offered by Takaful operators. In Family Takaful products, participant may use *hibah* as a mean to distribute the benefits to a sole beneficiary of nominee using different approaches. *Hibah* in Takaful can appear in two forms. Firstly, *hibah* given to the nominee upon the death of the participant and secondly, *hibah* as part of the structure of Takaful products themselves as can be found in education Takaful (Nor Muhamad, 2010:74-79; Abdul Razak and Ahmad, 2008:212-213). The first type of *hibah* according to Abdul Razak and Ahmad (2008:214) is void based on the reasons listed previously. Most of the scholars agree that the second type of *hibah* is valid.

Nor Muhamad (2010) describes that Etiqa Takaful Bhd., uses the principle of 'absolute assignkent' (*hibah mutlaqah*). Meanwhile, Takaful Ikhlas Sdn. Bhd. uses 'proposed *hibah*' in order to prevent the dispute among legal heirs. In addition, these Takaful operators do not fully comply with the Bank Negara Malaysia's resolutions. Takaful operators through their Shariah advisory has built their own model based on their *ijtihad* to ensure that the Takaful operations in their companies do not conflict with Shariah as

[3] "The person who revokes his gift is like the dog that licks its vomit" and "The donor should not revoke his gift except when the father makes gift to his son".

well as producing a greater competitive Takaful product. However, this finding is contrary to a study that conducted by Abdullah and Abdul Aziz (2010) which shows Etiqa Takaful Sdn. Bhd. does not offered *hibah* Takaful benefit.

3. *Hibah*: Shariah Jurisprudence

Hibah is precisely defined as a contract to transfer ownership of existent and deliverable property voluntarily without compensation involved between living individuals whereby the intention and the action of giving the *hibah* and property transfer must be portrayed clearly in the contract language (Al-Zuhayli, 2007:539; Jantan, 2001:42; Tanzil-ur-Rahman, 1980:1). The Malikis permit giving gifts with a stipulated condition that the donee must give the donor compensation with a similar value of the *hibah* (Al-Zuhaily, 2007:560). Based on the definitions, loans, non-valued properties, undeliverable objects, legal obligation such as *zakah*, alimony and spousal expenses as well as commutative and sales contracts are excluded from being a *hibah* (Al-Zuhayli, 2007:539; Jantan, 2001:42).

Three components comprising offer, acceptance and receipt constitute the main features of the *hibah* contract (Al-Zuhayli, 2007:552; Tanzil-ur-Rahman, 1980:2), for which there is no divergence of views among jurists on the first and second cornerstone, receipt as a third component is treated differently. Receipt as a 'bindingness' condition for the *hibah* contract is av view shared by the Hanafis and Shafi'is, since for them a new ownership is not established without such receipt. However, the Hanbalis favor the view that receipt is a validity condition for goods measured by weight and volume. For items not measured by weight or volume, the Hanbalis rule that the *hibah* become binding immediately following the conclusion of the contract. It means ownership of the *hibah* is established prior to receipt. Meanwhile, the Malikis view receipt is neither a validity condition nor a binding condition. Receipt in fact is regarded as a condition for the full effects of the contract to be achieved (Al-Zuhayli, 2007:552-553)

The receipt can be either on behalf of oneself or on behalf of another. A receipt by a sane and discerning person is valid when he/she receives the *hibah* himself /herself whereas children and insane individuals are not entitled to receive gifts for themselves. Receiving

gifts on the behalf of a young child who does not have the legal right to take receipt on his/her own can be done by his/her legal guardian[4] (Al-Zuhayli, 2007:556).

Looking in more detail on the Islamic view on types of goft, some gift can be regarded as restricted gifts; gifts with certain conditions attached to them and there are three types of them. The first type of restricted *hibah* is a temporal *hibah* or a lifetime-*hibah* called *'umra*. In a very simple description, "it is a contract of *hibah* during the life of the donor or donee with condition that if the donee dies first, the *hibah* is to be returned to the donor" (Rasban and Mohd., 2006:68). Al-Zuhayli (2003:542-543) decribes that:-

> "a temporal condition imposed on the *hibah* is normally stated as if the *hibah* was given for the duration of the recipient's life, then it would be returned to the donor or his heirs upon the recipient's death and if *hibah* was given for the duration of the donor's life, then it must be returned to the donor's heirs upon his death."

Tanzil-ur-Rahman (1980:56) defines it as "*hibah* of property made for life of the donee." According to Rasban and Mohd. (2006:68-69), there are three types of *'umra*. Firstly *mua'bbadah*, which is *'umra* forever for the donee, for example, the donor says, "I give this land to you forever of throughout your life. Should ypu die then your legal heirs will have this land". secondly, *mutlaqah*, which is *'umra* that is not tied to any condition and is not limited. For example the donor says, "I give this land to you". Final results of *mua'bbadah* and *mutlaqah* imply that the donee's legal heirs will inherit the estate when the donee die. Thirdly, *muqayyadah*, such as, the donor says, "I give this land to you while you are alive, but if you predecease me, the land must be returned to me, and is I die after you then the land must be given to my legal heirs."

[4] The Hanafis list the legal guardians in the following order which begins with the father, a legal guardian commissioned by the father, the grandfather and a legal guardian commissioned by the grandfather and in the absence of these four persons, the other relatives and whoever is taking care of the child will take the obligation to receive the *hibah* instead of postponing the receipt. It is permissible for a legal guardian to keep the *hibah* tha he has given to the child in his own possession. This act implies the receipt on the behalf of the child (Al-Zuhayli, 2007:556)

The second type of restricted *hibah* is a conditional *hibah* (*ruqba*), whereby the donor lays down that the *hibah* will belong to the donee if the donor dies first. Tanzil-ur-Rahman (1980:62) defines it as "a contingent *hibah* on the death of the donor or donee". On the other hand, if the donee predeceases the donor then the *hibah* must be returned to the donor. It can be understood that, at the end of the day, the surviving party will own the estate. For example, the donor says, "I give this land to you while you are alive, but if you predecease me the land must be returned to me, and if I predecease you, the land is for you".

The four *Sunni* school of laws unanimously agree on the validity of the *'umra* and *ruqba* conditions. Regarding the validity of *'umra*, Abu Yusuf and the Shafi'is and the Hanbalis invalidate any temporal constraints on the *hibah* (Al-Zuhayli, 2007:543). To the Malaikis, the *'umra* condition is valid on the grounds that it is a *hibah* of *manfa'ah* (usufruct) of the object for the duration of the donee's life (Al-Zuhayli, 2007:544). Al-Zuhayli (2007:542-543) says that Prophet (pbuh) invalidate the temporal component of those gifts on the grounds of the following *Hadith*, "Keep your properties rather than giving them as temporal gifts. If you give something as a temporal gift, it becomes the recipient's property permanently". Abd, Ghaffar (2005:72) and Tanzil-ur-Rahman (1980:57) agree that condition of *'umra* is void. Meanwhile, Ismail (2008:146) cites that some of the jurists allow it. Accordingly, to sum up, the *hibah* is valid but most of the jurists agree the condition is void.

Turning to *ruqba*, Abu Yusuf, the Shafi'is, the Hanbalis, the Malikis, Abu Hanifa and Muhammad also invalidate any conditional constraints on the gifts. Abu Hanifa and Muhammad say that such conditional *hibah* is actually a contract of loan (*'ariyyah*) which allows the donor to ask for the return of the property whenever he wishes (Al-Zuhayli, 2007:543-544); Tanzil-ur-Rahman, 1980:62). However, Ismail (2008:148) claims that *ruqba* is valid without providing a sound foundation for his argument.

The last type of restricted *hibah* is usufruct gift. According to the Hanafis, it depends on whether or not the object itself survives after the donee collects its usufruct. Usufruct of non-fungible objects is considered as a type of loan to the donee. Usufruct of fungible

objects where the usufruct derived can only be used by consumption is tantamount to a full *hibah* (Al-Zuhayli, 2007:542-544).

There are three different views regarding gifts given to the offspring. The Hanafis jurists Abu Yusuf, the Malikis and Shafi'is share the opinion that there should be equal treatment among children regardless of gender[5]. However, this should be interpreted as a recommendation rather than an obligation (Al-Zuhayli, 2007:569). In contrast, a few jurists, including Ahmad, Al-Thawri, Tawus and 'Ishaq, hold that the equality in *hibah* distribution among children is obligatory. Jurists have dissimilar opinions over the definition of equality in which some say that equality entails equal share for males and females alike. According to Ahmad, the exceptional case of unequal distribution is permissible provided that there is strong reason for this such as chronic illness, indebtedness, the size of his family or occupation with his religious studies (Al-Zuhayli, 2007:570). The issue of to the extent of the permissibility of giving unequal gifts to children was answered by the fatwa issued by the committee of Al-Azhar. First, unequal gifts among children are allowed as compensations on the grounds that a father spends different amounts of money for education and providing comfort for each child. Second, it is permissible provided that a legal justification exists. The legal justification here includes a handicap that affects the child's earning ability, blindness, paralysis, other impediments to earning a living and occupation with religious studies (Al-Zuhayli, 2007:570-571). The third opinion is from the Hanafi jurist, Muhammad and the Hanbalis who they view that a father should follow the laws of inheritance which rule the male gets twice the share of the female (Al-Zuhayli, 2007:571). Apart from these, equality is recommended when giving gifts to parents and siblings although it is permissible to give more to the mothers and oldest siblings (Al-Zuhayli, 2007:571).

With regard to recalling the *hibah* and voiding the contract, the Hanafis is the only school that permits recalling the *hibah* and voiding the contract on the grounds that rule status of the *hibah* contract is non-binding (Al-Zuhayli, 2007:561; Tanzil-ur-Rahman, 1980:82),

[5] Al-Zuhayli (2003:569) says it is based on *Hadith*, "When giving gifts, give all your children equal amounts. In fact, if I were to give unequal amounts, I would give more to the women". A version of this *Hadith* in Al-Bukhari was narrated as follow, "Be wary of Allah and be fair to your children.

while other jurists share a view that disallows recalling the *hibah* and voiding the contract as they consider it is binding except for a father giving a *hibah* to his child[6] (Al-Zuhayli, 2007:561; Jantan, 2001:45) as long as child still owns the property (Jantan, 2001:45). The Shafi'is extend this permission from the father, grandfathers and great grandfathers (how high soever) who are the child's paternal lineage (Al-Zuhayli, 2007:560-561). However, they differ on the time that the father is allowed to do so. The Malikis permit rescinding the *hibah* before receipt only while the Shafi'is and Hanbalis permit a father to rescind the *hibah* before or after receipt (Al-Zuhayli, 2007:561). The difference appears because the Malikis rule that ownership of the *hibah* object is established through the contract and the contract becomes biding through receipt. As result it is generally not permissible for the donor to rescind the *hibah* after receipt. (Al-Zuhayli, 2007:559). In addition, the Malikis add that rescinding is allowed provided that the following five conditions are not violated. The *hibah* is not given for the purpose of charity and religion, the son must not have married after the *hibah* was given, the son must not have a deferred debt in point of time, the object of the *hibah* must have remained unchanged and neither the donor nor the donee should have fallen sick (Al-Zuhayli, 2007:559-560). As previously mentioned, since the Malikis allow the donor to stipulate the condition of demanding compensation for the *hibah* given, if he does not receive the appropriate compensation he may rescind the offer (Al-Zuhayli, 2007:560). According to Tanzil-ur-Rahman (1980:80-81), the donor is entitled to revoke his *hibah* at any time before transfer the possession of the property. The donor is also entitled to revoke his *hibah* even after making over possession of the *hibah* property except for the following circumstances: *hibah* from husband to wife and vice versa, the donee is the blood relation within prohibited degree[7], the donee is dead, the *hibah* property is no longer in the possession of the donor, the *hibah* property has physically changed, something is combined with the *hibah* property and it is impossible to separate the *hibah* property from its original form or structure and the *hibah* is with exchange.

[6] Al-Zuhayli (2003:560) says it is derived from the *Hadith* saying, "Nobody is allowed to give a *hibah* and then rescind it except for the father's right to rescind gifts given to his child".

[7] See Tanzil-ur-Rahman (1980:82-83)

4. RESEARCH METHODOLOGY

This study is qualitative research in nature. Data is collected via semi-structured interviews with Shariah Advisory of WSSB on 27th March 2012. The question is designed in order to identify the type and modus operanci of *hibah* Takaful benefit service offered by WSSB, the status of the contract, documentation process made by WSSB, the validity contract of *hibah* and the extent to which the product has been used to avoid the Islamic inheritance law – *faraid.*

5. DATA ANALYSIS AND DISCUSSION

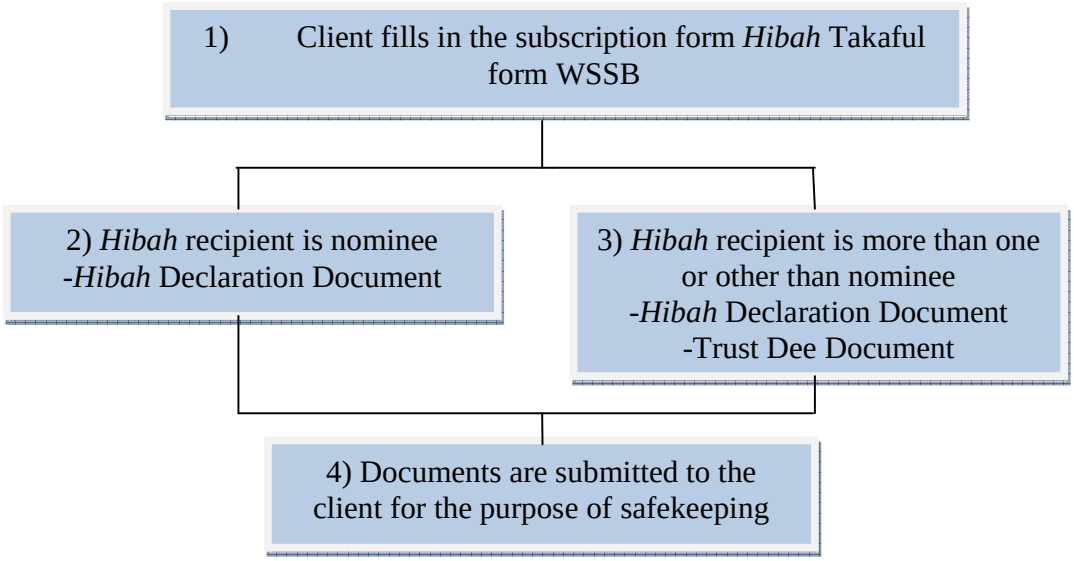
5.1 Profile of Company

Wasiyyah Shoppe Sdn. Bhd. (WSSB) provides service in Islamic estate planning and management in Malaysia since 2004. WSSB offers the preparation of Islamic estate planning documents namely Document of *Hibah* Declaration, Islamic *Wasiyyah*, Jointly Acquired Property (Harta Sepencarian), Trust and estate claiming processes at the Syariah Court, High Court and Department of Director General of Lands and Mines. WSSB has assisted more than 20,000 of its clients and has addressed over 120 cases regarding estate claiming until the end of 2010 without any payments from the heirs. In addition, until the end of 2008, WSSB has managed *hibah* properties more than RM200 million and expects the property value may increase to RM500 milion at the end of 2009. As at 30th June 2009, WSSB has been successfully acquired more than 30 judgment order for *hibah* from Syariah Court. This proves that the documents of *hibah* declaration provided by WSSB are valid from Shariah pointof view and enforceable from the Malaysian legislation point of view (Wasiyyah Shoppe, 2012).

5.2 *Hibah* Takaful Benefit at WSSB: Modus Operandi

figure 1 illustrates the structure and the implementation of *hibah* Takaful benefit implemented by WSSB.

Figure 1: The Structure of *Hibah* Takaful Benefit at WSSB



1. The client fills in the subscription *Hibah* Takaful form. He/She signs the agreement *aqad* for the provision of *Hibah* Declaration Document. The client also need to submit the following documents – a copy of Takaful policy or give information of the policy to WSSB, a copy of client's identity card, a copy of *hibah* recipient's identity card or birth certificate, a copy of the legal guardian's identity card if *hibah* recipient is under 18 years.

2. If *Hibah* recipient is nominees, client will be asked to sign a *Hibah* Declaration Document. This document is a proof of the existence of contract between client and *hibah* recipeints.

3. If *Hibah* recipients are more than one or other than nominee, WSSB will prepare an additional document which is Trust Deed Document to appoint a particular individual or Trustee Company as a Trustee. The Trustee is responsible to distribute Takaful benefit to the recipients that stated in *Hibah* Declaration Document.

4. Documents are submitted to the client for the purpose of safekeeping. It should be noted that the element of *Al-Qabdh* (receipt) which is the 'bindingness' condition

of *hibah* contract has implicitly established upon the submission of the of the *Hibah* Declaration Document and the Takaful policy to the *hibah* recipient. However, client may keep the documents either at UBB Trustee (The Trustee company which WSSB has collaborated with). The client must submit the document to *hibah* recipient for the purpose of *Al-Qabdh* (receipt).

Once *hibah* Takaful benefit contract has been executed, there are five circumstances that might occur:-

1. *Hibah* revocation by the client

The client needs to get the consent from *hibah* recipient because this contract has been legally established. However, if the *hibah*_recipient is children or grandchildren, *hibah* can be revoked without any consent from them.

2. Client is still alive until the maturity of the Takaful policy

The Takaful benefit that is paid by Takaful operators should be delivered to *hibah* recipient because this contract has been completed. If the client requires this Takaful benefit, he/she needs to get the permission from the *hibah* recipient.

3. Client dies before the maturity of Takaful policy

The Takaful operators will pay the Takaful benefit to the *hibah* recipient as specified in the *Hibah* Declaration Document or to the Trustee Company that stated in Trust Deed Document. Then, the Trustee Company will give the Takaful benefit to *hibah* recipients. If there is any argument among other legal heirs in second (2) and third (3) circumstances, then *hibah* recipient must obtain '*Hibah* Command' from the Syariah Court through lawyer appointed by WSSB or any lawyer according to his/her preference in order to certify that the *hibah* Takaful benefit is legitimate and enforceable.

4. *Hibah* recipient predeceases the client

The *hibah* contract is null and void. The ownership of the Takaful benefit will be returned to client based on *ruqba* principle.

5. In the event of permanent disability

The Takaful benefit will be paid to the client because the Takaful operators because the incomplete ownership of the Takaful benefit.

5.3 Other Major Issues

a) Type and modus operandi *hibah* Takaful benefit vary across Takaful operators and Islamic estate planning company.

This study finds that there is a significant difference in terms of types and modus operandi of *hibah* Takaful benefit which is conducted by Takaful Ikhlas Sdn. Bhd., Etiqa Takaful Bhd. and WSSB, for the purpose of comparison, Table 1 compiles the types of *hibah* Takaful benefit between Takaful Ikhlas Sdn. Bhd., Etiqa Takaful Bhd. and WSSB.

Table 1 : Types of *Hibah* Takaful Benefit at Takaful Ikhlas Sdn. Bhd, Etiqa Takaful Bhd. and WSSB.

	Status	***Hibah* Takaful Benefit from PA (Participant Account)**	***Hibah* Takaful Benefit from SPA (Special Participant Account)**
Etiqa Takaful Bhd.	Takaful operator	Absolute assignment	Absolute assignment
Takaful Ikhlas Sdn. Bhd.	Takaful operator	*Hibah* is not allowed. Nominee should distribute the Takaful benefit according to *faraid*	'Proposed *Hibah*' to close heirs
WSSB	Islamic estate planning company	*Ruqba*	*Ruqba*

Takaful Ikhlas Sdn. Bhd. implements the 'proposed *hibah*', Etiqa Takaful Bhd. implements the 'absolute assignment', while WSSB implements *hibah* based on *ruqba* principle. According to respondent, this is due to the different opinions in classifying the ownership of Takaful benefit among Takaful operators. *Hibah* will be valid if the Takaful

benefit is fully ownership by clients. If the Takaful operators are classifying the Takaful benefit as not fully-owned by participants, the 'proposed *hibah*', is the best choice to solve this issue. If the Takaful operators have classified the Takaful benefit is fully-owned by the participants, the 'absolute assignment' and conditional *hibah* or *hibah* based on *ruqba* principle are more pratical. This information can be found in the statement of the respondents as follows:-

> "This matter should be viewed from the perspective of the ownership because to make *hibah*, this existence of full ownership is obligatory. If the ownership is not a full ownership, therefore consent from Takaful operators required for the purpose of making *hibah*. If the Takaful operator gives the consent, this *hibah* Takaful benefit can be made. This is because the Takaful operator holds the fund contributed by the participant. It depends to the Takaful operator itself to interpret the ownership of the participant's contribution into Takaful fund."

We understand that this argument is related to the issue of ownership of Takaful benefit as discussed in the literature review. Since PSA is *Tabarru'* account, scholars have different view regarding the ownership and heritability Takaful benefit from this account.

b) Making *hibah* by filling the nomination form provided by the Takaful operator or using service of Islamic estate planning company

One may view that he/she can make *hibah* Takaful benefit by filling the nomination form provided by the Takaful operator at no cost at all. Therefore, he/she might think that there is no need to make *hibah* contract and pay additional cost to another estate planning company. WSSB in this circumstance could be perceived as third part. Another possible situation that might occur is that a client who has made *hibah* by filling nomination form, at the same time, get another *hibah* service from WSSB.

According to Nor Muhamad (2011:215), the *hibah* documentation that made by the law firms or other companies is to verify the *hibah* in terms of Shariah legislation. It may become an evident that the participant has given the property to the *hibah* recipients. Therefore, it can be concluded that the provision of the *Hibah* Declaration Document at

WSSB will be able to strengthen and verify contract between the participant and *hibah* recipients.

c) The validity of *ruqba* contract

Through semi-structured interviews, we find that WSSB has implemented *hibah* based on *ruqba* principle. Therefore, when *hibah* recipient predeceases than Takaful participant, the *hibah* contract is void and the ownership of Takaful benefit will be returned to the Takaful participant. However, the situation is not as simple as expected if we take into account the common practice in Malaysia. He raises a number of situations that are going on:-

1. The National Fatwa Council has still not issued any decisions relating to *hibah ruqba*. If the National Fatwa Council issues a fatwa of *hibahi ruqba*, the validity and marketability issue of product can be solved. There is a huge market for *hibah ruqba* in Malaysia and it is able to help certain cases of estate problem.

2. Although the fatwa is issued, the National Fatwa Council could not bind the decisions that will be made by the Shariah Court relating *hibah* Takaful benefits. Syariah Court may reach a differentb verdict which is not in line with the fatwa issued by the National Fatwa Council.

Despite the absence of resolution concerning this situation, the Securites Commission (SC) has officially recognized *hibah* based on *ruqba* principle in financial products (Muda. 2008:12). According to the respondents, the National Fatwa Council is soon expected to authorize the implementation of *hibah* based on *ruqba* principle for the needs of society and he emphasizes that is does not conflict with other *Mazhab* rather than Shafi'is.

WSSB has chosen to implement *hibah* based on *ruqba* principle because it is more flexible than 'absolute assignment' and it is able to protect the interest of Takaful participant such as in the case of *hibah* recipient predecease than Takaful participant. In the event of 'absolute assignment', the Takaful benefit need to be distributed to the *hibah* recipeint's legal heirs according Islamic law of inheritance upon the maturity of Takaful

policy or the death of participants. According to Mohd. Noor and Abdullah (2009:41), this matter is contrary to the objective of participants' contributions in the Takaful policy in order to provide financial help and assistance for the purpose of easing the burden of the participants' dependents. However, *hibah* based on *ruqba* principle can be revoked if *hibah* recipient agrees to return that Takaful benefit to the Takaful participants. On top of that, this *hibah* will be null and void if the *hibah* recipient predecease than the Takaful participant. The *hibah* based on *ruqba* principle has greater marketing opportunities currently due to its flexibility rather than 'absolue assignment'.

WSSB as a third party which is specializes in preparing Islamic estate planning documents. The documents that are prepared by WSSB will be able to support the *hibah* Takaful benefit made by Takaful participants through their respective Takaful operators. This document is significant especially for *hibah* recipient to reinforce *hibah* Takaful benefit that is made by Takaful participants. The services that offered by WSSB also help the Takaful participant if they are subscribing Takaful operators' services which do not offer *hibah* for Takaful benefit.

The *Hibah* Declaration Document based on *ruqba* principle that provided by WSSB is a document in terms of legislation form. Any argument among legal heirs concerning the validity of this contract is depended on the decision made by Syariah Courts even though the National Fatwa Council is still not issued any decisions concerning the validity this *hibah* based on *ruqba* principle.

d) Using *hibah* Takaful benefit to circumvent *faraid.*

This issue is driven by Abdullah and Abdul Aziz (2010). According the respondents:-

> "The issue related to the avoidance of *faraid* law should not arise. *Hibah* is a gift that is made valontarily without expecting any substitutions, *iwad* or payment in return. Death is not definite. *Hibah* is a sincere gift. If *hibah* is made with the intention of avoiding the law of *faraid,* it seems we definitely know we will die earlier than *hibah* recipient. This *hibah* Takaful benefit shows the determination of the participant to give their Takaful benefit to the *hibah* recipient. If the gift is made during the death-

> sickness (*Mawdhatul Mawut*), it may become a will (*wasiyyah*). Therefore, the *hibah* must be mde by a healthy person. In addition, as long as we still alive, we will strive to accumulate wealth. Thus, the property is distributed to the legal heirs according to the Islamic law of inheritance when we had died. *Hibah* is a gift during their life, so the participant may give their property to those they want."

From his statements above, it is clear that the objective of *hibah* Takaful benefit is not to avoid the *faraid.* In fact, unlike *faraid,* an individual is given freedom in making *hibah* to those who he/she favors with.

6. IMPLICATIONS AND RECOMMENDATIONS

There are substantial differences in terms of modus operandi between WSSB, Etiqa Takaful Bhd. and Takaful Ikhlas Sdn. Bhd. WSSB implements *hibah* based on *ruqba* principle, Etiqa Takaful Bhd. uses the concept of 'absolute assignment' or '*hibah mutlaqah*', and Takaful Ikhlas Sdn. Bhd. uses the concept of 'proposed *hibah*' only for benefits generated from PA. This difference occurs because there is no rule in offering *hibah* Takaful benefit (Abdullah and Abdul Aziz, 2010) and the Takaful operators through their own Shariah Advisors have built their own model *hibah* Takaful benefit based on their *ijtihad* to certify that their operational structures are consistent with Shariah law as well as are able to produce a more competitive Takaful product (Nor Muhamad, 2010). The difference implementation is also due to the different understading regarding the *hibah* contract and how it can be implemented in this area. The literature regarding *hibah* is insufficient in comparison to other Islamic financial instruments. Therefore, numerous studies should conduct in order to provide a clearer understanding of this product and may contribute to the existing research.

Although the difference implementation of this contract gives a competitive advantage among Takaful operators, it may contribute a negative impact to the Shariah jurisprudence and legislation especially in Malaysia where it has dual legal system. For example, *hibah* Takaful benefit that applied at WSSB is based on *ruqba* principles. The status of this type of *hibah* is still being questionable as the National Fatwa Council in

Malaysia still does not issue any decision regarding the validity of this contract. This is due to Shafi'is scholar does not recognize the concept of *ruqba* in *hibah* contract. However, even though the National Fatwa Council has resolved this contract as lawful, the validity and enforceability of this contract is still based on the decision of the Syariah Court. The decision that made by the Syariah Court might be different from the decision by the National Fatwa Council, because the National Fatwa Council cannot bind the court's decision (Muda, 2008:12).

Accoding to Nor Muhamad (2011:236-237). There is no particular rule that related to the implementation of *hibah* in Malaysia. In fact, the interpretations of *hibah* are different across states in Malaysia. This matter will impact the validity of *hibah* that is made by Takaful participants and their wishes will not be realized if Syariah Court decides the contract is invalid according to Islamic law and not enforceable. Therefore a client must be well briefed about the product offered must be aware the consequences he/she bears.

According to Abdullah and Abdul Aziz (2010:96), the amendments of laws such as Takaful Act 1984 are needed to prescribe and coordinate the implementation of this contract. This will strengthen product of *hibah* Takaful benefit and may increase the confidence level among Malaysian Muslim community.

A greater implication from the development of this product is that it may encourage the development of the various similar innovations for other moveable assets. For example, *hibah* of the investment account, Employees Provident Fund (EPF), the Islamic securities, Tabung Haji accounts, saving accounts in Islamic bank and financial institutions and others. According to the respondent, currently WSSB is developing a *hibah* product for EPF account. However, a greater study should be conducted so that this product is in line with Shariah principles and legal system in Malaysia. This is also particularly significant to prevent any conflict on Islamic estate planning product in future and conflicts between Syariah Court and Civil Court.

Another implication of this situation is that the communities may tend to distribute all of their estate through this instrument and other legal heirs, in the end of the day, might not receive any share of the estate of the deceased. Therefore, *hibah* Takaful benefit must be

reviewed so that it does not deny other legal heirs' right. This has been done by Takaful Ikhlas Sdn. Bhd. in which only *Tabarru'* Fund or Special Participant Account (PSA) can be given to a particular beneficiary through *hibah* contract while the Personal Account (PA) must be divided through *faraid* law.

7. CONCLUSION

Takaful industry and Islamic estate planning are growing rapidly. There are various innovation made by Takaful operators to attract the clients to subscribe their services. The latest innovation is engaging *hibah* in Takaful. Islamic estate planning service providers have identified that *hibah* product can be extended to *hibah* Takaful benefit and WSSB has taken initiative to promote this product. This study finds that the implementation of the *hibah* Takaful benefit at WSSB is difference among other Takaful operators in terms of contract and modus operandi. Due the lack of study in this area, further research should be carried out to enrich the literature. This study provides the recommendations which benefit the stakeholders.

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PERSEPSI USAHAWAN WANITA TERHADAP PERBANKAN ISLAM – PERBANDINGAN TINJAUAN LAPANGAN DI BIMB DAN BMMB

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Abstrak

Sistem kewangan dan perbankan Islam menjadi semakin komplek dan berkembang pesat. Aliran dana yang meningkat serta permintaan global yang besar merancakkan lagi perkembangannya Kajian berkaitan keusahawanan terutamanya dalam perniagaan kecil dan sederhana telah banyak dilakukan dewasa ini. Walau bagaimanapun tidak banyak kajian yang memfokuskan kepada usahawan wanita secara spesifik. Kajian-kajian terdahulu melaporkan yang usahawan wanita terutamanya dalam perniagaan kecil menghadapi masalah mendapatkan pembiayaan terutamanya daripada pihak bank serta juga layanan yang tidak sepatutnya sebagaimana usahawan lelaki. Penyelidikan ini bertujuan untuk meninjau persepsi usahawan wanita terhadap perbankan Islam secara umum. Kajian yang telah dijalankan ini mengambil sampel usahawan wanita di Malaysia. Bank Islam Malaysia Berhad (BIMB) dan Bank Muamalat Malaysia Berhad (BMMB) dipilih sebagai perbandingan kes kajian. Hasil mendapati arah aliran persepsi pelanggan usahawan wanita dengan BIMB dan BMMB adalah sealiran. Tiada terdapat perbezaan yang jelas antara keduanya.

Kata kunci : Persepsi, Usahawan Wanita, Perbankan Islam, Hubungan Pelanggan Dengan Bank

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Abstract

The emerging on finance and banking system turns the system to become more complex. Increasing funds flow together with the additional global demand is always a great stimulation towards the development. Research on entrepreneurship, particularly in small and medium enterprise (SME's) had been covered in various study recently. Having said that very few studies have focused on women entrepreneurs specifically. Previous studies reported that women entrepreneurs, particularly in small businesses facing a major setbacks where they having a difficulties in getting financing from banks as compared to their counterparts i.e male entrepreneurs. This research examined the perceptions of women entrepreneurs on Islamic banking in general. This study was conducted by taking samples of women entrepreneurs in Malaysia as respondents. The result shows that the Islamic banking system led by the Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad (BMMB) has actually had a good perception among women entrepreneurs. There is not much difference between the two.

Keywords: Perception, Women Entrepreneurs, Islamic Banking, Bank Relationship

1. Pengenalan

Kerajaan Malaysia hari ini amat menggalakkan penglibatan kaum wanita di dalam bidang perniagaan dan berusaha menjadikan Malaysia sebagai sebuah pusat kewangan Islam serantau yang maju dan terkehadapan. Justeru situasi ini, kertas ini bertujuan meninjau persepsi usahawan wanita terhadap hubungan yang wujud di antara usahawan wanita dengan sektor perbankan Islam di Malaysia. Ini penting bagi kedua belah pihak untuk kesinambungan hubungan yang lebih berfungsi di masa akan datang. Pengenalpastian persepsi corak dan struktur hubungan diyakini akan lebih membantu terutamanya kepada pihak bank memasarkan kemudahan kewangan yang secocok dengan keperluan semasa usahawan wanita. Atas dasar ini kertas penyelidikan ini ditulis sebagai satu sumbangan kepada pemahaman yang mendasar mengenai isu di atas.

Dewasa ini perbankan Islam telah menjadi satu alternatif kepada pelanggan-pelanggan beragama Islam yang mahukan sebuah sistem kewangan dan perbankan yang selaras dengan kehendak Syariah. Justeru itu Bank Islam Malaysia Berhad (BIMB) sebagai bank Islam perintis dan Bank Muamalat Malaysia Berhad (BMMB) sebagai bank Islam kedua di Malaysia telah secara konsistan menawarkan produk-produk perbankan yang mampu

menarik pelanggan menggunakan perkhidmatan yang berlandaskan Syariah ini. Produk-produk yang ditawarkan melalui perbankan runcit (*retail banking*) serta perbankan korporat (*corporate banking*) termasuklah aktiviti pendepositan, pembiayaan, pembiayaan perdagangan serta perkhidmatan-perkhidmatan sebanding perbankan konvensional yang lain. Aktiviti ini sesuai dengan konsep *al ihsan*, yang menganjurkan kesemua unit ekonomi bekerjasama dalam menjalankan kegiatan ekonomi yang akan menjamin kestabilan dan kemakmuran kepada masyarakat (Nik Mustapha Nik Hassan 2002). Sesuai dengan aktiviti pelaburan yang melibatkan perniagaan yang halal selaras dengan kaedah fiqh iaitu ’pembayaran atau pembiayaan dibalas dengan ganjaran (A.B.Hameed., M.F.M Ali., M. Hashim., H. Sabri (2005). Oleh yang demikian persepsi terhadap hubungan yang wujud di antara usahawan wanita dengan aktiviti perbankan Islam sudah semestinya perlu dilihat dan ditinjau bagi membolehkan ruang, peluang, kerjasama serta penambahbaikan dapat kenalpasti. Seterusnya usaha-usaha yang bersesuaian boleh dikoordinasikan secara sistematik supaya kejayaan boleh diperluaskan pembaziran perbelanjaan yang tinggi di dalam usaha membantu usahawan-usahawan tersebut dapat dielakan (Norsidah, 1999).

Kertas penyelidikan ini mengandungi tujuh objektif kajian untuk melihat persepsi usahawan wanita terhadap hubungan dengan sektor perbankan Islam. Antara objektif-objektifnya adalah mengenalpasti profail usahawan wanita BIMB dan BMMB, mengenalpasti profail perniagaan usahawan wanita BIMB dan BMMB, melihat persepsi usahawan wanita terhadap hubungan yang wujud antara mereka dan BIMB dan BMMB, melihat tahap pengetahuan dan kefahaman perkhidmatan BIMB dan BMMB di kalangan usahawan wanita terbabit, melihat tahap kepuasan usahawan wanita terhadap kualiti perkhidmatan perbankan yang ditawarkan oleh BIMB dan BMMB dan tanggapan usahawan wanita terhadap perkhidmatan BIMB dan BMMB serta melihat tahap konsistensi usahawan wanita kepada perkhidmatan perbankan BIMB dan BMMB.

Objektif-objektif kajian di atas adalah wajar dilihat di dalam mengenalpasti asas hubungan yang wujud di atas kapasiti saling mewujudkan suasana ekonomi yang baik dan sihat untuk kemajuan di dalam bidang perusahaan kecil dan sederhana (PKS) yang

melibatkan usahawan wanita dan kewangan Islam secara keseluruhannya. Kertas penyelidikan ini terbahagi kepada lima bahagian iaitu pengenalan, ulasan karya, kaedah kajian, temuan kajian serta kesimpulan.

2. Ulasan Karya

Kerajaan Malaysia sentiasa menekankan pembangunan keusahawanan kerana ianya dapat memberikan sumbangan yang positif ke arah usaha-usaha kerajaan untuk menyusun semula masyarakat dan mempercepatkan proses industrialisasi selaras dengan matlamat pewujudan Masyarakat Perdagangan dan Perindustrian Bumiputera (MPPB). Usahawan termasuklan usahawan wanita adalah enjin pertumbuhan pembangunan ekonomi sesebuah negara. Bank merupakan sumber utama pembiayaan bagi sesebuah perniagaan dan ini menyebabkan wujud satu hubungan antara bank-bank pembiaya dan usahawan itu sendiri. Ibbotson dan Moran (2003) mendapati kebanyakan pemilik PKS berpuas hati dengan perkhidmatan dan bantuan yang disediakan oleh pihak bank dan pembangunan perniagaan mereka.

Selaras dengan dasar ini, pelbagai usaha telah dilakukan oleh pihak kerajaan dan agensi-agensi sokongan kerajaaan bagi membantu usahawan-usahawan bumiputera. Dorongan, galakan serta tumpuan pihak kerajaan akan memudahkan lagi usaha untuk melibatkan lebih ramai bumiputera ke dalam bidang perniagaan dan perindustrian. Walau bagaimanapun, keberkesanan perkhidmatan yang diberikan oleh kerajaan melalui jentera-jenteranya tidak diketahui ramai kerana tidak ada data-data yang dikumpulkan secara sistematik. Khidmat-khidmat sokongan adakalanya mengalami pertindihan fungsi antara agensi dan jabatan terbabit. Alternatif kepada ini ialah penglibatan pihak swasta secara serius terutamanya sektor perbankan terutamanya perbankan Islam sebagai penyedia perkhidmatan pembiayaan bagi PKS bumiputra terbabit adalah sesuatu yang sangat mendesak.

Bersesuaian dengan hala tuju kerajaan terhadap pembangunan PKS ini, peranan kaum wanita juga tidak ketinggalan diberikan perhatian. Usahawan wanita yang menerajui PKS

juga tidak ketinggalan dalam merebut peluang perniagaan yang disediakan oleh kerajaan. Walaupun begitu, kajian terhadap penglibatan wanita di dalam bidang perniagaan adalah sangat kurang (Collins & Moore, 1964). Pengalaman di Malaysia juga menunjukkan keadaan yang sama (Chamhuri, Kassim & Ismail, 1992). Di sebalik itu sejarah telah membuktikan bahawa wanita telah lama berkecimpung dalam perniagaan sendiri (Anderson & Zinsser, 1988). Bagaimanapun, kajian oleh Ibbotson & Moran (2003) mendapati wujudnya elemen yang boleh mengganggu hubungan baik antara perusahaan kecil dan sederhana dan bank seperti kadar faedah yang dikenakan oleh pihak bank.

Penyertaan wanita dalam sektor industri secara realitinya adalah rendah, meskipun terdapat peningkatan pencapaian pendidikan di samping pasaran kerja yang cerah. Penyertaan yang rendah ini disebabkan sebahagian besar mereka tidak mempunyai modal yang mencukupi di samping terikat dengan tanggungjawab yang besar dalam pengurusan rumahtangga. Walaupun kadar penyertaan tenaga buruh wanita Malaysia adalah rendah berbanding dengan negara-negara maju, ia adalah lebih tinggi berbanding dengan beberapa negara membangun yang lain. Industri yang dimiliki oleh wanita bagaimanapun menjadi semakin penting bagi sektor PKS (Coleman, 2000).

Coleman (2002) menggariskan lima kekangan yang mungkin dihadapi oleh usahawan wanita dalam memulakan perniagaan. Kekangan-kekangan ialah:

1. Kekangan pendidikan terdahulu
2. Takut menghadapi risiko yang akan datang
3. Kekangan sosial
4. Jenis perniagaan yang akan dijalankan
5. Diskriminasi dalam mendapatkan pinjaman

Secara umumnya kekangan-kekangan di atas adalah berhubung kait. Contohnya, wanita yang kurang hubungan sosialnya mudah takut kepada risiko. Ini disokong oleh Coleman dan Carsky (1996), yang menyimpulkan bahawa usahawan wanita kurang mendapatkan pinjaman dari bank kerana takut kepada risiko. Jadi mereka lebih cenderung untuk

memulakan perniagaan yang kecil di mana risikonya tidak terlalu tinggi. Loscocco dan Robinson (1991) dan Reshmi (2002) menyatakan bahawa usahawan wanita lebih cenderung kepada industri yang kecil yang tertumpu kepada penawaran perkhidmatan.

Sememangnya terdapat faktor-faktor tertentu yang mewujudkan hubungan di antara pihak bank dan pelanggan. (Haron, Ahmad dan Planisek (1994). Institusi kewangan biasanya kurang berminat kepada perniagaan yang kecil dan secara tidak langsung ini akan menyukarkan usahawan wanita untuk mendapatkan pinjaman perniagaan. Bank memerlukan peminjam yang mempunyai rekod keuntungan yang baik, hubungan yang telah lama terjalin dan aset yang bernilai sebagai pajakan (Cole dan Wolken, 1995; Ennew dan Binks 1995). Kekurangan yang yang dihadapi oleh wanita akan menjadi kelemahan bagi mereka untuk mendapatkan pinjaman dari bank (Coleman, 2000). Akhir sekali bank akan mempersoalkan latar belakang pendidikan yang diterima oleh usahawan wanita. Rajivan (1997) dan Reshmi (2002) menulis bahawa wanita yang memiliki taraf pendidikan yang tinggi tetapi menjalankan perniagaan yang tidak selari dengan pendidikannya turut mengundang masalah kepada mereka.

Richard dan Nicole (2001) dalam kajian mengenai usahawan wanita di Poland mendapati dua masalah utama yang dihadapai oleh usahawan wanita: 1.) kurangnya perhatian dari kerajaan untuk para usahawan; dan 2.) perbezaan antara usahawan wanita dan lelaki dalam beberapa dimensi yang akhirnya memerlukan bantuan. Hal ini turut diakui oleh Kolvereid dan Obloj (1994) yang mengkaji usahawan di Poland, Britain dan Norway. Mereka turut mendapati bahawa sektor awam kurang menyediakan polisi dan bantuan untuk memajukan usahawan. Berdasarkan kepada situasi ini, jelas kelihatan yang keperluan kepada usahawan wanita untuk mempunyai hubungan yang baik dengan bank kerana ini akan menyumbang kepada peluang yang lebih besar kepada mereka untuk mendapat pinjaman daripada pihak bank.

Kajian terdahulu yang memfokuskan kepada hubungan antara pelanggan dan bank telah banyak dilaksanakan oleh para pengkaji. Kebanyakannya melihat daripada pelbagai perspektif yang berbeza. Majalah Business Line keluaran Oktober 2005, melaporkan

perusahaan kecil dan sederhana memainkan peranan yang penting dalam pembangunan sesebuah negara. Industri adalah enjin pertumbuhan pembangunan ekonomi sesebuah negara yang sangat penting. Bank merupakan sumber utama pembiayaan bagi sesebuah perusahaan dan ini menyebabkan wujud satu hubungan antara bank-bank pembiaya dan perusahaan itu sendiri. Terdapat beberapa kajian lepas yang cuba mengupas hubungan antara insustri dan bank.

Dari segi perspektif Islam pula, kepuasan pelanggan adalah elemen yang penting dalam hubungan antara bank dan orang awam (Metawa dan Almossawi, 1998). Kajian ini juga mendapati kebanyakan pelanggan perbankan Islam amat berpuas hati dengan produk dan perkhidmatan yang ditawarkan oleh bank-bank Islam. Ibbotson dan Moran (2003) mendapati kebanyakan empunya perusahaan kecil dan sederhana berpuas hati dengan perkhidmatan dan bantuan yang disediakan oleh pihak bank dan pembangunan perniagaan mereka. Terdapat beberapa kajianlain seperti Lam dan Burton (2005), yang mendapati hubungan baik antara perusahaan kecil dan sederhana dan bank wujud disebabkan perkhidmatan berkualiti yang ditawarkan oleh pihak bank kepada perusahaan kecil dan sederhana. Lam dan Burton (2005) turut mendapati kesetiaan perusahaan kecil dan sederhana kepada sesebuah bank bergantung kepada perkhidmatan yang ditawarkan dan tempoh masa yang telah wujud dalam hubungan antara perusahaan kecil dan sederhana dan bank

Bagaimanapun, kajian oleh Ibbotson dan Moran (2003) mendapati wujudnya elemen yang boleh mengganggu hubungan baik antara perusahaan kecil dan sederhana dan bank seperti kadar faedah yang dikenakan oleh pihak bank. Panthrose (2005) pula telah mengenalpasti bahawa cagaran adalah faktor yang boleh menggugat hubungan perusahaan kecil dan sederhana dan bank. Dalam kajiannya, beliau mengatakan pembiayaan perusahaan kecil dan sederhana berisiko tinggi kerana kurangnya asset yang boleh dijadikan cagaran untuk mendapat pembiayaan. Kegagalan perusahaan kecil dan sederhana menawarkan cagaran yang sesuai untuk pembiayaan yang dipohon dari pihak bank akan menyebabkan pihak bank meragui kemahiran teknikal, pengurusan dan

pemasaran perusahaan kecil dan sederhana tersebut untuk menjana aliran tunai yang sesuai dengan perniagaan perusahaan kecil dan sederhana itu.

Hubungan antara bank dan pelanggan perniagaan kecil dan sederhana telah mendapat perhatian daripada pelbagai sumber kebelakangan ini (Binks et al., 1989; Butler and Durkin, 1995, 1998; Forum of Private Business, 2000; Connolly, 2000) dengan masalah-masalah hubungan ini mula didokumenkan dari awal 70an. Bevan (1978) merumuskan 3 teras yang menyebabkan masalah dalam hubungan perusahaan kecil dan sederhana dan bank. Tiga teras ini adalah (i) kurangnya budi bicara di kalangan pengurus bank tempatan (ii) kurangnya kefahaman tentang keperluan industri tempatan, dan (iii) jaminan peribadi yang dikehendaki oleh pemilik perniagaan. Butler dan Durkin (1995) telah mengesahkan penemuan di atas apabila mereka mengenalpasti masalah yang wujud antara pelanggan bank berkait rapat dengan syarat yang ditetapkan pihak bank dalam pembiayaan dan nasihat yang diberikan pihak bank.

Laporan-laporan kebelakangan ini menunjukkan hubungan antara perusahaan kecil dan sederhana dan bank semakin teruk (Harrison, 2001). Keputusan oleh The Cruickshank Report yang dibincangkan dalam *First Voice* yang diterbitkan oleh Small Business Federation mendapati bahawa bank-bank di UK telah mengenakan lebihan bayaran (overcharge) sehingga hampir RM35 juta setahun terhadap pelanggangnya. Laporan tersebut juga mengatakan bank-bank di UK beroperasi sebagai ‘anti kompetitif’, dimana ia lebih menekan perniagaan kecil untuk memohon pembiayaan dari bank (Harrison, 2001).

Berdasarkan kepada sumber-sumber ini jelas yang hubungan pelanggan dengan pihak bank yang baik adalah sangat penting. Terutamanya bagi pelanggan yang menjalankan perniagaan, seperti antaranya perusahaan kecil dan sederhana (PKS).

Oleh yang demikian, tinjauan ini adalah bagi mengkaji persepsi usahawan wanita terhadap perbankan Islam yang mana ini diwakili oleh Bank Islam Malaysia Berhad (BIMB) dan Bank Muamalat Malaysia Berhad (BMMB). Tinjauan akan melihat

sekiranya ada persamaan dalam arah aliran hubungan dan juga permasalahan yang wujud antaranya jika ada.

3. Kaedah Kajian

3.1 Sampel dan Kaedah Persampelan

Sejumlah 300 borang soalselidik (150 bagi setiap bank) telah diedarkan kepada usahawan wanita yang menjadi pelanggan BIMB dan BMMB. Sebanyak 176 (58.67%) borang soalselidik iaitu 130 (86.67%) daripada BMMB dan 46 (30.67%) daripada BIMB telah berjaya di perolehi. Pengedaran borang soal selidik ini dilakukan secara bebas, di mana penyelidik telah mengedarkan borang soal selidik hasil tinjauan di tiga negeri di utara semenanjung Malaysia iaitu Kedah, Perlis dan Pulau Pinang.

3.2 Instrumen Kajian

Borang soal selidik dibahagikan kepada tujuh bahagian yang meliputi bahagian profail responden, profil perniagaan responden, hubungan responden dengan BIMB dan BMMB, perkhidmatan yang ditawarkan oleh BIMB dan BMMB kepada responden, pemahaman responden terhadap perkhidmatan BIMB dan BMMB, tanggapan responden terhadap BIMB dan BMMB dan tahap konsistensi pengguna perkhidmatan kepada BIMB dan BMMB di kalangan responden.

Penggunaan borang soal selidik ini bertujuan mengesahkan persepsi terhadap hubungan yang wujud di kalangan usahawan wanita berdasarkan keperluan mereka dan peranan BIMB dan BMMB dalam aktiviti perniagaan mereka.

4. Temuan Kajian

4.1 Profail Usahawan Wanita BIMB dan BMMB[4]

Analisa terhadap responden BIMB, mendapati majoriti usahawan wanita yang berurusan dengan BIMB adalah terdiri daripada mereka yang telah berkeluarga iaitu sebanyak 58.7% manakala 30.4% lagi berstatus bujang dan selebihnya sama ada ibu atau bapa tunggal. Hampir keseluruhan daripada responden dalam kajian ini beragama Islam, iaitu sebanyak 91.3%. Majoriti umur usahawan wanita dalam kajian ini ialah lingkungan antara 30 tahun hingga 49 tahun. Sebanyak 50% berpendidikan setakat sekolah menengah manakala 41.3% lagi berkelulusan universiti.

Bagi BMMB pula didapati majoriti pelanggan usahawan wanita adalah terdiri daripada golongan bujang dengan peratusan sebanyak 67% berbanding 26.1% yang telah berkahwin. Seperti di BIMB, majoriti pelanggan BMMB adalah Muslim dengan 89.5%. Apa yang menarik ialah majoriti pelanggan usahawan wanita di BMMB dalam kajian ini ialah lingkungan antara 20 tahun hingga 29 tahun. Dari segi tahap pendidikan, lulusan universiti mewakili 72.2% diikuti dengan pedidikan tahap menengah sebanyak 19%.

4.2 Profail Perniagaan Usahawan Wanita BIMB dan BMMB[5]

Kajian profail perniagaan bagi pelanggan usahawan wanita BIMB mendapati majoriti pelanggan dengan peratusan sebanyak 36.8% telah terlibat dengan perniagaan di antara 10 hingga 14 tahun. Ini diikuti dengan kurang daripada 5 tahun iaitu sebanyak 28.9% dan antara 5 hingga 9 tahun sebanyak 23.7%.. Terdapat pelanggan yang mencatatkan jualan bulanan melebihi RM 100 iaitu sebanyak 5.3% begitu juga mereka yang mencatatkan jualan bulanan di antara RM 50 ribu sehingga RM 99,999 dengan peratusan yang sama. Namun begitu, peratusan jualan bulanan tertinggi oleh usahawan wanita BIMB ialah dalam lingkungan RM15 ribu hingga RM29,999 iaitu sebanyak 36.8%, kurang daripada RM15 ribu sebanyak 31.6% manakala 21.1% lagi mencatatkan jualan bulanan antara RM

[4] Rujuk lampiran I, Jadual 1

[5] Rujuk lampiran II, Jadual 2

30 ribu hingga RM 49,999. Majoriti daripada responden iaitu sebanyak 51.4% terlibat dalam perniagaan milikan tunggal manakala 37.8% dalam perkongsian dan selebihnya dalam pegangan awam dan pegangan terhad. Industri perkhidmatan menjadi jenis industri paling banyak di ceburi oleh usahawan wanita BIMB iaitu sebanyak 30.8% manakala industri makanan pula sebanyak 28.2%. 10.3% terlibat dalam perkilangan manakala selebihnya dalam industri hiliran lain.

Usahawan wanita yang berurusan dengan BMMB pula boleh di bahagikan kepada dua kumpulan utama iaitu kurang daripada 5 tahun sebanyak 59.4%, dan antara 5 hingga 9 tahun iaitu sebanyak 31.7%. Pendapatan jualan bulanan tertinggi untuk pelanggan usahawan wanita BMMB adalah di antara RM 50 ribu hingga RM 99,999 dan ini hanyalah sebanyak 1% daripada bilangan usahawan wanita terbabit, manakala peratusan jualan bulanan tertinggi usahawan wanita BMMB ialah kurang dari RM15 ribu iaitu sebanyak 62.0%, diikuti oleh jualan bulanan antara RM15 hingga RM 29,999 sebanyak 25.0% manakala 12.0% lagi mencatatkan jualan bulanan antara RM 30 ribu hingga RM 49,999. Majoriti daripada responden iaitu sebanyak 57.0% terlibat dalam perniagaan milikan tunggal manakala 38.0% dalam perkongsian dan selebihnya dalam pegangan awam dan pegangan terhad. Industri perkhidmatan menjadi jenis industri paling banyak di ceburi oleh usahawan wanita BMMB iaitu sebanyak 42.4% manakala industri makanan pula sebanyak 39.4%. 6.1% terlibat dalam perkilangan manakala selebihnya dalam industri hiliran lain.

4.3 Hubungan Usahawan Wanita dengan BIMB dan BMMB[6]

Hasil kajian mendapati, keutamaan penggunaan kemudahan perbankan di kalangan pelanggan usahawan wanita bagi kedua-dua bank adalah hanya sebagai tempat simpanan dan tabungan dan masih lagi kurang di maksimakan penggunaan di dalam aspek pembiayaan.

[6] Rujuk lampiran III, Jadual 3a dan Jadual 3b

Sebanyak 22.76% usahawan wanita BIMB yang menjadi responden dalam kajian ini menggunakan perkhidmatan akaun semasa, 13.1% menggunakan kad smart, 11.72% menggunakan akaun simpanan wadiah dan 6.21% menggunakan kemudahan rangkaian MEPS. Hanya kira-kira 15% responden menggunakan perkhidmatan yang berkaitan dengan pembiayaan perniagaan.

48.9% daripada pelanggan telah menggunakan perkhidmatan BIMB antara 1 hingga 5 tahun. 26.7% menggunakan perkhidmatan BIMB antara 5 hingga 10 tahun manakala 17.8% lagi kurang dari setahun. Akhbar dan majalah menjadi pembekal maklumat berkenaan BIMB yang utama kepada kumpulan usahawan wanita ini iaitu sebanyak 32.6% diikuti oleh kawan dan ahli keluarga 26.1%, saluran televisyen dan radio 19.6% manakala 13% dalam perjumpaan perniagaan. Sentimen keagamaan merupakan antara sebab utama responden memilih BIMB iaitu sebanyak 66.7% manakala faktor keuntungan dan agama 20% dan keuntungan semata-mata hanya 11.1%. Walau bagaimanapun, tipikal para pengusaha yang mana impak keberuntungan adalah penting dan besar. Majoriti responden iaitu sebanyak 58.7% menyatakan kesetiaan kepada BIMB biarpun tidak mendapat sebarang keuntungan dalam urusniaga yang dilakukan.

Bagi pelanggan usahawan wanita BMMB pula, sebanyak 36.92% usahawan wanita BMMB yang menjadi responden dalam kajian ini menggunakan perkhidmatan akaun semasa Wadiah, 11.6% menggunakan kaedah kiriman wang, 5.61% menggunakan pelaburan am mudharabah dan peti keselamatan muamalat dan 5.14% menggunakan kemudahan M cash @ oberderaf dan pembiayaan perumahan BBA Muamalat . Kira-kira 21% responden menggunakan perkhidmatan yang berkaitan dengan pembiayaan perniagaan.

56.9% daripada pelanggan telah menggunakan perkhidmatan BMMB antara 1 hingga 5 tahun. 31.2% menggunakan perkhidmatan BMMB kurang dari setahun manakala 11.0% lagi antara 5 tahun hingga 10 tahun. Kawan dan ahli keluarga menjadi pembekal maklumat berkenaan BMMB yang utama kepada kumpulan usahawan wanita ini iaitu sebanyak 36.2% diikuti oleh televisyen dan radio 28.5%, akhbar dan majalah 25.4%

manakala 6.9% dalam perjumpaan perniagaan. Faktor keuntungan dan keagamaan merupakan antara sebab utama responden memilih BMMB iaitu sebanyak 63.9% manakala faktor keuntungan sebanyak 22.1% dan faktor keagamaan sebanyak 11.5%. Walau bagaimanapun, tipikal para pengusaha yang mana impak keberuntungan adalah penting dan besar. Majoriti responden iaitu sebanyak 50.9% akan beralih ke bank lain sekiranya tidak mendapat sebarang keuntungan dalam urusniaga yang dilakukan.

4.4 Pengetahuan dan kefahaman Usahawan Wanita terhadap perkhidmatan yang ditawarkan oleh BIMB dan BMMB[7]

Berdasarkan kepada jadual 4 di bawah, didapati majoriti responden BIMB hanya memahami sekadarnya perbezaan di antara perbankan Islam dan perbankan konvensional. Ini dapat dilihat dari segi peratusan 60.9% daripada responden BIMB dan 41.7% daripada responden BMMB menyatakan pandangan sedemikian. Walau bagaimana pun sebanyak 46.9% responden BMMB memahami perbezaan antara perbankan Islam dan juga perbankan konvensional.

Majoriti pelanggan BIMB dan BMMB secara umumnya memahami pengharaman unsur riba yang diamalkan oleh perbankan konvensional. Namun mereka sependapat yang BIMB dan BMMB mesti juga menerapkan pemaksimuman keuntungan dalam persekitaran perniagaan. Ini di tunjukkan dengan peratusan 52.2% responden dari BIMB dan 62.3% responden dari BMMB berpendapat sedemikian. Walaupun begitu peratusan responden yang tidak pasti berkenaan isu ini juga tinggi iaitu masing-masing 30.4% bagi BIMB manakala 24.6% bagi BMMB.

Di dalam mengenalpasti aplikasi konsep kerjasama untung rugi (Mudharabah dan Musyarakah) di dalam operasinya, sebanyak 47.8% responden bersetuju bahawa BIMB hanya menggunakan prinsip untung rugi dalam operasi sementara 15.2% lagi tidak bersetuju manakala sebanyak 48.3% responden bersetuju bahawa BMMB hanya

[7] Rujuk Lampiran IV, Jadual 4

menggunakan prinsip untung rugi dalam operasi sementara 6.1% lagi tidak bersetuju. Walaupun begitu, majoriti responden mengaku mereka mempunyai pengetahuan dalam sistem perbankan Islam.

4.5 Kepuasan Usahawan Wanita terhadap kualiti perkhidmatan BIMB dan MMB[8]

Jadual 5 merujuk kepada kepada kepuasan usahawan wanita terhadap kualiti perkhidmatan yang diberikan oleh BMMB dan BIMB. Sebanyak 88.9% responden sangat berpuashati dan berpuashati dengan perkhidmatan yang ditawarkan oleh BIMB dan 60.1% responden sangat berpuashati dan berpuashati dengan perkhidmatan yang ditawarkan oleh BMMB. Ini jelas menunjukan yang usahawan wanita berpuashati dengan perkhidmatan sektor perbankan Islam yang ditawarkan oleh kedua-dua bank. Namun peratusan neutral bagi BMMB juga agak tinggi iaitu sekitar 38.9%.

Dari segi mutu berurusan dengan pekerja, majoriti responden di BIMB dengan peratusan sebanyak 84.5% sangat berpuashati dan berpuashati apabila berurusan dengan pekerja BIMB dan manakala 58.4% sangat berpuashati dan berpuashati apabila berurusan dengan pekerja BMMB. Responden dari BIMB juga menunjukkan mereka lebih berpuashati dengan kualiti perkhidmatan dengan dapatan peratusan setinggi 72.8% sangat berpuashati dan berpuashati berbanding hanya 62.8% bagi BMMB untuk situasi yang sama.

Apa yang lebih menarik, bagi ketiga-tiga soalan tiada pelanggan yang menyatakan mereka tidak berpuashati dengan perkhidmatan BIMB manakala sebanyak 8.9% pelanggan menyatakan yang mereka tidak berpuashati dengan perkhidmatan BMMB untuk ke tiga-tiga soalan.

[8] Rujuk Lampiran V, Jadual 5

4.6 Tanggapan Usahawan Wanita terhadap BIMB dan BMMB[9]

Objektif ini memfokuskan kepada penilaian berkenaan pengetahuan dan kefahaman pelanggan terhadap pekhidmatan perbankan Islam yang ditawarkan oleh BIMB dan BMMB. Tanggapan terhadap potensi produk perbankan Islam, perbezaan dengan produk perbankan konvensional, pemasaran produk perbankan, tanggapan pelanggan terhadap kesesuaian produk kepada pelanggan, daya penarik dan pengetahuan tentang perbankan Islam dijadikan sebagai pengukur untuk analisa ini.

Tinjauan mengenai tanggapan usahawan wanita terhadap BIMB pula mendapati 69.6% responden mengatakan potensi produk perbankan Islam di sektor pelanggan yang menjalankan perniagaan adalah baik dan sangat baik. Hanya 2.2% sahaja yang tidak bersetuju dan berpendapat produk perbankan Islam BIMB tiada potensi. Analisa di BMMB pula mendapati 76.3% responden mengatakan potensi produk perbankan Islam di sektor pelanggan yang menjalankan perniagaan adalah baik dan sangat baik. Hanya 3.5% sahaja yang tidak bersetuju dan berpendapat produk perbankan Islam BMMB tiada potensi. Majoriti peratusan dari kedua-dua bank iaitu 58.7% responden dari BIMB dan 65.8% responden berpendapat mungkin benar bahawa produk yang ditawarkan serupa dengan perbankan konvensional dan perbezaan hanya dari segi nama sahaja.

Melihat dari sudut pemasaran produk, 35.6% responden berpendapat yang BIMB telah melakukan cukup dan lebih dari cukup dalam memasarkan produk mereka kepada pelanggan sasaran manakala 24.4% lagi sebaliknya. Sebanyak 37.8% responden berpendapat yang BIMB hanya sekadarnya melakukan pemasaran di kalangan pelanggan perniagaan. Keadaan berbeza dilihat di BMMB apabila data menunjukkan pelanggan BMMB berpendapat bahawa BMMB telah melakukan proses pemasaran yang agak baik dengan 50.9% responden berpendapat yang BMMB telah melakukan cukup dan lebih dari cukup dalam memasarkan produk mereka kepada pelanggan perniagaan dan hanya 15.8% lagi sebaliknya. Selain dari itu, 27.2% responden berpendapat yang BMMB hanya sekadarnya melakukan pemasaran di kalangan pelanggan perniagaan. Majoriti responden

[9] Rujuk Lampiran VI, Jadual 6

dari kedua-dua bank memahami bahawa produk perbankan Islam adalah untuk semua pelanggan dan tidak hanya terhad penawarannya kepada pelanggan Islam sahaja dengan 73.3% daripada responden BIMB dan 58.7% daripada responden BMMB berpendapat sedemikian.

Faktor keuntungan dan keagamaan menjadi sebab utama yang menyebabkan orang ramai menggunakan perkhidmatan perbankan Islam. Ini dibuktikan melalui 57.8% responden BIMB dan 61.9% responden BMMB berpendapat sedemikian. Kajian juga mendapati majoriti responden dari kedua-dua bank bersetuju dengan 77.8% responden dari BIMB dan 72.8% responden dari BMMB berpandangan bahawa orang ramai yang belum menjadi pelanggan, akan menjadi pelanggan perbankan Islam jika mereka diberi pengetahuan secukupnya mengenai konsep dan fungsi perbankan Islam

4.7 Tahap konsistensi Usahawan Wanita terhadap BIMB dan BMMB[10]

Data menunjukkan bahawa majoriti pelanggan BIMB iaitu sebanyak 58.7% tidak mempunyai hubungan dengan perbankan konvensional manakala 41.3% lagi mempunyai hubungan dengan perbankan konvensional. Keadaan sebaliknya berlaku pada BMMB di mana 60.4% responden mempunyai hubungan dengan perbankan konvensional manakala 39.6% lagi tidak mempunyai hubungan dengan perbankan konvensional.

Di kalangan responden BIMB yang mempunyai hubungan dengan perbankan konvensional, 37.93% mempunyai hubungan dengan menggunakan pinjaman perniagaan, 13.79% menggunakan jaminan bank, 10.34% pembiayaan semula kredit, 10.34% kemudahan nota terbitan manakala selebihnya penerimaan jurubank, surat jaminan kredit, bon dan pembiayaan semula kredit eksport. Manakala, bagi responden BMMB, dari sejumlah yang mempunyai hubungan dengan perbankan konvensional, 46.2% mempunyai hubungan dengan menggunakan pinjaman perniagaan, 12.50% menggunakan jaminan bank, 10.6% pembiayaan semula kredit, 6.7% pembiayaan semula kredit eksport

[10] Rujuk Lampiran VII, Jadual 7

dan penerimaan jurubank manakala selebihnya adalah bon, surat amanah, credit refinancing, kemudahan nota terbitan dan lain-lain.

Dari segi kesetiaan responden terhadap BIMB, separuh atau 50% akan bertukar kepada pesaing yang menawarkan perkhidmatan perbankan Islam jika mereka tidak berpuashati dengan BIMB. Hanya 29.5% lagi akan tetap setia dengan BIMB dan 20.5% lagi akan bertukar ke bank konvensional. Hanya 3.5% sahaja responden BMMB akan kekal setia dengan BMMB jika mereka tidak berpuas hati dengan bank tersebut manakala 66.4% responden akan bertukar ke bank Islam atau bank konvensional lain yang menawarkan perbankan Islam jika mereka tidak berpuas hati dengan BMMB malah 30.% lagi akan bertukar ke bank konvensional jika hal ini berlaku.

Usahawan wanita BIMB dalam kajian ini berpendapat yang perkhidmatan yang diberikan merupakan faktor utama pemilihan sesebuah bank. Ini diikuti oleh faktor kos dan keuntungan, keselesaan (lokasi dan parkir), saiz dan reputasi serta kakitangan yang mesra pelanggan. Ini berbeza dengan usahawan wanita di BMMB yang memilih faktor keuntungan sebagai faktor terpenting dan diikuti oleh perkhidmatan yang diberikan, saiz dan reputasi, kakitangan yang mesra pelanggan serta keselesaan (lokasi dan parkir).

5. Kesimpulan Dan Cadangan

5.1 Mengenalpasti profail Usahawan Wanita

Daripada analisa yang dilakukan, didapati majoriti pelanggan usahawan wanita BIMB berstatus telah berkeluarga dan beragama Islam serta berumur lingkungan 30 hingga 49 tahun. Sebahagian besar mereka mendapat pendidikan yang baik iaitu tahap sekolah menengah dan universiti/kolej. Manakala bagi BMMB pula, didapati majoriti pelanggan usahawan wanita BMMB berstatus bujang dan beragama Islam serta berumur lingkungan 20 hingga 29 tahun. Sebahagian besar mereka mendapat pendidikan yang baik iaitu tahap universiti/kolej.

Dapatan kajian jelas menunjukan yang usahawan wanita BIMB terdiri daripada golongan usahawan pada umur matang yang biasanya sangat produktif. Hala tuju mereka jelas dan akan lebih berdaya saing jika sekiranya pihak bank memberikan lebih perhatian kepada keperluan perniagaan mereka. Bagi BMMB pula, didapati usahawan wanita yang menumpu kepada BMMB ialah terdiri daripada golongan muda yang terpelajar dan baru menceburkan diri dalam dunia perniagaan dan juga sangat aktif. Jika diberikan bimbingan dan panduan sewajarnya, tidak mustahil golongan ini akan membawa golongan usahawan wanita ke tingkat yang lebih baik di masa hadapan.

Persamaaan yang ketara untuk kedua-dua bank ialah pelanggan usahawan wanita mereka masih lagi tertumpu kepada pelanggan beragama Islam. Usaha patut di buat bagi memperkemas serta mempermantapkan lagi strategi pemasaran supaya produk-produk yang ditawarkan dapat dipasarkan kepada bukan sahaja usahawan wanita Islam tetapi juga bukan Islam.

5.2 Mengenalpasti profail perniagaan Usahawan Wanita

Hasil analisa menunjukkan perbezaan ketara dari segi pengalaman peniagaaan bagi responden kedua-dua bank. Bagi BIMB, hanya 28.9% daripada pelanggan mereka yang mempunyai pengalaman tempoh perniagaan kurang dari 5 tahun berbanding dengan responden BMMB yang mana 91.1% pelanggan mereka masih belum mencecah 5 tahun tempoh perniagaan. Oleh yang demikian pihak BMMB perlu memberikan perhatian yang lebih kepada kumpulan ini agar kerjasama dan hubungan pelanggan-bank yang wujud dapat bertahan lama.

Usaha patut ditingkatkan oleh kedua-dua bank untuk dalam membantu pelanggan usahawan wanita mempertingkatkan jumlah pendapatan jualan bulanan mereka. Ini kerana hanya 4 responden dari BIMB mewakili 10.6% dari jumlah keseluruhan yang memperolehi pendapatan jualan bulanan yang melebihi RM 50 ribu manakala jumlah peratusan yang jauh lebih rendah di BMMB dengan hanya seorang atau 1% memperolehi jumlah pendapatan jualan bulanan melebihi RM 50 ribu. Majoriti pendapatan jualan bulanan responden BMMB adalah di bawah RM 15 ribu sebulan manakala majoriti

pendapatan jualan bulanan di kalangan pelanggan BIMB adalah di antara RM 15 000 hingga RM 29 999 sebulan.

Bidang utama usahawan wanita BIMB adalah industri perkhidmatan, makanan dan perkilangan manakala bagi BMMB bidangan utama ialah industri perkhidmatan dan makanan. Kebanyakkan responden bagi kedua-dua bank adalah perniagaan yang dijalankan terdiri daripada milikan tunggal dan perkongsian. Rancangan perlu dilakukan untuk menarik minat usahawan wanita menceburkan diri dalam bidang-bidang lain.

Pelbagai usaha boleh dilakukan untuk membantu golongan ini dengan menawarkan pakej pembiayaan yang bersesuaian dengan saiz perniagaan serta keperluan mereka seperti pembiayaan pembelian alatan dan mesin, pembiayaan pembelian stok di samping pembiayaan sediaada. BIMB dan BMMB juga boleh berperanan membantu golongan ini dari segi khidmat nasihat, lawatan susulan ke premis perniagaan dan juga memberi perhatian dari segi pemasaran dan bimbingan perniagaan . Adalah diyakini kumpulan ini boleh berjaya jika diberikan peluang serta sokongan yang khusus terutamanya daripada segi pembiayaan dan khidmat bimbingan.

5.3 Hubungan Usahawan Wanita dengan BIMB dan BMMB

Secara keseluruhannya, dapat disimpulkan bahawa terdapat hubungan antara usahawan wanita dan pihak bank. Perkhidmatan dan produk yang disediakan oleh BIMB dan BMMB kepada usahawan wanita dan PKS merupakan pemangkin untuk mewujudkan hubungan baik antara PKS dan bank. Walaupun begitu didapati yang peratusan usahawan wanita yang berurusan dengan BIMB dan BMMB bagi menggunakan produk dan perkhidmatan berkaitan perniagaan masih rendah. Responden hanya lebih menggunakan Kedua-dua bank untuk tujuan simpanan dan deposit. Seharusnya kedua-dua bank lebih giat memperkenalkan produk-produk mereka terutamanya produk pembiayaan perniagaan yang boleh direbut dan dimanfaatkan oleh usahawan wanita. Pendekatan yang lebih yang lebih proaktif perlu dilaksananakan bagi memperbaiki sistem penyampaian dan pemasaran produk dan membolehkan usahawan-usahawan muda wanita ini mendapat

maklumat dan pengetahuan yang lengkap dan tepat bagi membolehkan mereka lebih berdaya maju.

Kajian juga mendapati bahawa amat kurang iaitu, 6.7% bagi BIMB dan 0.9% bagi BMMB responden yang telah lebih 10 tahun berurusan dengan BMMB. Ini memberikan gambaran supaya bank-bank ini perlu berusaha untuk mengekalkan hubungan mereka dengan pelanggan usahawan wanita supaya mereka terus sentiasa memilih BIMB dan BMMB sebagai pelanggan mereka yang setia.

Medium perantaraan media, samada elektronik ataupun cetak serta maklumat dari keluarga dan sahabat menjadi sebab utama maklumat mengenai perbankan Islam yang ditawarkan oleh BIMB dan BMMB diketahui di kalangan responden. Selain itu, Sentimen keagamaan dan keuntungan masih menjadi pendorong utama mereka berurusan dengan BIMB dan BMMB. Tetapi terdapat satu perbezaan menarik di kalangan responden BIMB dan BMMB di mana 58.7% pelanggan BIMB akan kekal setia menggunakan kemudahan perbankan BIMB biarpun tidak mendapat sebarang keuntungan berbanding dengan 50.9% golongan usahawan muda wanita ini juga tidak akan berurusan dengan BMMB sekiranya mereka tidak mendapat sebarang keuntungan.

Apa yang boleh diperbaiki di sini adala perlunya usaha daripada pihak bank sendiri untuk mempertingkan kesedaran dan pengetahuan pelanggan terhadap perkhimatan perbankan Islam yang ditawarkan oleh kedua-dua bank melalui usaha dan kekuatan dalaman mereka sendiri iaitu melalui usaha promosi dilakukan sendiri oleh perkeja-pekerja mereka dalam memperkenalkan BIMB dan BMMB di samping mengoptimumkan rangkaian jaringan hubungan yang mereka miliki seperti kelab, , perniagaan dan lain-lain lagi.

5.4 Tahap kefahaman Usahawan Wanita terhadap perkhidmatan perbankan Islam

Majoriti pelanggan masih belum dapat memahami perkhidmatan perbankan Islam dengan sepenuhnya walaupun mengaku sebaliknya. Tahap pengetahuan dan kefahaman peserta dilihat dari segi pengetahuan am mereka terhadap maklumat umum operasi perbankan

Islam. Responden mengetahui tentang pengharaman riba dalam urusan pinjaman dan kewangan, tetapi pada masa yang sama mereka masih menganggap faktor keuntungan masih menjadi asas keterlibatan mereka di dalam perbankan Islam.

Pihak BIMB dan BMMB juga kerajaan mesti menjelaskan prinsip perbankan Islam yang syumul kepada golongan ini. Peniaga atau usahawan memang tidak dapat dipisahkan dengan kemahuan mereka untuk mendapat keuntungan. Pun begitu perlu dijelaskan yang keuntungan dalam Islam bukanlah lebihan daripada perolehan bahkan unsur-unsur kemaslahatan yang tidak boleh dinilai dengan angka.

5.5 Kepuasan Usahawan Wanita terhadap kualiti perkhidmatan

Walaupun hasil analisa jelas menunjukan pelanggan usahawan wanita amat berpuashati dengan kualiti perkhidmatan BIMB dan BMMB, kedua-duanya harus BMMB harus mengambil tindakan susulan dan juga langkah pembetulan ke atas beberapa perkara kecil yang melibatkan operasi bank ke arah penambahbaikan. Secara umumnya dalam urusniaga perbankan yang mana menerapkan penjualan perkhidmatan yang tidak nampak (untangible), dapatan seperti ini adalah sesuatu yang akan memberikan impak positif. Dan apa yang lebih penting lagi, BIMB dan BMMB mestilah sentiasa mengekalkan tahap kepuasan pelanggan sedih ada dan memastikan perkhidmatan terbaik menjadi satu keutamaan dalam perniagaan.

5.6 Tanggapan Usahawan Wanita

Analisa menunjukkan majoriti pelanggan berpandangan positif betapa produk perkhidmatan dan perbankan Islam sangat berpotensi. Pada masa yang sama, kedua-dua BIMB dan BMMB harus mendidik kepada pelanggan usahawan wanita ini supaya lebih mengetahui tentang keistimewaan produk perbankan Islam ini berbanding dengan perbankan konvensional.

Kajian juga menunjukkan keyakinan responden **bahawa** orang ramai yang belum menjadi pelanggan, akan menjadi pelanggan BIMB/BMMB jika mereka diberi pengetahuan secukupnya mengenai konsep dan fungsi perbankan Islam. Ini membuktikan masa depan

yang baik untuk perbankan Islam. Kedua-dua bank juga harus meningkatkan lagi promosi dan pemasaran bagi merealisasikan tujuan tersebut. Terdapat ruang dan "corrective action' yang masih boleh dilakukan lagi untuk meningkatkan kefahaman bahawa perbankan islam adalah untuk semua individu walaupun majoriti mereka sedar perbankan Islam yang ditawarkan oleh BIMB dan BMMB bukan hanya untuk pelanggan beragama Islam tetapi juga kepada semua pelanggan.

5.7 Konsistensi Usahawan Wanita

Terdapat hubungan yang kontra dalam keputusan kajian konsistensi usahawan wanita terhadap BMMB dan BIMB. Ini boleh dilihat di BIMB di mana hasil analisa menunjukkan majoriti daripada responden hanya mempunyai hubungan dengan BIMB sahaja. Perkara yang sebaliknya berlaku di BMMB yang mana hasil analisa menunjukkan majoriti daripada responden mempunyai hubungan dengan bank konvensional lain. Bagi responden BMMB yang turut menggunakan perbankan konvensional, mereka kelihatan lebih selesa menggunakan pembiayaan perniagaan yang ditawarkan oleh perbankan konvensional. Ini menunjukkan bahawa, golongan usahawan wanita ini tidak bergantung harap sepenuhya kepada BMMB dalam urusan perniagaan mereka. Bagi responden BIMB pula masih terdapat di kalangan mereka yang menggunakan pembiayaan perniagaan yang ditawarkan oleh perbankan konvensional walaupun bukan dalam jumlah yang besar. Separuh daripada responden dari BIMB akan bertukar ke bank Islam yang lain jika mereka kurang berpuashati terhadap perkhidmatan bank manakala 66% daripada BMMB akan melakukan tindakan yang sama juka hal ini berlaku.

Faktor terpenting dalam pemilihan sesebuah bank ialah perkhidmatan yang diberikan, diikuti dengan kos/keuntungan, keselesaan, saiz dan reputasi dan akhir sekali kakitangan yang mesra pelanggan. Oleh yang demikian pihak BIMB dan BMMB perlu memberi penekanan yang lebih kepada perkara yang menjadi sensitiviti terhadap kekonsistensi pelanggan kerana ini akan menentukan kejayaan keseluruhan sistem perbankan Islam ini selain memberikan impak keberdayasaingan dalam industri sendiri.

LAMPIRAN

Lampiran I: Mengenal pasti profil responden Usahawan Wanita BMMB dan BIMB

Jadual 1: Profil responden

Bil	Perkara	BMMB		BIMB	
		Jumlah	Peratus	Jumlah	Peratus
2.	**Status Perkahwinan**				
	Berkahwin	30	26.1	27	58.7
	Bujang	77	67.0	14	30.4
	Ibu tunggal	8	7.0	5	10.9
	Jumlah	**115**	**100.0**	**46**	**100.0**
3.	**Agama**				
	Islam	102	89.5	42	91.3
	Bukan Islam	12	10.5	4	8.7
	Jumlah	**114**	**100.0**	**46**	**100.0**
4.	**Umur**				
	Kurang 20 tahun	8	7.0	2	4.3
	20-29 tahun	76	66.1	1	2.2
	30-39 tahun	22	19.1	23	50.0
	40-49 tahun	8	7.0	19	41.3
	Lebih 50 tahun	1	.9	1	2.2
	Jumlah	**115**	**100.0**	**46**	**100.0**
5.	**Tahap pendidikan tertinggi**				
	Tiada pendidikan formal	3	2.6	2	4.3
	Sekolah rendah	1	.9	1	2.2
	Sekolah menengah	22	19.1	23	50.0
	Universiti/Kolej	83	72.2	19	41.3
	Kelayakan profesional	6	5.2	1	2.2
	Jumlah	**115**	**100.0**	**46**	**100.0**

Lampiran II: Mengenalpasti profil perniagaan responden Usahawan Wanita BMMB dan BIMB

Jadual 2: Profil perniagaan

Bil	Perkara	BMMB		BIMB	
		Jumlah	Peratus	Jumlah	Peratus
1.	**Tempoh menjalankan perniagaan**				
	< Setahun	60	59.4		
	1-5 tahun	32	31.7		
	5-10 tahun	5	5.0		
	>10 tahun	3	3.0		
	< 5 tahun			11	28.9
	5 - 9 tahun			9	23.7
	10 - 14 tahun			14	36.8
	15 - 20 tahun			3	7.9
	Lebih 20 tahun			1	2.6
	Jumlah	**101**	**100.0**	**38**	**100.0**
2.	**Jualan bulanan (RM)**				
	Kurang $15,000	62	62.0	12	31.6
	$15,000-$29,999	25	25.0	14	36.8
	$30,000-$49,999	12	12.0	8	21.1
	$50,000-$99,999	1	1.0	2	5.3
	$100,000 dan lebih			2	5.3
	Jumlah	**100**	**100.0**	**38**	**100.0**
3.	**Jenis perniagaan yang dijalankan**				
	Milikan tunggal	57	57.0	19	51.4
	Perkongsian	38	38.0	14	37.8
	Pegangan awam (Berhad)	4	4.0	1	2.7
	Pegangan terhad (Sendirian Berhad)	1	1.0	3	8.1
	Jumlah	**100**	**100.0**	**37**	**100.0**
4.	**Jenis industri yang diceburi**				
	Makanan	39	39.4	11	28.2
	Perkayuan	1	1.0	3	7.7
	Logam	1	1.0	1	2.6
	Kimia	1	1.0	1	2.6
	Perkilangan lain	6	6.1	4	10.3
	Perkhidmatan	42	42.4	12	30.8
	Pertanian	5	5.1	1	2.6
	Lain-lain (Sila nyatakan)	4	4.0	6	15.4
	Jumlah	**99**	**100.0**	**39**	**100.0**

Lampiran III: Hubungan Usahawan Wanita dengan BMMB dan BIMB

Jadual 3a: Jenis perkhidmatan BMMB dan BIMB yang digunakan oleh Usahawan Wanita

Bil	Perkara	BMMB		BIMB	
		Jumlah	Peratus	Jumlah	Peratus
1.	**Jenis perkhidmatan Perbankan Islam Bank Muamalat Malaysia Berhad (BMMB) yang digunakan (Responden boleh memilih lebih daripada 1 jawapan)**				
	Akaun Semasa Wadiah	79	36.92		
	Kiriman Wang	25	11.68		
	Pelaburan Am Mudharabah	12	5.61		
	Peti Keselamatan Muamalat	12	5.61		
	M cash @ Oberderaf	11	5.14		
	Pembiayaan Perumahan BBA Muamalat	11	5.14		
	Pembiayaan Perdagangan Muamalat - Pembiayaan Modal Kerja Mur	8	3.74		
	Pembiayaan Aset Tetap BBA Muamalat	7	3.27		
	Pembiayaan Perdagangan Muamalat - Surat Kredit Musyarakah	7	3.27		
	Pembiayaan Perumahan Al Istisna	6	2.80		
	Sistem pembayaran GIRO antara bank MEPS	6	2.80		
	Pembiayaan Perdagangan Muamalat - Surat Kredit Murabahah	5	2.34		
	Pembiayaan Perdagangan Muamalat - Bil Penerimaan	5	2.34		
	Pembiayaan Pusingan Murabahah Muamalat	4	1.87		
	Pelaburan Khas Mudharabah	3	1.40		
	Pembiayaan Perdagangan Muamalat - Surat Kredit Wakalah	3	1.40		
	Pembiayaan Projek	3	1.40		
	pembiayaan harta tetap istisna muamalat	2	0.93		
	Pembiayaan Perdagangan Muamalat - Pembiayaan Modal Kerja Bai	2	0.93		
	Pembiayaan Perdagangan Muamalat - Jaminan Perkapalan Al Kafa	1	0.47		
	Pembiayaan Perdagangan Muamalat - Pembiayaan Semula Kredit E	1	0.47		
	Surat Jaminan Kafalah	1	0.47		
2.	**Jenis perkhidmatan Perbankan Islam Bank Islam Malaysia Berhad (BIMB) yang digunakan (Responden boleh memilih lebih daripada 1 jawapan)**				
	Akaun semasa			33	22.76
	Kad smart			19	13.1
	Akaun simpanan Wadiah			17	11.72
	Kemudahan rangkaian MEPS			9	6.21
	Akaun Pelaburan			8	5.52
	Akaun simpanan Mudharabah			7	4.83
	Akaun simpanan Pewani			7	4.83
	Surat jaminan			6	4.14
	Amanah saham Bank Islam			5	3.45
	Akaun simpanan Wadi			3	2.07
	Ijarah			3	2.07
	Naqad			3	2.07
	Perbankan internet			3	2.07
	Surat kredit di bawah konsep Wakalah			3	2.07
	Akaun Pelaburan Sakinah			2	1.38
	Pembayaran zakat			2	1.38
	Pembiayaan berkala Bai Bithaman Ajil			2	1.38
	Pembiayaan modal pusingan di bawah konsep			2	1.38

	murabahah				
	Sistem pembayaran GIRO antara bank MEPS			2	1.38
	Akaun simpanan Ijraa			1	0.69
	Pembiayaan kenderaan			1	0.69
	Pembiayaan penyambung-Istisnaa			1	0.69
	Pembiayaan projek Mudharabah			1	0.69
	Pembiayaan projek Musharakah			1	0.69
	Pensekuritian dan bil penerimaan Islam (IAB-Import)			1	0.69
	Pensekuritian dan bil penerimaan Islam (IAB-Import)			1	0.69
	Skim pembiayaan semula kredit eksport (IECR)			1	0.69
	Skim pembiayaan SME			1	0.69
	Jumlah	**214**	**100**	**145**	**100**

Jadual 3b: Hubungan Usahawan Wanita dengan BMMB dan BIMB

Bil	Perkara	BMMB		BIMB	
		Jumlah	**Peratus**	**Jumlah**	**Peratus**
2.	**Tempoh menjadi pelanggan BMMB**				
	< Setahun	34	31.2	8	17.8
	1-5 tahun	62	56.9	22	48.9
	5-10 tahun	12	11.0	12	26.7
	>10 tahun	1	.9	3	6.7
	Jumlah	**109**	**100.0**	45	100.0
3.	**Sumber mana anda mula-mula mengetahui adanya BMMB**				
	Kawan dan ahli keluarga	47	36.2	12	26.1
	Televisyen dan radio	37	28.5	9	19.6
	Akhbar dan majalah	33	25.4	15	32.6
	Perjumpaan (Spt. Kelab, perniagaan dll)	9	6.9	6	13.0
	Pekerja BMMB	4	3.1	4	8.7
	Jumlah	**130**	**100**	46	100.0
4.	**Apakah faktor yang menyebabkan anda menjadi pelanggan BMMB?**				
	Faktor keuntungan dan keagamaan	78	63.9	9	20.0
	Faktor keuntungan	27	22.1	5	11.1
	Faktor keagamaan	14	11.5	30	66.7
	Sebab lain (Sila nyatakan)	3	2.5	1	2.2
	Jumlah	**122**	**100**	45	100.0
5.	**Jika anda mempunyai simpanan (tabungan, pelaburan) di BMMB dan BMMB tidak memberi sebarang hadiah (untung) kepada simpanan itu, adakah anda akan meletakan simpanan anda di bank lain?**				
	Ya	57	50.9	10	21.7
	Tidak	31	27.7	27	58.7
	Tidak pasti	24	21.4	9	19.6
	Jumlah	**112**	**100.0**	46	100.0

Lampiran IV: Tahap kefahaman terhadap perkhidmatan perbankan Islam BMMB oleh Usahawan Wanita

Jadual 4: Tahap kefahaman terhadap perkhidmatan perbankan Islam BMMB oleh Usahawan Wanita

Bil	Perkara	BMMB		BIMB	
		Jumlah	Peratus	Jumlah	Peratus
1.	**Adakah anda faham akan perbezaan antara BMMB/BIMB dengan bank konvensional**				
	Faham sepenuhnya	25	21.7	2	4.3
	Faham	29	25.2	15	32.6
	Faham sekadarnya	48	41.7	28	60.9
	Tidak faham	12	10.4	1	2.2
	Tidak faham langsung	1	.9		
	Jumlah	**115**	**100.0**	**46**	**100.0**
2.	**Sistem perbankan Islam BMMB/BIMB diperkenalkan kerana orang Islam ditegah daripada melibatkan diri dengan elemen faedah yang diamalkan oleh sistem perbankan konvensional**				
	Memang benar	28	24.6	17	37.0
	Benar	37	32.5	13	28.3
	Tidak pasti	28	24.6	14	30.4
	Tidak benar	17	14.9		
	Memang tidak benar	1	.9		
	Tiada idea	3	2.6	2	4.3
	Jumlah	**114**	**100.0**	**46**	**100.0**
3.	**Seperti bank konvensional, BMMB/BIMB mesti menerapkan prinsip pemaksimuman keuntungan dalam usaha untuk bersaing dalam persekitaran perniagaan**				
	Memang benar	19	16.7	7	15.2
	Benar	52	45.6	17	37.0
	Tidak pasti	34	29.8	14	30.4
	Tidak benar	7	6.1	7	15.2
	Memang tidak benar	1	.9		
	Tiada idea	1	.9	1	2.2
	Jumlah	**114**	**100.0**	**46**	**100.0**
4.	**BMMB/BIMB hanya menggunakan prinsip kerjasama untung rugi (Mudharabah dan Musyarakah) di dalam operasinya**				
	Memang benar	24	21.1	3	6.5
	Benar	31	27.2	19	41.3
	Tidak pasti	49	43.0	16	34.8
	Tidak benar	7	6.1	6	13.0
	Memang tidak benar			1	2.2
	Tiada idea	3	2.6	1	2.2
	Jumlah	**114**	**100.0**	**46**	**100.0**
5.	**Bagaimana tahap pengetahuan anda dalam sistem perbankan Islam**				

	Sangat berpengetahuan	17	14.8	2	4.3
	Berpengetahuan	35	30.4	12	26.1
	Berpengetahuan sekadarnya	49	42.6	29	63.0
	Tidak berpengetahuan	8	7.0	2	4.3
	Tiada pengetahuan langsung	6	5.2	1	2.2
	Jumlah	**115**	**100.0**	**46**	**100.0**

ampiran V: Kepuasan Usahawan Wanita terhadap kualiti perkhidmatan BMMB dan BIMB

Jadual 5: Kepuasan Usahawan Wanita terhadap kualiti perkhidmatan BMMB dan BIMB

Bil	Perkara	BMMB		BIMB	
		Jumlah	**Peratus**	**Jumlah**	**Peratus**
1.	**Perkhidmatan BMMB**				
	Tidak berpuashati	1	.9		
	Neutral	44	38.9	5	11.1
	Berpuashati	50	44.2	30	66.7
	Sangat berpuashati	18	15.9	10	22.2
	Jumlah	**113**	**100.0**	**45**	**100.0**
2.	**Saya sangat berpuashati apabila berurusan dengan pekerja BMMB**				
	Tidak berpuashati	3	2.7		
	Neutral	44	38.9	7	15.6
	Berpuashati	57	50.4	26	57.8
	Sangat berpuashati	9	8.0	12	26.7
	Jumlah	**113**	**100.0**	**45**	**100.0**
3.	**Kualiti perkhidmatan**				
	Tidak berpuashati	6	5.3		
	Neutral	36	31.9	12	27.3
	Berpuashati	59	52.2	23	52.3
	Sangat berpuashati	12	10.6	9	20.5
	Jumlah	**113**	**100.0**	**44**	**100.0**

Lampiran VI: Tanggapan Usahawan Wanita mengenai BMMB dan BIMB

Jadual 6: Tanggapan Usahawan Wanita mengenai BMMB dan BIMB

Bil	Perkara	BMMB		BIMB	
		Jumlah	Peratus	Jumlah	Peratus
1.	**Potensi produk perbankan Islam BIMB/BMMB di sektor pelanggan perniagaan (Business customer)**				
	Sangat baik	19	16.7	5	10.9
	Baik	68	59.6	27	58.7
	Sekadarnya	18	15.8	13	28.3
	Tiada potensi	4	3.5	1	2.2
	Tiada potensi langsung				
	Tiada idea	5	4.4		
	Jumlah	**114**	**100.0**	**46**	**100.0**
2.	**Adakah benar yang produk perbankan Islam BIMB/BMMB di Malaysia serupa dengan produk bank konvensional kecuali berbeza dari segi namanya sahaja?**				
	Sangat benar	5	4.4	1	2.2
	Benar	31	27.2	7	15.2
	Mungkin benar	39	34.2	19	41.3
	Tidak benar	28	24.6	15	32.6
	Sangat tidak benar	7	6.1	1	2.2
	Tiada idea	4	3.5	3	6.5
	Jumlah	**114**	**100.0**	**46**	**100.0**
3.	**Adakah anda berpendapat yang BIMB/BMMB telah melakukan secukupnya dalam memasarkan produk mereka kepada pelanggan perniagaan (Business customer)?**				
	Lebih dari cukup	4	3.5	3	6.7
	Cukup	54	47.4	13	28.9
	Sekadar	31	27.2	17	37.8
	Tidak cukup	18	15.8	10	22.2
	Memang tidak cukup			1	2.2
	Tiada idea (tidak tahu)	7	6.1	1	2.2
	Jumlah	**114**	**100.0**	**45**	**100.0**
4.	**Adakah anda fikir BIMB/BMMB hanya untuk pelanggan Islam sahaja**				
	Memang benar	4	3.5	3	6.7
	Benar	16	14.0	7	15.6
	Tidak pasti	21	18.4	2	4.4
	Tidak benar	51	44.7	27	60.0
	Memang tidak benar	16	14.0	6	13.3
	Tiada idea (tidak tahu)	6	5.3		
	Jumlah	**114**	**100.0**	**45**	**100.0**
5.	**Pada fikiran anda, apakah faktor yang menyebabkan orang ramai menggunakan perkhidmatan BIMB/BMMB ?**				
	Faktor keuntungan dan keagamaan	73	61.9	26	57.8
	Faktor keuntungan	30	25.4	5	11.1
	Faktor keagamaan	10	8.5	10	22.2
	Sebab lain (Sila nyatakan)	3	2.5	1	2.2

	Tiada idea	2	1.7	3	6.7
	Jumlah	**118**	**100**	**45**	**100.0**
6.	**Adakah pada fikiran anda orang ramai yang belum menjadi pelanggan, akan menjadi pelanggan BIMB/BMMB jika mereka diberi pengetahuan secukupnya mengenai konsep dan fungsi perbankan Islam?**				
	Ya	83	72.8	35	77.8
	Tidak	6	5.3	5	11.1
	Tidak pasti	25	21.9	5	11.1
	Jumlah	**114**	**100.0**	**45**	**100.0**

Lampiran VII: Konsistensi Usahawan Wanita terhadap BMMB dan BIMB

Jadual 7: Konsistensi Usahawan Wanita terhadap BMMB dan BIMB

Bil	Perkara	BMMB		BIMB	
		Jumlah	**Peratus**	**Jumlah**	**Peratus**
1.	**Adakah perniagaan anda mempunyai hubungan dengan bank konvensional ?**				
	Ya	64	60.4	19	41.3
	Tidak	42	39.6	27	58.7
	Jumlah	**106**	**100.0**	**46**	**100.0**
2.	**Jika ya, apakah hubungan tersebut (Responden boleh memilih lebih daripada 1 jawapan)**				
	Pinjaman perniagaan/Business loan	48	46.2	11	37.93
	Jaminan bank/Bank guarantee	13	12.5	4	13.79
	Surat jaminan kredit/Letters of credits	11	10.6	2	6.90
	Pembiayaan semula kredit eksport/Eksport	7	6.7	1	3.45
	Penerimaan Jurubank/Bankers acceptance	7	6.7	2	6.90
	Bon/Bond	6	5.8	1	3.45
	Surat amanah/Trusts receipts	5	4.8		
	Credit refinancing (CR)	3	2.9	3	10.34
	Kemudahan nota terbitan/Note issuance facility	3	2.9	3	10.34
	Lain-lain (sila nyatakan)	1	1.0	2	6.90
	Jumlah	**104**	**100**	**121**	**100.00**
3.	**Jika anda tidak berpuashati dengan BMMB/BIMB, adakah anda akan....**				
	Bertukar ke bank konvensional	34	30.1	9	20.5
	Bertukar ke BIMB@bank konv. yg tawar produk perbankan Islam	75	66.4	22	50.0
	Tetap setia dengan Bank Islam Malaysia Berhad	4	3.5	13	29.5
	Jumlah	**113**	**100.0**	**44**	**100.0**
4.	**Apakah faktor-faktor penting kepada anda di dalam memilih sesebuah bank? (Susun pilihan anda mengikut keutamaan 1, 2, 3, 4 dan 5)**		**Rank BMMB**		**Rank BIMB**
	Kos/Keuntungan	59	**1**		
	Perkhidmatan yang diberikan	39	**2**		
	Perkhidmatan yang diberikan	32	**3**		
	Saiz dan reputasi	31	**3**		
	Kakitangan yang mesra pelanggan	34	**4**		

Keselesaan(Lokasi dan tempat meletak kenderaan)	44	**5**		
Perkhidmatan yang diberikan			24	**1**
Kos/Keuntungan			16	**2**
Keselesaan(Lokasi dan tempat meletak kenderaan)			10	**3**
Keselesaan(Lokasi dan tempat meletak kenderaan)			14	**4**
Saiz dan reputasi			13	**4**
Saiz dan reputasi			12	**5**
Kakitangan yang mesra pelanggan			11	**5**

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KEDUDUKAN DAN HUKUM KAD KEAHLIAN PERNIAGAAN DALAM MUAMALAT ISLAM[1]

Muhammad Aunurrochim Mas'ad [2]
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Abstrak

Kualiti dan inovatif teknik pemasaran amat diperlukan bagi mempertingkatkan dan mengembangkan perniagaan yang sememangnya diharuskan oleh syarak. Di era global, segala urusan pemasaran perniagaan dipelbagaikan sehingga dapat memberi kemudahan dan keuntungan bagi pihak peniaga dan pelanggan. Salah satu bentuk inovatif dari tekhnik pemasaran adalah penggunaan kad keahlian yang dapat memberikan kemudahan dalam pulangan perniagaan lebih besar. Namun demikian sistem berkenaan perlu dikaji tentang kedudukan penggunaan kad keahlian perniagaan dari segi perspektif syariah. Terdapat perbezaan hukum mengikut jenis kad yang digunakan dalam perniagaan. Peranan prinsip syariah diperlukan bagi memantau kegiatan perniagaan agar ia selaras dengan kehendak syarak. Kad keahlian perniagaan boleh digunakan sepanjang ia mematuhi prinsip syariah.

Kata kunci: Kad keahlian, teknik pemasaran.

1. Pengenalan

Untuk menarik lebih ramai pelanggan pelbagai cara digunakan agar produk dan perkhidmatan yang ditawarkan dapat dipasarkan dengan baik dan sekali gus boleh mendatangkan pulangan yang memberangsangkan tanpa mengurangkan kualiti dari barangan ataupun perkhidmatan yang ditawarkan. Hal yang sedemikian dapat memberikan kepuasan hati pelanggan ataupun pengguna barangan secara berterusan. Di antara cara yang digunakan untuk menarik pelanggan adalah dengan menerbitkan kad keahlian yang diharapkan mampu memberi pulangan jualan yang lebih besar dalam perniagaan. Teknik ini dilihat dapat memberi daya tarik tersendiri dalam usaha meningkatkan perniagaan. Banyak syarikat atau peniaga yang telah menawarkan kad

[1] Kertas kerja disediakan untuk Islamic Banking, Accounting & Finance Conference (iBAF) 2012 pada 2 – 3 Oktober 2012 di FEM, USIM, Nilai, Negeri Sembilan, MALAYSIA

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pelbagai jenis kad untuk maksud tersebut, bermula dari kad ganjaran, kad diskaun sehinggalah kad jaminan dan sebagainya.

Penggunaan kad keahlian dalam urusniaga perniagaan perlu dikaji secara komprehensif agar ia selari dengan tuntutan syarak dan dapat memenuhi keperluan masyarakat yang semakin kompleks dalam berurusniaga.

1.1 Jenis-Jenis Kad Keahlian dalam Perniagaan

Muhammad bin Ali al-Kamili (2007) mengatakan terdapat pelbagai jenis kad keahlian dalam perniagaan sebagaimana berikut:

A. Kad pelanggan

Kad pelanggan adalah kad yang dikeluarkan oleh pihak syarikat/peniaga bagi pelanggan yang telah mendaftar untuk mendapatkan semua atau sebarang perkhidmatan dimana pihak syarikat/peniaga, sekiranya diminta oleh pelanggan menyediakan kepada pelanggan tertakluk kepada terma dan syarat sebagaimana yang ditetapkan oleh pihak syarikat/peniaga dari masa ke semasa. Kebiasannya kad dapat diperolehi dengan sedikit bayaran sebagai kos pembuatan atau penerbitan kad. Namun, ada juga syarikat yang memberikan secara percuma. Setelah bayaran dibuat, pelanggan atau pemegang kad mempunyai hak terhadap pelbagai kemudahan dan perkhidmatan yang .

Contoh: Sebuah kad dikeluarkan oleh peniaga dengan syarat pelanggan mesti membayar sebanyak RM 20.00. Setelah pembayaran dibuat, si pemegang kad dapat menikmati potongan harga sebesar 10% daripada produk yang ditawarkan oleh sesebuah syarikat.

B. Kad ganjaran

Dalam usaha meningkatkan penjualan dan pemasaran produk, sesetengah syarikat atau peniaga menawarkan kad ganjaran. Mata ganjaran akan diberikan sekiranya dalam transaksi jual beli tersebut pihak pelanggan menggunakan kad ganjaran

tersebut. Semakin banyak pembelian yang dibuat, semakin banyak pula ganjaran yang diperoleh. Ganjaran tersebut akan mencapai pada jumlah tertentu sehingga kemudian dapat ditukar dengan sesuatu barangan yang disediakan pihak pengeluar secara percuma, sama ada dalam bentuk barangan mahupun perkhidmatan. Hal ini tentunya tertakluk kepada terma dan syarat yang ditetapkan oleh pihak pengeluar.

C. Kad diskaun

Kad ini dikeluarkan oleh pihak tertentu sama ada pihak syarikat yang mengeluarkan barangan ataupun pihak lain yang telah menjalin kerjasama dengan syarikat pengeluar barangan. Kad ini berfungsi untuk memberikan potongan harga bagi pemegang kad tersebut.

D. Kad jaminan

Kad jaminan adalah kada yang diberikan oleh sesebuah syarikat kepada pelanggan sebagai jaminan bahawa sebarang kerosakan yang berlaku pada barangan yang dijual dalam tempoh tertentu (selepas digunakan) akan dibaiki/diganti tanpa sebarang bayaran. Tertakluk kepada terma dan syarat yang ditetapkan oleh pihak syarikat dari semasa ke semasa. Namun, dalam keadaan tertentu ada sesetengah syarikat yang mengenakan bayaran tambahan bagi perkhidmat tertentu atau untuk perpanjangan tempoh jaminan.

1.2 Hukum dan Kedudukan dalam Muamalat Islam

Islam sentiasa mengambil berat ke atas urusan perniagaan dari segi hukum dan pelaksanaannya. Dalam konteks kedudukan kad keahlian terdapat pelbagai pandangan mengenainya:

a) Hukum menggunakan kad keahlian adalah harus sekiranya kad tersebut diperolehi secara percuma, tanpa dikenakan sebarang bayaran. Begitu juga harus hukumnya menggunakan kad ganjaran sekiranya tanpa disertai dengan penambahan harga ke atas suatu produk dari harga biasa. Zaharuddin (2007) mengatakan jenis kad yang diberi percuma oleh syarikat untuk tujuan promosi barangan mereka tanpa

dikenakan bayaran merupakan hadiah yang disediakan dan hukumnya adalah harus. Hal ini selari dengan keputusan sidang Kesatuan Fiqh Sedunia ke 14 pada 8-13 ZulQaedah 1423H, bertepatan 11-16 Jan 2003, no 127 (14/1) yang memutuskan bahawa hadiah dari semua jenis permainan dan pertandingan yang diambil dari yuran penyertaan adalah haram. Kerana ia mengandungi unsur judi. Manakala kad jaminan yang diberikan secara percuma tanpa dikenakan sebarang bayaran adalah harus. Jaminan seumpama ini merupakan bahagian dari bentuk perkhidmatan. Dalam istilah fiqh muamalat ia dikenali dengan *'daman al-ayb'* (Ibn Qudamah t. th.). Daman atau jaminan mestilah mendatangkan manfaat. al-Dabu (1417H).

b) Hukum menggunakan kad keahlian adalah haram sekiranya disertai dengan bayaran tertentu kerana beberapa alasan:

1. Pelanggan pemegang kad yang mampu membeli barangan yang banyak akan mendapat manfaat lebih besar berbanding kos yang dikeluarkan untuk memiliki sebuah kad keahlian. Hal ini akan menimbulkan kerugian bagi pihak pengeluar kad tersebut.
2. Pelanggan pemegang kad yang hanya mampu membeli barangan yang sedikit akan mendapat manfaat lebih sedikit. Hal ini tentunya boleh menimbulkan kerugian bagi pihak pelanggan tersebut.

Sebagai natijah, kad keahlian mengandungi unsur gharar yang jelas bahkan merupakan sebahagian daripada perbuatan judi yang diharamkan. Manakala kad ganjaran, sekiranya disertai dengan penambahan harga produk dari harga biasa, maka haram hukumnya kerana wujud unsur gharar dan masuk dalam kategori memakan harta orang lain secara batil. Bagi kad diskaun pula dihukumi sebagai haram kerana pelanggan yang membayar jumlah amaun wang untuk kad tersebut tanpa mendapat manfaat pulangan, maka akan berlaku perbuatan yang membawa kepada memakan harga orang lain secara batil (Mustaq Ahmad 2001). Ini berdasarkan firman Allah dalam surah al-Baqarah 188 yang bermaksud:

Dan janganlah kamu makan (atau mengambil) harta (orang-orang lain) di antara kamu dengan jalan yang salah.

Adapun penggunaan kad diskaun sepertimana diputuskan menerusi fatwa no 11503, bertarikh 19 Zulkaedah 1808 H adalah haram kerana mengandungi unsur gharar dan judi serta boleh menimbulkan pertikaian di kalangan pihak pelanggan dan penerbit kad tersebut.

Kad jaminan yang dikenakan bayaran tertentu adalah haram hukumnya kerana mengandungi unsur gharar dan judi. Kebiasaannya, jaminan ditentukan dengan batasan masa, sama ada hari, bulan, ataupun tahun. Apabila pelanggan membayar sejumlah amaun sebagai yuran jaminan, dan produk yang dibeli tidak mengalami sebarang kerosakan sehingga berakhir tempo jaminan, pihak pelanggan akan mengalami kerugian kerana telah mengeluarkan biaya tanpa sebarang memperolehi perkhidmatan yang ditawarkan. Manakala pihak syarikat memperolehi keuntungan hasil daripada kutipan yuran yang dikenakan oleh pihak syarikat.

Sekiranya berlaku kerosakan pada produk sepanjang tempo jaminan, maka akan timbul beberapa kemungkinan, iaitu pengeluar akan mengeluarkan biaya perbaikan sama ada dalam amaun yang kecil, sama atau bahkan lebih besar dari amaun jaminan yang ditanggung pelanggan.

Berdasarkan keadaan tersebut muncul pandangan yang menyatakan urusniaga dengan menggunakan kad jaminan dengan bayaran tertentu adalah ditegah kerana wujud unsur ketidakpastian yang menjurus kepada amalan judi. Sebagaimana firman Allah dalam surah al-Maidah 90 yang bermaksud :

Wahai orang-orang yang beriman! Bahawa sesungguhnya arak, dan judi dan pemujaan berhala, dan mengundi nasib dengan batang-batang anak panah, adalah (semuanya) kotor (keji) dari perbuatan Syaitan. Oleh itu hendaklah kamu menjauhinya supaya kamu berjaya.

2. Penutup

Tidak dinafikan bahawa kad keahlian memiliki ciri-ciri yang memberikan kemudahan sama ada bagi pemiliknya ataupun syarikat dalam menjalankan transaksi perniagaan. Bagi pihak syarikat ia dapat membantu dari segi pendataan pelanggan sehingga dapat

bilangan pelanggan yang berurusan dengan syarikat berkenaan sekali gus mengekalkan status keahlian. Dengan demikian, jangkaan penjualan dapat dikekalkan walaupun bersifat spekulasi. Mempertingkatkan promosi jualan sehingga dapat menarik pelanggan untuk banyak memberi produk-produk yang ditawarkan pihak penjual. Keuntungan bagi pihak pelanggan bagi mendapat kemudahan yang ditawarkan pihak peniaga. Namun begitu, sekiranya berlaku perkara-perkara yang boleh menimbulkan keraguan dari segi pelakasanaan suatu urusniaga yang menggunakan kad keahlian maka hendaklah ditinggalkan. Seperti mengenakan bayaran tertentu, menaikkan harga barangan sebelum mendapat potongan harga dan sebagainya. Kad keahlian semestinya memberikan manfaat bagi kedua dua pihak sama ada pelanggan ataupun peniaga. Wa Allah A'lam.

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THE ROLE OF SUKUK IN MANAGING LIQUIDITY IN ISLAMIC FINANCIAL INSTITUTIONS

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Abstract

The absence of lender of last resort facility (LOLR) and limited availability of short term liquidity management instruments are the serious hindrances in development of Islamic interbank money market posing serious constraints for optimal utilization of liquid financial resources for Islamic Financial Institutions. The purpose of the paper is to analyze the role of Sukuk in managing liquidity in Islamic Financial Institutions and developing secondary market for development of Islamic interbank money market. Both quantitative and qualitative research approaches have been used for collection and analysis of data. The secondary data and information have been collected from the websites of IIFM, IFSB, AAOIFI, BNM, CBB, SBP, SECP, etc while interviews of executives of IFIs have been conducted for in-depth analysis. The optimal utilization of resources is vital to enhance profitability of IFIs and to compete with their counterparts in conventional financial industry. The analysis of Sukuk issued in Pakistan and their impact on liquidity management of Islamic banks has been carried out to investigate the role of Sukuk in the development of Islamic interbank money market in Pakistan. Despite fastest growth of Islamic banking in Pakistan, the Islamic interbank money market is not yet developed to meet the liquidity management of Islamic Financial Institutions. This research may help further explore the development of instruments for Islamic interbank money market. IFIs' treasury, research scholars, academia and regulatory authorities may benefit from the results of this study.

Keywords: Liquidity management, Sukuk and Islamic interbank money market

1. Introduction

In today's banking industry, Islamic finance is one of the fastest growing segments and has gained significant global exposure during the last three decades. According to IFSB (2010) the Islamic financial services industry currently represents approximately only 1% of global assets; however it has been growing by more than

[1] The views expressed in this study are of author's personal and not necessarily be of organizations wherein he is working.

20% annually since 2000. Islamic finance has a globalized presence[2] with its outreach beyond the Muslim Countries with asset base of about US$ 1 trillion. Presently more than 1100 Institutions offering Islamic Financial Services (IFS) operate across the globe, coupled with a number of dedicated academic, legal, regulatory and supervisory institutions, provides a solid platform for future growth and development of the Islamic finance industry. The leading Islamic banks are fast expanding their network from home base to develop a regional and global reach. Besides full fledged Islamic banks in Muslim countries, the global Islamic finance reach is also because of operations by conventional international banking giants.

According to IIFM (2011), Islamic finance emerged as novel phenomena based on participatory approach and risk sharing in the financial world in over the last three decades with establishment of Dubai Islamic Bank (DIB) as a financial intermediation in the private sector and Islamic Development Bank (IDB) as development financial institution by OIC sponsored in 1975. Since then the Islamic Financial Services Industry witnessed a robust growth and increasing acceptability in Muslim and non-Muslim world. This success of Islamic financial institutions led to a demand for capital market instruments for management of their balance-sheet liquidity. For the purpose of achieving this goal, the Council of the Islamic Fiqh Academy of the Organization of Islamic Conference (OIC) in its Fourth Session held in Jeddah, Kingdom of Saudi Arabia from 6-11 February, 1988 legitimized the concept of Sukuk which paved the way for an alternative source of financing to meet the diverse risk-return profiles and needs of Islamic issuers and investors who are not allowed under the Shariah principles to invest in conventional debt securities.

Islamic banks face more problems in liquidity management due to the fact that most available conventional instruments used for liquidity management are interest based which are not Shariah compatible while liquidity risk is the outcome from the disparity involving the maturities of the two sides of the balance sheet. This disparity either results in an excess of cash that wishes to be invested or result in a deficiency of cash that wishes to be funded. Also liquidity risk surfaces from complexities in

[2] Keynote Speech by Yaseen Anwar, Governor, SBP on the occasion of a talk by Dr. Mirakhor on "Narrowing Gap between Philosophical Underpinnings of Islamic Finance & Practice" organized by IBD, SBP Karachi on 10th February, 2011

acquiring cash at logical cost. As loans that are based on interest are forbidden in Islamic banks, cannot make use of such funds to congregate liquidity obligations in need. In various jurisdictions, many Islamic banks rely heavily on commodity Murabah for short-term investment and liquidity management despite reservations of Shariah Scholars. However, recently, several new Shariah compatible instruments were introduced to liquidity management such as Sukuk of various structures.

In 1990 the first Sukuk of RM 125 million was issued in Malaysia based on the principle of Bai' Bithaman Ajil. In Sudan, 77 million Sudanese Pound (SDG) domestic sovereign short-term Government *Musharakah* Certificates (GMC's) were issued by the Sudanese Government in 2000. In the year 2001, the Sukuk market went international with the issuance of the first United States Dollar denominated international sovereign Sukuk Al Ijarah of USD 100 million and a series of domestic sovereign short-term Sukuk Al Salam were issued by the Central Bank of Bahrain. Since then, the Sukuk market emerged as one of the main sections of the IFIs and a lot of innovations took place in its structures such as Ijarah, Musharakah, Mudarabah, Hybrid, Exchangeable and Convertible. In various jurisdictions such as the United Arab Emirates (UAE), Saudi Arabia, Indonesia, Qatar, Pakistan, Brunei Darussalam, Singapore, Kuwait have issued many sovereign and corporate Sukuk.

The International Sukuk market started in 2001 and it quickly gained momentum in terms of not only issuances but also structural innovation. The Sukuk market witnessed record growth between 2004 to 2007 and several milestones were achieved both in international and domestic issuances by corporates, semi-government and sovereign issuers. The 2008 financial crisis impacted the Sukuk market and we saw a reversal of high growth trend in international corporate issuances to a limited appetite mainly due to credit and liquidity issues. During late 2009 and 2010 period most of the international Sukuk were sovereign and semi-government issuances from Bahrain, Indonesia, UAE and Qatar. At the domestic level there has been turn around in corporate, semi-government and sovereign issuances in several jurisdictions led by Malaysia, Indonesia, Pakistan and Saudi Arabia (IIFM, 2011).

Research Objectives

The main objectives of the study are:

1. To assess the problems of Liquidity management in IFIs
2. To review Liquidity management in IFIs
3. To examine the role of Sukuk in Liquidity Management

2. The Problems of Liquidity Management in IFIs

According to IFSB (2006), effective liquidity risk management by Islamic banks has been constrained by the inadequate development of Islamic money markets. It is now increasingly recognized that the development of Islamic money markets for Shariah compatible short term financial instruments suitable for monetary operations of central banks and liquidity risk management of IFIs requires active markets for Islamic capital market instruments as a foundation on which short term financial instruments can be designed and traded.

The liquidity managing is among the most important activities conducted by banks as sudden rise in depositors' demand for cash above the expected level can lead to shortages of cash which can seriously cause the ongoing viability of any banking organization whether conventional or Islamic. Therefore, Sound liquidity management can reduce the probability of serious problems by the financial institutions. Liquidity risk arises from maturity mismatches where liabilities have a shorter tenor than assets. The main objectives of asset and liability management in the banking business are to optimally utilize assets coupled with to minimize liquidity risk. Islamic banks also have to meet their liquidity needs and obligations to ensure the smooth running of their business. However, the unique nature of Islamic banks, with their objective of avoiding riba (interest) in any form, has additional issues to address in order to meet their liquidity needs in a Shariah compliant manner. The liquidity risks in Islamic banks arise from the lack of sufficient Shariah based liquid instruments. It is difficult to transform the financial modes into negotiable financial instruments. Once a debt has been created, it cannot be transferred to anyone else except at par value[3].

[3] http://www.pakistanbanks.org/career_development/am/articles/07-09-22_01.html

The bank management tries to maximize bank's return on total assets by investing as much of the cash available. However, the management is also challenged by the need to have enough liquidity to meet any mismatch of the term structure of assets and liabilities. In their quest to achieve maximum returns for their clients, the Islamic banks therefore suffer major handicaps when compared to conventional banks as they lack access to the Central Banks' lender of last resort facility and prohibition of investment in government securities due to non-Shariah compliant. Thus they have to hold more cash to manage their liquidity requirements. Moreover, the liquidity problem in Islamic banks is due to limited number of Shariah compliant financial instruments. As a result, Islamic banks do not have the same funding options available to conventional banks. Whereas Islamic banks have liabilities of longer maturities against short term assts and absence of an adequate money market or a secondary capital market for Islamic financial instruments complicates the liquidity management problem.

Zaidi (2007) explained that liquidity management by Islamic Financial Institution is constrained by a number of issues. These arise due to a number of reasons including market driven factors (deficiencies in the market instruments), limited choice of instruments available to Islamic Investors, regulatory environment and lack of insight into the information and risk profile of Shariah compliant instruments. Due to a lack of products or assets in which to invest their money, IFIs are finding it increasingly difficult to manage temporary or short term excess liquidity. In addition to a regulatory environment which is still evolving, another factor constraining efficient Islamic financial markets that can provide liquidity management instruments is the pricing issue and informational limitations. Since investors with a preference for Shariah compliant products may have limited appreciation of the risks and rewards associated with such investments, the secondary market has not developed for such instruments. Various research studies on the subject mentioned following major problems in liquidity management in Islamic financial institutions.

- Lack of lender of last resort facility
- Different Shariah interpretations
- Lack of Islamic Interbank Market

- Limited Islamic Secondary market
- Slow development In Shariah compatible financial Instruments
- Small No. of participants
- Lack of Islamic interbank bench mark rate

3. The Liquidity Management in IFIs

The Islamic money market plays vital role in functioning of the Islamic banking system. It provides Islamic financial institutions the facility for funding and adjusting portfolios over the short-term. Financial instruments and interbank investment would allow surplus banks to channel funds to deficit banks. The Islamic Interbank Money Market (IIMM) was introduced in January 1994 to provide a ready source of short term investment outlets based on Shariah principles. This market is considered the first Islamic money market in the world. Interbank trading in Islamic financial instruments such as Islamic banks' acceptances, Islamic interbank investments where An Islamic bank with surplus funds can make an investment with another Islamic bank in deficit on the basis of Shaiah compliant Islamic financial instruments while interbank check clearing system are the key activities of this market. Bank Negara Malaysia (BNM) issued the Guidelines on the IIMM on December 18, 1993 to facilitate proper implementation of the IIMM. Various instruments have been introduced in the Malaysian Islamic interbank money market over the period of last eighteen years. Following instruments[4] are mostly used.

Mudharabah Interbank Investment (MII) refers to a mechanism whereby IFIs place their surplus funds in IFIs that are short of liquidity based on Mudharabah principles. The period of investment is from overnight to 12 months, while the rate of return is based on the rate of gross profit before distribution for investment of 1-year of the investee bank. The profit sharing ratio is negotiable among both parties.

Wadiah Acceptance is a transaction between BNM and IFIs. It refers to a mechanism whereby the Islamic banking institutions placed their surplus fund with BNM based on the concept of Al- Wadiah. Under the liquidity management operation, BNM uses

[4] IIMM,BNM and the detail of these instruments is given at the appendix-2

the Wadiah Acceptance to absorb excess liquidity from the IIMM by accepting overnight money or fixed tenure wadiah. **Government Investment Issue (GII):** The Malaysian Parliament passed the Government Investment Act in 1983 to enable the Government of Malaysia to issue non-interest bearing certificate known as Government Investment Certificates (GIC) {now replaced with Government Investment Issues (GII)}. The GII was introduced under the concept of Qard al-Hasan.

Bank Negara Monetary Notes-i (BNMN-i) are Islamic securities issued by Bank Negara Malaysia replacing the existing Bank Negara Negotiable Notes (BNNN) for purposes of managing liquidity in the Islamic financial market. **Sell and Buy Back Agreement (SBBA)** is an Islamic money market transaction entered by two parties in which an SBBA seller (seller) sells assets to an SBBA buyer (Buyer) at an agreed price, and subsequently, both parties entered into a separate agreement in which the buyer promises to sell back the said asset to the seller at an agreed price. **Cagamas Mudharabah Bonds (SMC)** was introduced by Cagamas Berhad to finance the purchase of Islamic housing debts from financial institutions that provides Islamic house financing to the public. Under RA-I (**Ar Rahnu Agreement)**, the Lender will provide a loan to the borrower based on the concept of Qard al-Hasan. The borrower will pledge its securities as collateral for the loan granted. However, in the event where the borrower fails to repay the loan on maturity date, the lender has the right to sell the pledged securities and use the proceeds from the sale of the securities to settle the loan. If there is surplus money, the lender will return the balance to the borrower.

The Bahrain Monetary Agency facilitated the setting-up of the Liquidity Management Center in 2002 in Bahrain, to sell Shariah compliant securities that Islamic banks could hold as liquid assets. The short-term non-tradable securities, known as Sukuk Al-Salam, are issued monthly and are to be held until maturity. In addition, Ijarah Sukuk, which are tradable are issued for longer periods (four and six year maturity). The main objective of issuing Ijarah securities is to address the requirements and needs of Islamic financial institutions and investors for attractive investment opportunities. Over the past few years, the International Islamic Financial Market (IIFM) has been in the forefront of global initiatives and efforts to help in establishing a sustainable, viable and feasible global Islamic Capital and Money Market (ICMM)

through its comprehensive documentation and product standardization initiatives that cater to the needs of Islamic Financial Services Industry[5].

Another development in developing Islamic Capital and Money Market was introduction of belated bench mark of Islamic finance. Thomson Reuters and AAOIFI in association with a consortium of Islamic banks, financial industry associations, including Islamic Development Bank (IDB) and SESRIC, and a group of Shariah scholars, launched the industry's first international Islamic interbank rate, the Islamic Interbank Benchmark Rate (IIBR), offering a Shariah compliant alternative to traditional interest based benchmarks. IIBR was announced officially on 22nd November 2011 during a special session at the 18th World Islamic Banking Conference, which was held on 21-23 November 2011 in Kingdom of Bahrain. Mr. Khalid Hamad Abdul Rahman, Executive Director for Banking Supervision at the Central Bank of Bahrain, inaugurated the new benchmark.

4. Sukuk and Liquidity Management

Definition and Structure of Sukuk

Sukuk (plural of Sak) is an Arabic word which means 'certificates'. Sukuk are certificates of equal value representing undivided shares in ownership of tangible assets, usufruct and services or (in the ownership of) the assets of particular projects or special investment activity[6]. Other definition as per IIFM is 'Arabic name for financial certificate, it can be seen as an Islamic equivalent of the conventional bonds. It is defined as "Certificates of equal value representing undivided shares in ownership of tangible assets, usufructs and services or (in the ownership of) the assets of particular projects or special investment activity".

Usmani (2006) explained that Sukuk were certificates issued in the name of the owner or bearer in order to establish the claim of the certificate owner over the financial rights and obligations represented by the certificate. Sukuk represented a common share in the ownership of the assets made available for investment, whether these

[5] IIFM

[6] Shariah Standard # 17- Investment Sukuk, AAOIFI

were non-monetary assets, usufructs, services or a mixture of these entire plus intangible rights, debts and monetary assets. These Sukuk do not represent a debt owed to the issuer by the certificate holder. The owners of these certificates share the return as agreed at the time of issuance and bear the losses in proportion to the certificates owned (held) by them.

According to Usmani (2006), the objective of Sukuk among others includes 'Sukuk represent an excellent way of managing liquidity for banks and Islamic financial institutions. When these are in need of disposing of excess liquidity they may purchase Sukuk; and when they are in need of liquidity, they may sell their Sukuk into the secondary market'. In comparison, under a Sukuk structure the Sukuk holders each hold an undivided beneficial ownership in the underlying assets. Consequently, Sukuk holders were entitled to share in the revenues generated by the Sukuk assets as well as being entitled to share in the proceeds of the realization of the underlying assets.

The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) had laid down 14 different types of Sukuk. However, we section discuss only those types which are widely issued in the domestic and international markets. The Sukuk structures relied on the creation of a Special Purpose Vehicle (SPV) which has the responsibility to issue certificates which represent for example the ownership of an asset, entitlement to a debt or to rental incomes or even accumulation of returns from various Sukuk (a hybrid Sukuk). The return provided to Sukuk holders therefore come in the form of profit from a sale, rental or a combination of both. We briefly discuss Sukuk based on Ijarah, Murabah, Salam and hybrid.

Ijarah Sukuk

According to Kahf (1997), Al-Ijarah bonds are securities of equal denomination of each issue, representing physical durable assets that are tied to an Al - Ijarah contract as defined by Shariah. These Sukuk gave their owners the right to own the real estate, receive the rent and dispose of their Sukuk in a manner that does not affect the right of the lessee, i.e. they are tradable. The holders of such Sukuk bear all cost of maintenance of and damage to the real estate. Ijarah Sukuk are the securities representing ownership of well defined existing and known assets tied up to a lease

contract, rental of which is the return payable to Sukuk holders. Payment of Al-Ijarah rentals can be unrelated to the period of taking usufruct by the lessee. It can be made before beginning of the lease period, during the period or after the period as the parties may mutually decide. This flexibility can be used to evolve different forms of contract and Sukuk that may serve different purposes of issuers and the holders.

Muhammad al-Amine (2001) has summarized the characteristics of Sukuk al Al - Ijarah as it offered a high degree of flexibility from the point of view of their issuance management and marketability. He said that the central government, municipalities, awqaf or any other asset users, private or public can issue these Sukuk to finance infrastructure projects. He said that Al - Ijarah bonds are completely negotiable and can be traded in the secondary markets. Subject to market conditions, these bonds would offer a high degree of liquidity and therefore, had both the characteristics and necessary conditions for functioning as successful securities. Usmani (2006) stated that these certificates, being an evidence of proportionate ownership in a tangible asset, can be negotiated and traded freely in the market and can serve as an instrument easily convertible into cash.

Murabah Sukuk

Usmani (2006) explained Murabah Sukuk as certificates of equal value issued for the purpose of financing the purchase of goods through Murabah so that the certificate holders become the owners of the Murabah commodity. The issuer of the certificates is the seller of the Murabah commodity, the subscribers are the buyers of that commodity and the realized funds are the purchasing cost of the commodity. The Sukuk holders own the Murabah commodity and are entitled to its sale price. Murabah Sukuk only represents a monetary debt receivable from the client in the form of Murabah price which is non-negotiable as per the rules of Shariah. Because, transfer of the Sukuk to a third party will mean transfer of money and according to Shariah principles money can only be exchanged against money at par value. This restricted the possibility of creating a secondary market for Murabah Sukuk.

Muhammad al-Amine (2001) said that despite the fact that the Murabah instruments are debt instruments, and given the fact that debt cannot be sold to another debt, it is permissible to sell these instruments if mixed with other assets such as commodities,

services and cash provided that real assets and services overwhelm debt and cash. In other words, the Murabah bonds could be negotiable if they are the smaller part of a package or a portfolio, the larger part of which is constituted of negotiable instruments based on Mudarabah, Musharakah or Ijarah. I Murabah Sukuk is popular in Malaysian market due to a more liberal interpretation of fiqh by Malaysian jurists permitting sale of debt (bay-al-dayn) at a negotiated price.

Al-Salam Sukuk

Tariq (2004) expalined that Al-Salam Sukuk are certificates of equal value issued for the purpose of mobilizing Salam capital so that the items to be delivered on the basis of Salam come to the ownership of the certificate holders. Usmani (2006) stated that the issuer of the certificates is a seller of the goods of Salam, the subscribers are the buyers of the goods, while the funds realized from subscription are the purchase price (Salam capital) of the goods. The holders of Salam certificates are the owners of the Salam goods and are entitled to the sale price of the certificates or the sale price of the Salam goods sold through a parallel Salam.

While discussing the Shariah conditions relating to Salam, as well as for creation of Salam Sukuk, he stated that it is the requirement that the purchased goods are not re-sold before actual possession at maturity. Such transactions amount to selling of debt. This constraint renders the Salam instrument illiquid and hence somewhat less attractive to investors. Thus, an investor will buy a Salam certificate if he expects prices of the underlying commodity to be higher on the maturity date.

Hybrid Sukuk

Paper presented by team of Dar Al Istithmar (2006) explained that while considering the fact that Sukuk issuance and trading are important means of investment and taking into account the various demands of investors, a more diversified Sukuk - hybrid or mixed asset Sukuk - emerged in the market. Paper also clarified that in a hybrid Sukuk, the underlying pool of assets can comprise of Istisna, Murabah receivables as well as Al - Ijarah. Having a portfolio of assets comprising of different classes allows for a greater mobilization of funds. However, as Murabah and Istisna contracts cannot be traded on secondary markets as securitized instruments at least 51 percent of the pool in a hybrid Sukuk must comprise of Sukuk tradable in the market such as an Al -

Ijarah Sukuk. Due to the fact the Murabah and Istisna receivables are part of the pool, the return on these certificates can only be a pre-determined fixed rate of return.

Zahari (2006) said in his research work that the Malaysian capital market has exhibited tremendous growth in the last 10 years with Islamic securities predominantly premised on the Islamic concept of Bai Bithaman Ajil. The consistent growth in number of Islamic securities issuances; increase in knowledge and expertise amongst market players; progressive development of the Malaysian regulatory framework; and desire to seek a wider investor base into the Middle East market, prompted the promulgation of Islamic bonds issues based on principles of Ijarah, Istisna, Musharakah and Mudarabah for Islamic money and capital market.

Global Sukuk Market

The first Sukuk was issued in Malaysia by Shell MDS a foreign owned, non-Islamic corporation with a modest size of RM 125 million in 1990 based on the principle of Bai' Bithaman Ajil. In Sudan, 77 million Sudanese Pound (SDG) domestic sovereign short-term Government *Musharakah* Certificates (GMC's) were issued by the Sudanese Government in 2000. In the year 2001, the Sukuk market went international with the issuance of the first United States Dollar denominated international sovereign Sukuk Al Ijarah of USD 100 million and a series of domestic sovereign short-term Sukuk Al Salam were issued by the Central Bank of Bahrain on behalf of the Government of Bahrain. Since then, the *Sukuk* market emerged as one of the main sections of the IFIs and a lot of innovations took place in its structures such as *Ijarah*, Musharakah, Mudarabah, Hybrid, Exchangeable and Convertible. In various jurisdictions such as the United Arab Emirates (UAE), Saudi Arabia, Indonesia, Qatar, Pakistan, Brunei Darussalam, Singapore, Kuwait have issued many sovereign and corporate Sukuk (IIFM).

Table-1	
Year	**Amount UDS Billion**
2001	1.17
2002	1.37
2003	6.41
2004	8.14
2005	12.18
2006	30.03
2007	48.89
2008	18.60
2009	25.73
2010	45.12
Total	**197.64**

The global Sukuk market witnessed record growth during the pre-crisis period from 2001-07 with total global Sukuk issuance was accounted for USD 108.2 billion with its peak at USD 48.9 billion in a single year 2007. The growth of global Sukuk market was affected during the global crisis and it showed a declining trend with Sukuk issuance of USD 18.60 billion and USD 25.73 billion during the years 2008 and 2009 respectively. The Sukuk market saw a revival in 2010 with global Sukuk issuance of USD 45.12 billion in 2010 near to the pre-crisis issuance level. The total global Sukuk issuance from 2001 to 2010 was touched the level of about USD 197 billion. The corporate Sukuk got lead with 63% (USD 124.15 billion) followed by sovereign Sukuk accounted for 34% (USD 67.20 billion) and remaining 3% pertained to quasi-sovereign Sukuk. The issuance of Sukuk can be categorized into international Sukuk and domestic Sukuk. The international Sukuk accounted for USD 46.6 billion (24%) while domestic issuance of Sukuk was USD 149.8 billion 76% during the period 2001-10. The GCC and Middle East has lion's share of 83% (USD 39.7 billion) in international Sukuk and remaining 17% (USD 6.9 billion) pertained to Asia and Far East. In domestic Sukuk issuance Malaysia has lead with largest domestic issuer with USD 108.0 billion or 72% by value of domestic Sukuk issuance with the remaining USD 41.8 billion or 28% split between a number of issuers, such as Sudan, Saudi Arabia, UAE, Bahrain, Brunei, Pakistan and Indonesia.

The global Sukuk market was mainly driven by corporate Sukuk issuances during the pre-crisis period. During 2001-07, the share of corporate Sukuk issuance was highest at 82% and 70% both in domestic and international Sukuk issuances respectively. However, during the post-financial crisis period, corporate Sukuk issuances have been declined while the sovereign Sukuk issuance has provided support to the Sukuk market mainly from Bahrain, Qatar, UAE, Indonesia, Malaysia and Pakistan. The sovereign Sukuk issuance provides more depth to the Sukuk market and kept its growth potential intact at the level of over USD 45 billion in 2010. During the period from 2008-10, the sovereign Sukuk issuance took lead at 53% in domestic Sukuk issuance and corporate Sukuk issuance kept its highest position with 46% in total global Sukuk issuance. At present the global Sukuk market reached to the level of US$ 197.6 billion as on December 2010[7] with Malaysia having the major share of about 60% (USD 113.5 billion) in value and more than eighty percent in total domestic and international Sukuk issuances.

Ijarah Sukuk structure has been the most dominant and widely used structure for both International Sukuk issuance while Murabah structure is the most used at the domestic market, During 2001-07, the share of Murabah Sukuk issuance was highest at 30% at domestic level while Al-Slam Sukuk with 46% share at international Sukuk issuances. During the period from 2008-10, the Ijarah Sukuk issuance took lead at 64% in international Sukuk issuance while Murabah Sukuk issuance kept its highest position with 46% domestic Sukuk issuance. However, the share Ijarah Sukuk increased from 16% during 2001-07 to 25% during 2008-10 in domestic Sukuk market. This implies most acceptability of Ijarah Sukuk both at domestic and international Sukuk market during post crisis period.

Different Sukuk structures have been emerging over the years but most of the Sukuk issuance to date has been Al-Ijarah Sukuk for liquidity management, since they are based on the undivided pro-rata ownership of the underlying leased asset, it is freely tradable at par, premium or discount. Tradability of the Sukuk in the secondary market makes them more attractive. Kahf (1997) discussed that Al - Ijarah bonds are completely negotiable and can be traded in the secondary financial markets. Subject

[7] IIFM

to market conditions, these bonds will offer a high degree of liquidity. Rating Agency Malaysia (RAM) also mentioned that Sukuk in particular, playing a catalytic role in advancing the growth and development of domestic Islamic bond markets and promoting cross-border issuance and investments, especially the interregional flows between Asia and the Middle East. Malaysia represents Asia's fourth-largest local-currency corporate bond market by market capitalization and the world's largest Sukuk market[8].

Sukuk Market in Pakistan

In Pakistan Islamic banking emerged as a response to both religious and economic needs. Efforts for economy wide elimination of riba started during 1970s and most of the significant and practical steps were taken in 1980s. The initiative to re-introduce Islamic Banking in Pakistan was launched back in 2001 when the government decided to promote Islamic banking in a gradual manner and as a parallel and compatible system that is in line with best international practices. Following the decision of the government to shift to interest free economy in a phased manner without causing any disruptions the effort was envisaged to be based on a market driven and flexible approach[9]. Currently there are 6 full fledged Islamic banks and 13 conventional banks have licenses to operate dedicated Islamic banking branches. The total assets of the Islamic banking industry are over Rs. 441 billion as of 30th June, 2010 which accounts for a market share of 6.1% of total banking industry assets. Total branch network of the industry comprises of more than 667 branches with presence in over 80 cities[10].

8 http://www.ram.com.my/press_Release_View

9 IBD, SBP: Pakistan's Islamic Banking Sector Review, 2003 to 2007

10 SBP Islamic Banking Bulletin, Vol. V No.2 June 2010

Table-2	
Period	**Amount Rs. Billion**
2006	8.625
2007	48.055
2008	33.086
2009	55.899
2010	89.861
2011	95.443
Total	330.969

The first international sovereign Sukuk of USD 600 million was issued in January, 2005 in Pakistan. The tenor of this Sukuk was five year and it was based on Ijara agreement. It was listed at Luxemburg Stock Exchange and the demand for this Sukuk came from diverse geographic locations with concentration in Middle East[11]. After one year of issuance of first international Sukuk, the first Sukuk in the domestic market amounting to Rs. 8.0 billion was issued in January, 2006. It was quasi-sovereign issued by WAPDA in energy sector and by June 2011 total of 60 Sukuk amounting to Rs. 331.0 billion (about USD 3.7 billion[12]) were issuedin Pakistan. It accounted for about 2.2% of the global Sukuk market. The emergence of domestic Sukuk market has been a significant milestone in development of the domestic industry as it provided attractive investment avenue to Islamic banks for efficiently placing their liquidity in Shariah compliant securities. The growth of Sukuk was attributed by issuance of sovereign Sukuk in domestic market during the post crisis period. The investments by banks and DFIs in domestic Sukuk showed that more than sixty percent of the investments have been made in sovereign Sukuk. Further amongst the banking sector, more than 90 percent of overall investment in Sukuk has been done by Islamic financial institutions[13].

The tenor wise issuance of Sukuk were medium to long term ranging between 3-7 years. In line with the global trend the most widely used Sukuk structure in Pakistan

11 IFMM

12 USD 1=Rs. 90

13 SBP:IBB June 2011

was Ijarah. The dominance of Ijarah based Sukuk can be attributed to its simple structure, tradability and flexibility. All sovereign Sukuk issuances in domestic or international markets were based on Ijarah. The Sukuk issuances in Pakistan was also gained buoyancy in the domestic Sukuk markets in 2007 and lost momentum in 2008 mainly due to indirect second round effects of crisis in line with global Sukuk issuances. However, Sukuk market found impetus in Pakistan due to issuance of sovereign Sukuk in domestic market since March 2009. During the period from 2005-2009, corporate Sukuk had major share in total Sukuk issuances in Pakistan. However, a structural shift from corporate to sovereign Sukuk witnessed as corporate Sukuk issuances declined whereas the sovereign Sukuk issuance surpassed the share in total Sukuk in Pakistan as it accounted for more than 68 percent in total domestic and international Sukuk issuances**.** This shift was in line with global trend where share of corporate Sukuk declined to 63 percent in 2010 from 90 percent in 2005.

5. The Role of Sukuk in Liquidity Management

According to Usmai, Sukuk represent an excellent way of managing liquidity for banks and Islamic financial institutions. When these are in need of disposing of excess liquidity they may purchase Sukuk; and when they are in need of liquidity, they may sell their Sukuk into the secondary market[14]. The domestic Sukuk market in a number of jurisdictions is becoming active and central banks are providing avenues to Islamic banks to invest their surplus liquidity in government Sukuk programs designed to provide level playing fields to the Islamic Financial Institutions (IFI's).

[14] http://www.muftitaqiusmani.com/images/stories/downloads/pdf/sukuk.pdf

Table-3 **(Rs. In Billions)**[15]

Islamic Banks	**2009**	**2010**	**2011**
Federal Government Securities	25.60	78.60	179.00
% of Total Investment	35.2%	49.8%	65.3%
Fully Pid up Ordinary Shares	1.90	2.20	2.30
% of Total Investment	2.6%	1.4%	0.8%
TFCs, Debentures, Bonds & PTCs	26.50	36.00	27.50
% of Total Investment	36.5%	22.8%	10.0%
Other Investments	18.70	42.00	66.60
% of Total Investment	25.7%	26.6%	24.3%
Total Investments	**72.70**	**157.80**	**274.30**
Total Assets	366.0	477.0	641.0
Investments as % of Assets	**19.9%**	**33.1%**	**42.8%**

In Pakistan, the issuance of sovereign Sukuk helped in providing the much needed benchmark besides facilitating Islamic financial institutions in their liquidity management and improving their asset quality. Sukuk have encouraged Islamic banks to change their asset structure by shifting their investment from interbank placements to these Islamic bonds. This structural shift has helped the industry to improve its profitability and earnings[16]. In Pakistan the investment of IFIs in Sukuk was witnessed a tremendous increase from Rs. 72.7 billion to Rs. 274.3 billion. Such a massive investment was mainly attributed to the issuance of sovereign Sukuk from Rs. 25.6 billion in 2009 to Rs. 179.0 billion in 2011. During the period from 2009 t0 2011 the share of investment to total assets was increased more than double from 19.9% in 2009 to 42.8% in 2011. Similarly the profitability of Islamic financial institutions was also showed an excellent improvement due to investment in Sukuk. The ROA (after tax) of IFIs in Pakistan was increased from 0.6% in 2009 to 1.6% in 2011while ROE (after tax) was increased from 4.6% in 2009 to 17.3% in 2011. The simultaneous increase in investment in Sukuk and profitability showed that liquidity management of Islamic financial institutions was optimally deployed and they found a better yield instruments in Sukuk market.

[15] SBP

[16]SBP: IBB, June 2011

According to IIFM's Sukuk report-second edition (2011), the share of sovereign Sukuk issuances has increased and this will help the domestic, and indirectly the international Sukuk market in developing a yield curve as well as contribute to the development of the secondary market. Another interesting and welcome development is the increase in the number of fixed rate Sukuk issuances which again will contribute to the development of the secondary market as fixed-rate instruments provide more trading opportunities and will also help in the development of the yield curve.

Short-term Sukuk issuance is essential for liquidity management purposes. Sudan is the leader in domestic short-term Sukuk issuances (USD 11.3 billion) or 66% of total global short term Sukuk market followed by Bahrain with USD 3.7 billion (22%) and Malaysia (USD 0.9 billion) during the period from 2001 to 2010. In Pakistan the first short term Sukuk was issued amounting to Rs, 1.5 billion in 2011 with maturity of five months. It is expected that short term Sukuk market will gain momentum as the Sukuk market is growing rapidly in Pakistan during the last two years with issuance of sovereign Sukuk in domestic market.

6. Conclusion

Sukuk is fast growing sector of Islamic fiance both at domestic and international level. Malaysia is market leader in Sukuk market. Sukuk help liquidity management in IFIs and increase optimal utilization of liquid assets. The developed Sukuk market will not only help in replacing conventional interest based financing with Islamic Financing but will also develop an efficient and diversified Islamic capital and money market. Sukuk play an essential role in the development of Islamic Capital and Money Market (ICMM) as well as in contributing to the economic growth and prosperity of Islamic and other issuing countries. The buoyancy in Sukuk market during the period of 2009-2011 was due to issuance of sovereign Sukuk in Pakistan. However, there is a need to develop a secondary market for Sukuk as it has become an instrument for liquidity management in various jurisdictions. Such a secondary Sukuk market will allow banks to buy and then readily sell Sukuk for cash, depending on their liquidity needs. Once this market exists, Islamic banks will have a true liquidity management tool that they can use to manage their short and medium term investments and to

adjust their risk levels. The regulatory and standard issuing authorities, IIFM, Islamic Rating Agency and Islamic Interbank benchmark rate will help develop secondary market for Sukuk.

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Appendix-1

Issuance of Domestic Sukuk in Pakistan

Sr. #.	Issuer Name	Date of Issue	Tenor (Years)	Type of Sukuk	Amount Rs. In Million
1	WAPDA	2006	7	Ijarah	8,000.00
2	Sitara Chemical Industries Limited	2006	5	DM	625.00
3	Security Leasing Corporation Limited	2007	5	Musharakah	750.00
4	Sui Southern Gas Company Limited	2007	5	DM	1,000.00
5	Sui Southern Gas Company Limited	2007	5	DM	2,000.00
6	ORIX Leasing Pakistan Limited	2007	5	DM	525.00
7	Sitara Energy Limited	2007	5	DM	600.00
8	WAPDA	2007	10	DM	8,000.00
9	New Allied Electronics Industries (Pvt) Ltd	2007	5	DM	600.00
10	National Industrial Parks Development and Management Company	2007	7	Musharakah	2,000.00
11	Security Leasing Corporation Limited	2007	5	Musharakah	750.00
12	Engro Fertilizers Limited	2007	9	Musharakah	3,000.00
13	Dawood Hercules Chemicals Limited	2007	5	Musharakah	6,500.00
14	Century Paper & Board Mills Limited.	2007	7	DM	3,500.00
15	Shahmurad Sugar Mills Limited	2007	5	Ijarah	500.00
16	Amtex Limited	2007	5	DM	650.00
17	Karachi Shipyard & Engineering Works Ltd	2007	8	Ijarah	1,500.00
18	Sitara Chemical Industries Limited	2007	5	DM	1,100.00
19	New Allied Electronics Industries (Pvt) Ltd.	2007	5	DM	750.00
20	Maple Leaf Cement Factory Limited	2007	6	DM	8,000.00
21	Sui Southern Gas Company Limited	2007	5	DM	4,700.00
22	Eden Housing Limited	2007	5	Musharakah	1,630.00
23	Pak Electron Limited	2008	5	DM	1,200.00
24	Karachi Shipyard & Engineering Works Ltd.	2008	8	Ijarah	1,900.00
25	Optimus Limited	2008	7	DM	250.00
26	Eden Housing Limited	2008	5	Musharakah	730.00
27	Arzoo Textile Mills Limited	2008	6	Ijarah	740.00
28	Lahore Electric Supply Company Limited	2008	1	DM	5,000.00
29	House Building Finance Corporation Ltd	2008	6	Musharakah	1,500.00

Sr. #.	Issuer Name	Date	Tenor	Type	Amount
30	B.R.R. Guardian Mudarabah	2008	6	DM	800.00
31	JDW Sugar Mills Limited	2008	6	DM	500.00
32	K.S. Sulemanji & Sons (Pvt.) Limited	2008	4	DM	1,300.00
33	Three Stars Hosiery Mills (Private) Limited	2008	5	Ijarah	400.00
34	AgriTech Limited (formerly Pak American Fertilizers Limited)	2008	7	Musharakah	1,600.00
35	Haq Bahu Sugar Mills (Pvt) Ltd.	2008	3	Musharakah	290.00
36	Sitara Peroxide Limited	2008	5	Musharakah	1,400.00
37	Eden Builders Limited*	2008	5.5	DM	468.00
38	Quetta Textiles Mills Limited	2008	7	Musharakah	1,385.00
39	Pakistan Domestic Sukuk Company Limited	2008	3	Ijarah	6,522.50
40	Pak Elektron Limited	2008	7	DM	1,100.00
41	Pakistan Domestic Sukuk Company Limited	2008	3	Ijarah	6,000.00
42	Engro Foods Limited	2009	8	Musharakah	950.00
43	Sitara Energy Limited	2009	4	DM	620.00
44	Liberty Power Technology Limited	2009	12	DM	13,488.39
45	Pakistan Domestic Sukuk Company Limited	2009	3	Ijarah	15,325.00
46	Pakistan Domestic Sukuk Company Limited	2009	3	Ijarah	14,396.00
47	Pace (Pakistan) Limited.	2009	3.5	DM	400.00
48	Pakistan International Airlines.	2009	5	Ijarah	6,800.00
49	Kohat Cement Company Limited	2009	5	Musharakah	2,500.00
50	Amreli Steels Limited	2009	7	DM	880.00
51	Educational Excellence Limited	2009	5	Musharakah	540.00
52	Maple Leaf Cement Factory Limited	2010	2	DM	300.00
53	Engro Fertilizers Limited	2010	7	DM	500.00
54	Haq Bahu Sugar Mills (Pvt) Ltd.	2010		Musharakah	50.00
55	Pakistan Domestic Sukuk Company Limited	2010	3	Ijarah	51,837.00
56	Pakistan Domestic Sukuk Company Limited	2010	3	Ijarah	37,174.00
57	Al Razi Healthcare	2011		DM	600.00
58	Pakistan Domestic Sukuk Company Limited	2011	3	Ijarah	47,539.70
59	Pakistan Domestic Sukuk Company Limited	2011	3	Ijarah	45,803.70
60	Kot Addu Power Company	2011	0.5		1,500.00
	Total				**330,969.29**

Source: SECP

Appendix-2

Development of BNM Operations in Islamic Interbank Money Market

03 Jan 1994	Islamic Interbank Money Market (IIMM) was introduced
13 Feb 1996	Mudharabah Interbank Investment (MII) was implemented to ensure mobility of fund in the MII
05 Aug 1999	Bai Al-Inah Funding facility was introduced. The instrument serves as a last resort funding facility by BNM to cover an Islamic banking institution's deficit position
21 Sep 1999	BNM introduced Mudharabah money market tender. Islamic banking institutions which participate in the tender exercise are required to submit their bids via Fully Automated System for Issuing/Tendering System (FAST)
29 Nov 2000	Bank Negara Negotiable Notes (BNNN) which is based on the concept of Bai Al-Inah was introduced
15 Jun 2001	Government Investment Issue (GII) based on Bai al-Inah was introduced and issued on behalf of the Government of Malaysia
01 Oct 2001	Circular on When Issue (WI) was issued by BNM to all the Islamic banking institutions
15 Apr 2002	Wadiah Acceptance based on Al Wadiah was introduced
13 May 2002	Akauntan Negara Malaysia (ANM) opened current account (Al Wadiah) with BNM
01 Aug 2002	BNM issued Guidance Notes on Sell and Buy Back Agreement (SBBA) to IFIs
21 Dec 2002	Sell and Buy Back Tender via fully automated system of Issuing/Tendering system (FAST) was introduced
09 Jul 2003	Ar Rahnu Agreement-i was Ar Rahnu Agreement-i approved by the Management Committee of Bank Negara approved
17 Sep 2004	First Malaysian Islamic Treasury Bills (MITB) was issued
8 Oct 2004	Website of Islamic Interbank Money Market launched by the Governor, BNM
17 Jan 2005	Islamic Overnight Tender through FAST based on Al-Wadiah was introduced
16 Mar 2005	Issued first Profit-Based GII (Government Investment Issues) coupon bearing
24 Jun 2005	Islamic Derivatives Seminar to promote new Islamic Instruments; Islamic FX Forward and Islamic Rate Swap (IRS)
16 Feb 2006	Inaugural issuance of Sukuk Bank Negara Malaysia Ijarah (SBNMI)
08 Feb 2007	Introduced Commodity Murabahah Programme (CMP)
21 Apr 2009	AIBIM adopted two standardized interbank master agreements for Islamic deposit-taking and placement transactions
02 Jul 2009	Issuance of Bank Negara Monetary Notes Murabahah (BNMN-Murabahah)
17 Aug 2009	Bursa Suq Al Sila: World's first, end-to-end Shariah-compliant commodity trading platform was launched
21 Aug 2009	CMMA: a standard document for deposit taking between financial institutions and corporate customers was launched
17 Sep 2009	AIBIM launched two standardized documents for deposit taking and placement transactions. The move significantly enhanced Islamic interbank activities by improving efficiency, limit misunderstandings and reducing the cost of Islamic banking transactions
24 Nov 2009	AIBIM launched the standard Wakalah Placement Agreement (WPA)

Source: BNM, IIMM <http://iimm.bnm.gov.my/index.php?ch=4&pg=4&ac=22>

A NORMATIVE APPROACH TO ECONOMIC UNCERTAINTY ESTIMATION

Pei-Tha Gan[1]
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Han Yu

Abstract

A notable feature of the empirical studies on economic uncertainty index is that almost all published papers rely on the approximate form of economic uncertainty index, a method substantially used the variability measures, which is moving sample standard-deviation type. It can, therefore, not be ruled out for the refusal of economic uncertainty index precision is simply the outcome of a misspecification of a commonly used model and an elaborate data snooping process. In order to overcome these limitations, the paper considers the theoretical and practical that must be contented to construct the best economic uncertainty index, while considering Islamic rate as monetary policy instrument. Using the proposed grid search optimization procedure, the best economic uncertainty index anticipates that: (i) it can characterize the certainty of macroeconomic conditions in conformity with the expectation and (ii) it can serve as a guiding policy tool for improving certainty in macroeconomic conditions.

Keywords: Grid search, optimal economic uncertainty, Islamic monetary policy

1. Introduction

Economic uncertainty states uncertain of future economic events. Since the seminal work on the idea of uncertainty by Knight (1921), researchers have been attempting to investigate the vagueness aversion from several methods. A prominent feature of the empirical studies on economic uncertainty index is that almost all published papers rely on the approximate form of economic uncertainty index, a method substantially used the variability measures, which is moving sample standard-deviation type. It can, therefore, not be ruled out for the refusal of economic uncertainty index precision is simply the outcome of a misspecification of a commonly used model and an elaborate data snooping process.

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For instance, Hall and Noble (1987) and Thornton (1995) used such variability measures as uncertainty in testing the Friedman hypothesis. Choi and Oh (2003) provided time-varying volatility series, the measure of uncertainty by using the rolling regression VAR model. Atta-Mensah (2004) measured the broad uncertainty through the summation of individual uncertainties, in which individual uncertainties were estimated with GARCH models. Greiber and Lemke (2005) used unobserved components model to compute a single estimate of uncertainty based on several observable indicators for the euro area. Cronin and Kennedy (2007) examined the true level of uncertainty in a "two-step" method to study the macroeconomic uncertainty in US money demand. Apergis (1999) employed ARCH modelling based on Engle's (1982) methodology to estimate the inflation uncertainty for the Greece.

Against the above background, though the performance of uncertainty measures is rarely disastrous, however, they can involve large welfare losses relatively to fully optimal uncertainty measure. According to the optimal measure, it is central bank's welfare maximization subjected to its model of the economy. It represents the minimum welfare loss given the structure of the economy and variability of the shocks hitting it (e.g. Jensen, 2002; Jondeau and Sahuc, 2008). In specific, this doctrine is a normative analysis that expresses value judgments about what the economy/goals of public policy ought to be (Caplin and Schotte, 2008).

The motivation for this paper is stimulated by the immense importance that no policy makers (hereafter central banks) have published the optimal uncertainty – best uncertainty so far – for the reason might rest on unwilling to publish it, or such an explicit formula simply does not exist. Having witnessed numbers of austerity due to outbreaks of economic since the end of 1990s, economic uncertainty has been spotted globally with its noticeable increase pace. Bernanke (2010) stressed economic engineering need to be improved in which it is fine dealt with the economic uncertainties. Moreover, it is no harm determining economic uncertainties through Islamic instrument, constitutes basis for the analysis, societal loss function is in line with a welfare maximizing policy of the central bank.[2]

[2] Islamic instrument is superior to the conventional instrument because the former generated greater welfare gain compared to the latter one (cf. Gan and Kwek, 2010a).

The objective of the current paper is to propose the derivation of the best economic uncertainty in simple macroeconomic model. This hypothesizes that the best economic uncertainty should help (i) it can characterize the certainty of macroeconomic conditions in conformity with the expectation and (ii) it can serve as a guiding policy tool for improving certainty in macroeconomic conditions. The main innovative feature of the paper is suggesting grid search method, which consists in choosing a wide range of sets of uncertainty parameters for lastly retaining the set that gives the smallest loss value. The paper hopes when one follows this best economic uncertainty procedure, encouraging the application of grid search technique to the literature on the measurement of uncertainty.

Remaining portion of the paper is organized as follow. Section 2 formally discusses a conceptual framework and theoretical model specification yielding the best economic uncertainty, and presents an empirical model to be used in the proposed grid search estimation. Methodology is discussed in Section 3. Section 4 concludes the paper.

2. Model Specification

(a) Conceptual Framework

The “tube in tube” design has potential as a readily means for analyzing of economic uncertainty of economic conditions, which it can be further delineated using economic modeling in the next section. An example of the optimal economic uncertainty index design with an entire macro model that has a zero uncertainty index of macroeconomic conditions (perfect form) is seen in the tube in Figure 1(*a*). In the tube, the track on each surface is the period of time over which sample data are collected; the respective surface is an entire macro model; the inner shaded tube is the optimal economic uncertainty index that crossing over time from one surface to another. The optimal economic uncertainty index can be constructed when the optimal set of its coefficients are identified.

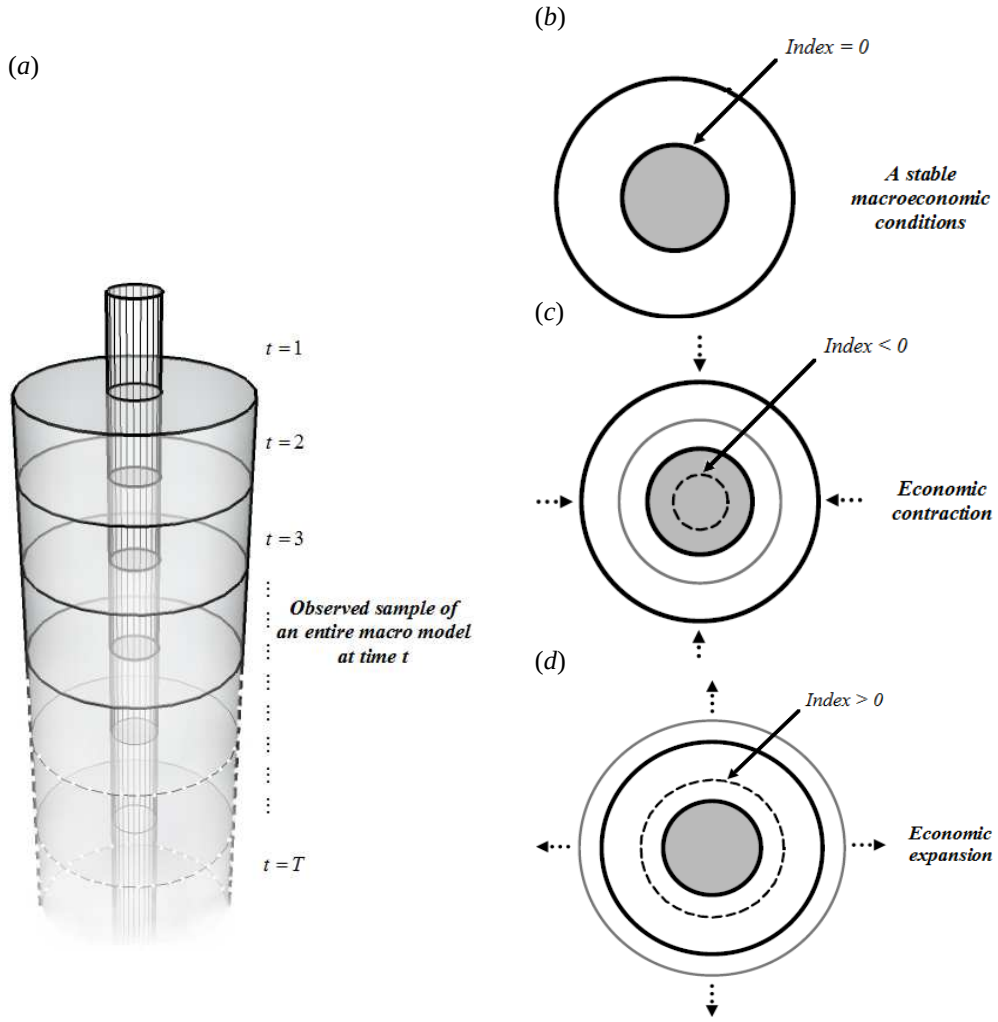


Figure. 1 The view optimal economic uncertainty index of macroeconomic conditions.

Figure 1(*b*) shows a field of the perfect surface. An inner shaded circle inside the perfect surface provides the information that the optimal economic uncertainty index is zero and the welfare is maximal (loss function close to zero). However, in reality the macroeconomic conditions rarely at a zero uncertainty index (it can be an economic contraction or an economic expansion) due to unforeseen economic shocks. Thus, the surfaces in the tube like the one in Figure 1(*a*) may not be perfect, and the inner circle of surface can be placed inside (see Figure 1(*c*)) or outside (see Figure 1(*d*)) the inner shaded circle of surface in the tube (the optimal economic uncertainty index is not equal to zero and the flow of surface over the time is no longer a straight tube).

(b) General Model

In general, an economic uncertainty index is used to describe the combined effects of related macro indicators and policy indicators, and thus, captures the level of the stability – certain or uncertain – of economic activity. This index has a significant bearing on the measure of other economic variables. The general form to identify the best uncertainty reaction function can be obtained through constructing an entire macro model and a loss function for the central bank.

$$
\begin{aligned}
y_1 &= \psi_1 x_{11} + \psi_2 x_{21} + \cdots + \psi_k x_{k1} + \omega_1 \\
y_2 &= \psi_1 x_{12} + \psi_2 x_{22} + \cdots + \psi_k x_{k2} + \omega_2 \\
&\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots\cdots \\
y_n &= \psi_1 x_{1N} + \psi_2 x_{2N} + \cdots + \psi_k x_{kN} + \omega_N \\
U &= \varphi_1 y_1 + \varphi_2 y_2 + \cdots + \varphi_N y_N + \varpi_N
\end{aligned}
\qquad (1)
$$

Loss function :

$$E_t \sum_{\tau=0}^{\infty} \beta^{\tau} L_{t+\tau}$$

where y and x are the dependent variable and the independent variable; these variables are expressed in terms of the gap with their equilibrium value (i.e. the deviation of the actual value from the potential one). U, k and N are economic uncertainty index, k variables and N observations respectively. ψ and φ are coefficients or weights. L stands for the loss function of the central bank (Woodford, 2003); the current policy prescription is assumed to focus on the low and stable inflation. ω and ϖ are errors.

From model 1, economic uncertainty index is defined as a combination of related gap variables (i.e. y) and the gap variables can be calculated from a potential period; potential period is an equilibrium period. Given that the equation of economic uncertainty index is at constant/certainty level, $U = U^{optimal} = 0$, the economy is then close to its long-run equilibrium (i.e. at constant level the U encompass the total effects of related macro indicators and policy indicators at optimal level). Ideally, this would provide possibility to compare any situation with the equilibrium and to conclude whether or not macroeconomic conditions in the period have positive uncertainty movements or negative uncertainty movements compared with the

equilibrium. Thereby, if increases in related indicators outweigh decreases in related indicators, which indicates a higher U figure and, therefore, tighter economic policy can be materialized to mitigate positive level of U.[3] In practice, the estimation of the weights of related macro indicators and policy indicators in the U is at the heart of calculating of the U; in this context, the weight is also known as the degree of uncertainty. These weights reflect the relative impacts and changes of related indicators affected on economic uncertainty.

Regrettably, the uncertainty index is not perceivable in reality but it can be derived with the grid search procedure. The next section would augment the general form with theoretic modelling of the best economic uncertainty index; the optimal means (hereafter optimal economic uncertainty index).

(c) Theoretic Modelling of Optimal Economic Uncertainty Index

The standard macroeconomic model used to construct the level of optimal economic uncertainty index is an extension of the small structural model of Svensson (2000). Among others, it is used by Ball (1997) and Gan and Kwek (2010a; 2010b). In line with this purpose, the contemporaneous model of economic uncertainty index is included in the small structural model. The sources of small structural model are presumed by the following equations:

$$y_{g_t} = \alpha_1 y_{g_{t-1}} - \lambda_1 r_{g_{t-1}} - \delta_1 e_{g_{t-1}} + \varepsilon_t \quad (2)$$

$$\pi_{g_t} = \alpha_2 y_{g_{t-1}} + \beta_{\pi_1} \pi_{g_{t-1}} - \delta_2 e_{g_{t-1}} + \eta_t \quad (3)$$

$$e_{g_t} = \lambda_2 r_{g_t} + v_t \quad (4)$$

$$U_t = \alpha_3 y_{g_t} + \beta_{\pi_2} \pi_{g_t} - \delta_3 e_{g_t} - \lambda_3 r_{g_t} + \varpi_t \quad (5)$$

$$r_{g_t} = \alpha_4 y_{g_{t-1}} + \beta_{\pi_3} \pi_{g_{t-1}} - \delta_4 e_{g_{t-1}} + U_{t-1} + \zeta_t \quad (6)$$

where, y_g the real output gap, π_g the inflation gap, e_g the real exchange rate gap[4], r_g the real interest rate gap (Islamic interest rate) and U the economic uncertainty

[3] One may softer economic policy to mitigate negative level of economic uncertainty index if the above process is the other way round.

[4] An increase in real effective exchange rate (REER) represents a real appreciation while a decrease represents a real depreciation of the domestic currency relative to its trading partners.

index. y_g, π_g, e_g and r_g are centred, in other words, they are expressed in terms of the gap with their equilibrium value – the deviation of the actual value from the potential one.

Equation (2) is IS curve. Output gap depends positively on its own past value; negatively on the real interest rate gap and the real exchange rate gap. In addition, ε_t is a demand shock.

Equation (3) is Phillips curve. The change in inflation depends positively on the level of activity (output gap); negatively on the real exchange rate gap.

Equation (4) posits a positive link between the interest rate and exchange rate. The shock v_t captures other influences on the exchange rate.

Equation (5) is a contemporaneous economic uncertainty function. The positive signs on y_g and π_g indicate that the output gap mitigation and the inflation reduction could reduce economic uncertainty. The negative signs on e_g and r_g specify that central bank could reduce economic uncertainty by appreciating exchange rate and rising interest rate.

Equation (6) represents the Islamic monetary policy. The positive signs on y_g, π_g and U point out that the monetary authority has to stabilize the output gap, inflation gap and economic uncertainty by raising the short-term interest rates. The negative sign on e_g shows that monetary authority stabilizes the real exchange rate gap by reducing the short-term Islamic interest rate.

In this section, the derivation of theoretic modelling of the optimal economic uncertainty index assumes the central bank chooses a sequence of inflation, output gap and interest rates to minimize the discounted expected loss subject to the small structural model above (equation two to six). The central bank's loss function is assumed to be quadratic in inflation gap, output gap and interest rate gap; the period loss function is modelled as

$$L_t = \mu_{y_g} V_{y_g} + \mu_{\pi_g} V_{\pi_g} + \gamma_{r_g} V_{r_g} \tag{7}$$

where μ_{y_g}, μ_{π_g} and γ_{r_g} denote weights attached to the stabilization of the output gap, the inflation gap and the interest rate gap, respectively.

Here, V_{y_g} and V_{π_g} respectively stands for the unconditional variance of the output gap and the inflation gap. The variance of the interest rate gap, V_{r_g}, here is mainly functioned to avoid unrealistic situation of the high interest rate volatility. Finally, the optimal economic uncertainty index is then expressed as equation (8), which minimizes L, given the weights of μ_{y_g}, μ_{π_g} and γ_{r_g} (to be discussed in the next section).

$$U_t^{optimal} = \alpha_3^{optimal} y_{g_t} + \beta_{\pi_2}^{optimal} \pi_{g_t} - \delta_3^{optimal} e_{g_t} - \lambda_3^{optimal} r_{g_t} + \varpi_t \tag{8}$$

3. Methodology

This section explains the method applied in estimating the optimal economic uncertainty index, the small structural model from Section 2(c) would provide the basis for formulating the optimal economic uncertainty index.

(a) The Grid Search Method: Finding the Optimal Economic Uncertainty Index

Grid search method is a direct search algorithm for solving nonlinear optimization, which requires objective functions (Ruud, 2000). To apply this technique, supposing the small structural model can be written as a general matrix system, $X_t = BX_{t-1} + K_t$. One should modify the matrix system when the small structural model contents some contemporaneous components. Given this, the small structural model (i.e. equation from two to six) in Section 2(c) is inscribed as equation 9 to define the following state-space form model:

$$A_1 X_t = A_2 X_{t-1} + Z_t \tag{9}$$

thereby,

$$\begin{bmatrix} 1 & 0 & 0 & 0 & 0 & 0 \\ 0 & 1 & 0 & 0 & 0 & 0 \\ 0 & 0 & 1 & 0 & -\lambda_2 & 0 \\ -\alpha_3 & -\beta_{\pi_2} & \delta_3 & 1 & \lambda_3 & 0 \\ 0 & 0 & 0 & -1 & 1 & 0 \\ 0 & 0 & 0 & 0 & -1 & 1 \end{bmatrix} \begin{bmatrix} y_{g_t} \\ \pi_{g_t} \\ e_{g_t} \\ U_t \\ r_{g_t} \\ \Delta r_{g_t} \end{bmatrix} = \begin{bmatrix} \alpha_1 & 0 & -\delta_1 & 0 & -\lambda_1 & 0 \\ \alpha_2 & \beta_{\pi_1} & -\delta_2 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & 0 & 0 \\ \alpha_4 & \beta_{\pi_3} & -\delta_4 & 0 & 0 & 0 \\ 0 & 0 & 0 & 0 & -1 & 0 \end{bmatrix} \begin{bmatrix} y_{g_{t-1}} \\ \pi_{g_{t-1}} \\ e_{g_{t-1}} \\ U_{t-1} \\ r_{t-1} \\ p_{t-1} \end{bmatrix} + \begin{bmatrix} \varepsilon_t \\ \eta_t \\ \nu_t \\ \varpi_t \\ \zeta_t \\ 0 \end{bmatrix}$$

with Ω as the covariance matrix associated to Z, the system can be written like $X_t = BX_{t-1} + K_t$ but now with:

$$B \equiv A_1^{-1} A_2 \tag{10}$$

$$K \equiv A_1^{-1} Z_t \tag{11}$$

It is followed by the Σ – the covariances matrix associated with the error terms K can be given by $\Sigma = E[KK'] = E\left[(A_1^{-1}Z_t)(A_1^{-1}Z_t)'\right] = A_1^{-1}\Omega(A_1^{-1})'$.

Given that the objective of the central bank is to minimize the standard quadratic loss function (L), it is then can be subjected to the model of the economy as follows:

$$\begin{cases} \underset{\{\beta_{y_g}, \beta_{\pi_g}, r_g\}}{Min} & L = \mu_{y_g} V_{y_g} + \mu_{\pi_g} V_{\pi_g} + \gamma_{r_g} V_{r_g} \\ s.t. & A_1 X_t = A_2 X_{t-1} + Z_t \end{cases}$$

with $\alpha_3, \beta_{\pi_2}, \delta_3,$ and λ_3 the parameters of the economic uncertainty index; μ_{y_g}, μ_{π_g} and γ_{r_g} are respective weights on output gap, inflation gap and interest rate gap, these weights reflect the central bank's preference parameters; V_y and V_π respectively the unconditional variance of the output gap and inflation gap. As the fact that central banks are likely to move their instrument (i.e. interest rate) in moderate steps, it is necessary to add an identity formula, $\Delta r_{g_t} = r_{g_t} - r_{g_{t-1}}$, in the. The optimal economic uncertainty index is then the combination of optimal economic uncertainty reaction coefficients $(\alpha_3^{optimal}, \beta_{\pi_2}^{optimal}, \delta_3^{optimal}, \lambda_3^{optimal})$ which minimizes L, given the weights of μ_{y_g}, μ_{π_g} and γ_{r_g}.

Following Svensson (2000), the unconditional contemporaneous covariance matrix of X , devoted V , can be given in vector form by:

$$Vec(V) = \left[I - B \otimes B\right]^{-1} Vec(\Sigma) \tag{12}$$

In this method, V_{y_g} , V_{π_g} and V_{r_g} are then can be given by the 1^{st} , the 8^{th} and 36^{th} element of $VecV$. Given the combination $(\alpha_3, \beta_{\pi_2}, \delta_3, \lambda_3)$ in solving this sequence, the method consists then can be displayed as below,

$$(\alpha_3, \beta_{\pi_2}, \delta_3, \lambda_3) \Rightarrow B, S \text{ and } \Sigma \Rightarrow VecV \Rightarrow L \tag{13}$$

The grid search procedure explained above can be exercised with a help of various computer programming software.

4. Conclusions

The objective of the current paper is to propose the derivation of the best economic uncertainty in simple macroeconomic model. The results anticipated from the estimated best economic uncertainty index using grid search optimization procedure would strongly accept the hypothesis that best economic uncertainty should help (i) a good summative information tool to characterize the certainty of macroeconomic conditions and (ii) a guiding policy tool for improving certainty in macroeconomic conditions.

In terms of the policy implication, by examining the best economic uncertainty index reaction process and its forecasting performance, the paper expects that the central bank did care about both inflation and the output. The paper also expects that Islamic interest rate continues to be an important policy instrument of the central bank (Gan and Kwek, 2010a); central bank should take into account exchange rate as a tool of the central bank. The used of exchange rate and interest rate as central bank's tools not only can assign as a framework to attain low and/or stable inflation but the exchange rate alone can serve as independent operating target would certain stability

in the foreign capital market. Despite the usefulness of the optimal economic uncertainty, a caveat remains that the optimal economic uncertainty estimation is not an economic turbulence stop policy but it would make the crisis less likely to happen and mitigate the effect of the crisis if any economic and financial tragedy emerged.

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FUTURE CONTRACTS: ISLAMIC CONTRACT LAW PERSPECTIVE

Mirza Vejzagic[1]

Abstract

Futures contracts were a matter of disagreement in Shariah long before the U.S. subprime mortgage market collapsed. Reflective of the diverse interpretations of Islamic law by different schools of thoughts, the scholars are divided over the use of futures contracts, for different reasons. According to western point of view and some moderate Islamic scholars this has left Islamic finance with far fewer hedging devices than their conventional peers. In respond, questions could be raised does Islamic finance needs futures contracts and their risky, uncertain and speculative way of performance. Looking from the input and output point of view, this uncertain and speculative behavior of futures contracts had led to discovery of various hedging devices. If Shariah has clearly defined the basic principles of Islamic contracts, which prohibits uncertainty and speculation, does Islamic finance really needs hedging devices? Furthermore, conservative scholars (علمـاء) are questioning a "blind" following of conventional financial engineering. Recent mortgage market collapse, to a great extent based on financial derivatives, distressed the fundamentals of conventional finance. In other hand, Islamic finance was extremely resilient, particularly owing to Shariah and its principles. If Islamic finance confidently follows their conventional peers in development and applications of future contracts and hedging instruments, shell the next financial crisis come from Islamic world? In view of this, and in the light of the Shariah principle of permissibility (إباحـة) that makes all commercial transactions permissible in the absence of a clear prohibition, the rulings of not only the Mecca based Fiqh Academy but also of many Muslim scholars who have proscribed futures contracts disallowed is a most discouraging form of imitation (تَقْليد). This firm opinion is founded on the analysis that futures contracts do not fulfill the requirements of the conventional Islamic law of contract.

Keywords: Futures Contracts, Islamic Finance, Hedging Instruments

1. Introduction

The development of future contracts, as part of derivatives instruments, has accelerated rapidly in the last thirty years. However, there is obvious lack of a consensus regarding

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the permissibility of futures contracts among different Islamic scholars. Even where scholars have agreed on their disallowance, their stated reasons for prohibition is often based on very different grounds. This is further convoluted by diverse elaboration among the different school of thought (مذهب).[2]

The purpose of this paper is to elaborate position of futures contracts throughout Islamic law of contract perspective. The first part of paper addresses general principles of contract (عقد) in the Qur'an and the Sunnah and essential elements of a valid Islamic law contract. After Shariah point of view on contract is elaborated, general application of futures contracts is presented.

The main body of the paper concentrates on Islamic scholars' arguments over legitimacy of futures contracts. Opinions of the scholars are "mounted" around five issues. First issue involves the goods and values of sale which are fictional at the time of contract, i.e. goods are not delivered at the time as well as price is not paid. As such, contract in this case is mere paper transaction, not a valid sale. Therefore, futures are built on exchange of promise made for the exclusive purpose of speculative profit making. To make lawful a sale from the perspective of Shariah, it is necessary that goods and values must be present at the time of contract.[3] The second issue is related to short – selling in which the seller does not possess or owns subject – matter he sells. In this case the principle of ownership is not fulfilled, as from Islamic point of view of contract "sale is to transfer ownership of the matter of sale from seller to buyer".[4] If the seller does not possess or have ownership of underlying matter, he cannot transfer ownership. Third issue involves principle of "qabd". Literally, it is failure of taking the subject matter into possession prior to resale[5]. A fourth issue relates to "bay al kali bi l – kali" which factually means

[2] Obiyathulla Ismath Bacha, *Derivative Instruments and Islamic Finance: Some Thoughts for a Reconsideration.* International Journal of Islamic Financial Services 1, no. 1, 1999.

[3] Mahdi Zahraa and Shafaai M. Mahmor, *The validity of contracts when the goods are not yet in existence in Islamic law of sale of goods*, Arab Law Quarterly 17, no. 4, 2002, pp. 379-397.
[4] Nabil Saleh, *Definition and Formation of Contract under Islamic and Arab Laws*, Arab Law Quarterly 5, no. 2, 1990, pp. 101-116.
[5] Mohammad Hashim Kemali, *Islamic Commercial Law: An Analysis of Futures and Options*, Cambridge: the Islamic Texts Society, 2000.

sale of one debt for another. In this case the both values are postponed to a future date, which basically converts them to debt – matter, which is forbidden in Islamic law.[6] Lastly, reflecting previous five stated issues; fifth issue elaborates the relationship between future contract and speculation which is closely related to gambling, uncertainty and risk taking.[7] Majority of these issues are derived completely from Islamic scholars' perspective on the validity of conventional sale.

However, paper also addresses the potential affirmative side of future contract, particularly from the point of Ibn Taymiya, Ibn Al-Qayyim and Imam Maliki.
In addition, paper will elaborate some recent studies on futures contracts. Several researches are highlighting the view that derivatives encourage price volatility and tend to destabilize the market.[8] On the other hand some emphasized the economic benefits of futures contracts as well as their necessity in modern Islamic finance.[9]

Conclusion will readdress all the main concerns, provide some ideas, and touch an issue related to necessity for futures contracts in Islamic finance from perspective of Shariah.

2. General Principles of Contract (عقد) in The Qur'an and The Sunnah

The early source of Islamic contract law is apparent through the Quranic revelation of the Ayah: يَا أَيُّهَا الَّذِينَ آمَنُواْ أَوْفُواْ بِالْعُقُودِ "O ye who believe! Fulfil (all) obligations".[10]
وَأَوْفُواْ بِعَهْدِ اللّهِ إِذَا عَاهَدتُّمْ وَلاَ تَنقُضُواْ الْأَيْمَانَ بَعْدَ تَوْكِيدِهَا… "Fulfil the covenant of Allah when you have entered into it, and break not your oaths after you have confirmed them…"[11]

[6] Hanudin Amin, *An Analysis of the Classical and Contemporary Juristic Opinions on Bay Al- Dayn*, Labuan e-Journal of Muamalat and Society, 2007, pp. 31-43.

[7] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.
[8] Obiyathulla Ismath Bacha, *Derivative Instruments and Islamic Finance: Some Thoughts for a Reconsideration.* International Journal of Islamic Financial Services 1, no. 1, 1999.
[9] Muhammad Fahim Khan, *Islamic futures and their markets: with special reference to their role in developing rural financial markets*, Jeddah: Islamic Research and Training Institute, Research paper no 32, 1996.
[10] Quran 5:1.

[11] Quran 16:91.

These Quranic verses are the basis of the sanctity of a wide variety of obligations. The Arabic word "عقـد" covers the entire field of obligations, including those that are spiritual, social, political, and commercial. In the spiritual realm "عقـد" deals with the individual's obligation to Allah (عبــادة). In social relations the term refers to relations including the contract of marriage. In the political arena it encompasses treaty obligations, while in the field of commerce (معاملات), it covers the whole spectrum of obligations of parties in regard to their respective undertakings. Hence the generic word "عقـد" forms the foundation of contract and attendant liabilities.[12] The Quran and the Sunnah have dealt with عبــادة (devotional acts and obedience to Creator) in detail and لاتمعام (commercial transactions) in general. According to the Muhammad Tahir Mansuri some important principles governing commercial contracts and transactions are as under:[13]

i. The contract should be by free mutual consent.

Principle of free mutual consent has been highlighted in a Quran Ayah and Hadith of Prophet (s.a.w.s). The following verse and tradition can be cited in support:

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالَكُم بَيْنَكُم بِالْبَاطِلِ إِلَّا أَن تَكُونَ تِجَارَةً عَن تَرَاضٍ مِّنكُمْ "O you who believe! Eat not up your property among yourselves unjustly except it be a trade amongst you, by mutual consent".[14]

- ❖ The Prophet (s.a.w.s.) said: "The contract of sale is valid only by mutual consent".[15]

ii. The contract should be devoid of Gharar الغرر

Prohibition of gharar is another principle that governs all contracts and transactions. Literally the Arabic word الغرر means indeterminacy, speculation, hazard and risk. A contract is presumed to suffer from gharar if it is involving *(this part particularly should be considered in future contract elaboration)*: (a) a thing whose quantum is unknown; (b) a thing about which is not known whether it exists or not; (c) a thing that is not within the

[12] Noor Mohammed, *Principles of Islamic Contract Law*, Journal of Law and Religion 6, no. 1, 1988, pp. 115-130.
[13] Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions.* Adam Publishers & Distributors, 2006, pp. 3-16.
[14] Quran 4:29

[15] Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions.* Adam Publishers & Distributors, 2006, pp. 3-16.

knowledge of the parties; (d) the parties are unaware whether a sale will take place or not.[16]

Prohibition of gharar has been mentioned in a numerous Hadith.

- The Prophet (s.a.w.s.) said: "If Allah spoiled the fruits what right would one party have to take the money of his brother?"[17]

iii. The contract should be free of Riba الربـــا

A further principle that governs transactions is prohibition of riba. It is unanimously agreed that riba means increase or growth, unlawful gain in an exchange. The Prophet (s.a.w.s.) cursed one who charged riba, gives it, records it, and witnesses it.[18] The prohibition of riba appears in eight Ayahs of the Quran, three times in 2:275 (al – Baqarah), and one time each in 2:276; 2:278; 3:130 (al – Imran); 4:161(al – Nisa); and 30:39 (al – Rum).

وَأَحَلَّ اللَّهُ الْبَيْعَ وَحَرَّمَ الرِّبَا … "But Allah has permitted trade and has forbidden interest..."[19]

يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا الرِّبَا أَضْعَافًا مُضَاعَفَةً ۖ وَاتَّقُوا اللَّهَ لَعَلَّكُمْ تُفْلِحُونَ "O ye who believe! Devour not usury, doubling and quadrupling (the sum lent). Observe your duty to Allah, that ye may be successful".[20]

iv. The contract should not contain an attribute of gambling (القمار) *and games of chance* (الميســـر)

Qimar comprises every form of increase or money gaining of which depends entirely on luck on chance, for instance acquiring income as a outcome of lottery or lucky draw.

[16] Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions.* Adam Publishers & Distributors, 2006, pp. 3-16.

[17] Rafik Issa Beekun, *Islamic Business Ethics*, University of Nevada and Islamic Training Foundation, 1996.

[18] Mohammad Nejatullah Siddiqi, *Riba, Bank Interest and Rational of its Prohibition*, Jeddah: Islamic Research and Training Institute, Visiting Scholars' Research Series, no 32, 2004.

[19] Quran 2: 275.

[20] Quran 3:130

Maysir factually means getting something to easy or getting a profit without working for it.[21] The Quran has unambiguously forbidden these practices:

يَا أَيُّهَا الَّذِينَ آمَنُوا إِنَّمَا الْخَمْرُ وَالْمَيْسِرُ وَالْأَنصَابُ وَالْأَزْلَامُ رِجْسٌ مِّنْ عَمَلِ الشَّيْطَانِ فَاجْتَنِبُوهُ لَعَلَّكُمْ تُفْلِحُونَ .

"O ye who believe! Intoxicants and gambling (dedication of) stones and (divination by) arrows are an abomination of Satan's handiwork: eschew such (abomination) that ye may prosper.[22]

v. The contract should be free from fraud and cheating

Fraud and cheating have been strongly condemned in the Quran and the Sunnah. Fraud includes a number of practices such us giving short measures and short weight, false bidding to rise price of an item, false swearing, hiding defects in sale, etc.[23] Quran mentioned prohibition of fraud and cheating in Surah al-Muţaffifīn:

وَيْلٌ الَّذِينَ إِذَا اكْتَالُوا عَلَى النَّاسِ يَسْتَوْفُونَ وَإِذَا كَالُوهُمْ أَو وَّزَنُوهُمْ يُخْسِرُونَ أَلَا يَظُنُّ أُولَٰئِكَ أَنَّهُم مَّبْعُوثُونَ ... لِّلْمُطَفِّفِينَ "Woe to those that deal in fraud, those who, when they have to receive by measure, exact full measure, but when they have t give by measure or weight to man, give less than due. Do they not think they will be called to account on a Mighty Day".[24]

vi. Two mutually inconsistent contracts are not permissible

Prophet (s.a.w.s.) prohibited two mutually inconsistent contracts. It includes the sale of two articles for two prices, the contingent sale, and the sale of single object for two prices.[25]

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[21] Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions.* Adam Publishers & Distributors, 2006, pp. 3-16.

[22] Quran 5:90

[23] Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions.* Adam Publishers & Distributors, 2006, pp. 3-16.

[24] Quran 83: 1-6

[25] Razali Hj Nawawi, *Islamic Law on Commercial Transactions,* CERT Publication Sdn. Bhd., Kuala Lumpur, 2009, pp. 59-100.

vii. A contract should not be contrary to objectives of Shariah

Any transaction or contract that offends or jeopardizes any of the objectives "makasid" (مقاصـــد) of Shariah is automatically invalid. Maqasid al Shariah is alternately referred as huquq Allah (rights of Allah) in Islamic Law.[26] The objectives of Shariah or huquk Allah have been mentioned in several Ayah of the Quran.

وَلَكُمْ فِي الْقِصَاصِ حَيَاةٌ يَا أُولِي الْأَلْبَابِ لَعَلَّكُمْ تَتَّقُون

"In the law of equality, there is saving of life to you, O man of understanding".[27]

viii. Entitlement of profit depend upon liability for risk

Another principle that governs contract and commercial transactions is principle of liability for loss and entitlement to profit. This principle provides that a person is entitled to profit only when he bears the risk of loss. This principle operates in number of contracts such as contract of sale, hire or partnership.

ix. Permissibility as a General Rule. "What is not explicitly prohibited is permissible".

In the field of transactions and contracts everything that is not prohibited is permissible. This rule has been emphasized in number of Ayah in Quran:

قُلْ مَنْ حَرَّمَ زِينَةَ اللَّهِ الَّتِي أَخْرَجَ لِعِبَادِهِ وَالطَّيِّبَاتِ مِنَ الرِّزْق … "Say (O Muhammad): Who has forbidden the adornment of Allah, which he has brought forth for His bondsmen, and the good things of His providing.[28]

3. Essential Elements Of A Valid Islamic Law Contract[29]

For a legitimate contract to take place in Islamic contract law, certain conditions must be fulfilled. From the definition of the general theory of contract, a valid Islamic law

[26] Muhammad Tahir Mansuri, *Islamic Law of Contract and Business Transactions.* Adam Publishers & Distributors, 2006, pp. 3-16.

[27] Quran 2:179.

[28] Quran 6:145.

[29] Due to its limited length, the paper will give only elementary information related to valid Islamic contract. Depth analysis is deliberately omitted.

contract bases itself on several imperative elements. On the whole these elements are related to the three pillars (ركن) of a contract: (i) a statement or a form (صيغة), (ii) two contracting parties (عاقدان), and (iii) the subject of a contract (المعقود عليه).[30]

With reference to a statement or a form (صيغة) a Hadith narrated that Prophet Muhammad (s.a.w.s.) said: "Sale is constituted by mutual consent"[31]. Therefore, causes nullifying full consent must be removed. Majority of Muslim scholars support the significance to the statement or صيغة because it utters the mutual consent of both parties involved. If it is missing, the contract will render to be invalid[32]. Statement or صيغة is created through offer and acceptance. Offer and acceptance that led to the mutual consent denote the internal aspects. The offer (الإيجاب) and acceptance (القبول) are considered as external proof of the contract. الإيجاب represents the compliance of a party to do something. الإيجاب is interpreted as a statement that is made first with a view to creating an obligation whilst القبول is defined as a declaration of an accepting the obligation.[33] In Islamic contract law offer and acceptance can be expressed in a various ways such as by words, writing, gesture or indication and by conduct. The acceptance must be made to correspond with the proposal. It is compulsory that the acceptance must conform to the offer in all its details irrespective of whether such conformity is express or implied. If this conformity does not exist, there will be no consent. This conformity could either be explicit or implicit.[34]

A further statement of صيغة that lead to the legality of the contract is that the acceptance of the offer made must be made in the same meeting (unity of session). The doctrine of

[30] Razali Hj Nawawi, *Islamic Law on Commercial Transactions*, CERT Publication Sdn. Bhd., Kuala Lumpur, 2009, pp. 59-100.

[31] Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, Kuala Lumpur, 2007.

[32] Abdurrahman Raden Aji Haqqi, *An Islamic Legal Framework Input in the Validity of Electronic Contracts*, Electronic Transactions Conference, Brunei Darussalam, 2000.

[33] Abdurrahman Raden Aji Haqqi, *The Philosophy of Islamic Law of Transactions*, CERT Publication Sdn. Bhd., Kuala Lumpur, 2009.

[34] Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, Kuala Lumpur, 2007

session of contract states that in order for offer to be conformed to the acceptance, both parties should be present in the same session.[35]

Scholars have a different opinions on whether a contract is obligatory instantaneously following an offer and acceptance, or parties are allowed to delay for further thinking about it until the end of the session. Majority of scholars (except Hanafi and Maliki) uphold that both parties are endorsed to rethink and delay until end of the session. This view could be supported by a Hadith which narrates: “Both seller and purchaser have the choice (to revoke the contract) unless they have separated from each other”.[36]

Contractual capacity is the second important requirement that is obligatory to have the valid Islamic contract. The parties who have the legal capability to enter into a contract must have the following attributes; (i) puberty, (ii) sanity, and (iii) maturity.[37]
The Quran revealed:
وَابْتَلُوا الْيَتَامَىٰ حَتَّىٰ إِذَا بَلَغُوا النِّكَاحَ فَإِنْ آنَسْتُم مِّنْهُمْ رُشْدًا فَادْفَعُوا إِلَيْهِمْ أَمْوَالَهُمْ…
"And test the orphans [in their abilities] until they reach marriageable age. Then if you perceive in them sound judgment, release their property to them".[38]

In general rule of the Islamic Law of contract, both parties must be sane. The inclusive capacity for the parties to take the contract is when he/she attains full mental growth and maturity. This standard is the puberty.[39] However, reaching puberty in itself alone is not ample evidence that a person has obtained capacity for business performance. In addition,

[35] Abdurrahman Raden Aji Haqqi, *An Islamic Legal Framework Input in the Validity of Electronic Contracts,* Electronic Transactions Conference, Brunei Darussalam, 2000.

[36] Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, Kuala Lumpur, 2007

[37] Razali Hj Nawawi, *Islamic Law on Commercial Transactions,* CERT Publication Sdn. Bhd., Kuala Lumpur, 2009, pp. 59-100.
[38] Quran 4:6.

[39] Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, Kuala Lumpur, 2007

one must have the possession of maturity of action when it is considered necessary, not only with regards to financial matters but also in matter of *din* (religion).[40]

The subject matter of the contract (المعقود عليه) is also one of the pillars of the Islamic Law of contract. This is due to a fact that a contract is an agreement or promise between two parties on a particular subject matter. Therefore, no contract can exist without a subject matter, which is usually in the form of goods or property. The Islamic Law of contract has uttered the following conditions for the subject matter: (i) Suitability, (ii) Precise determination of subject matter, (iii) Existence of subject matter, and (iv) Certainty of delivery.[41]

For the subject matter scholars have collectively retained that a subject matter must be suitable for concluding a contract on it. From the Islamic contract law point of view, suitability of the subject matter refers to its legality. Primarily, the subject of sale must have the value. The goods must have a clear material value, which is verified by the market. Goods without real value cannot be subject of sale or purchase. In addition, the subject matter must be permissible article in Shariah viewpoint. Legitimacy of subject matter also entails ownership (it must be possessed). Lastly, legality of subject matter also requires that there should be no hindrance or right attained to it. The subject of sale should not be a thing used for un-Islamic intentions.[42]

The subject matter must be accurately determined by both parties. All scholars generally agree that both parties must know in details the particulars about subject matter. The general principle in Islamic contract law is that the subject matter must be exactly determined in relation to its nature, quantity and value. Likewise, if the subject matter is

[40] Razali Hj Nawawi, *Islamic Law on Commercial Transactions,* CERT Publication Sdn. Bhd., Kuala Lumpur, 2009, pp. 59-100.

[41] Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, Kuala Lumpur, 2007

[42] Abdurrahman Raden Aji Haqqi, *An Islamic Legal Framework Input in the Validity of Electronic Contracts,* Electronic Transactions Conference, Brunei Darussalam, 2000.

an obligation or performance, it must be precisely determined at the time of the contract or else the contract will be invalid.[43]

The subject must be specifically known and identified to the buyer. If the goods are not specified and agreed to up-front, the sale is void, as the goods may differ from goods agreed at the initial point of agreement. If the goods are not agreed initially upon entering the contract there is likelihood of gamble and cheating. The quantity and attributes of the subject matter must be also precisely known and agreed upon together with the certainty of the timing for completion and delivery of the contractual obligations. The price of the subject must be definite and becomes a necessary condition to the validity of the sale contract. If the price is uncertain, the sale is void.[44]

Islamic contract law also uphold that the subject matter for transactions should be in actual existence at the time of contract and should be competent of being obtained and delivered to a prospective buyer in the future. The subject must exist at the time of the sale. If subject matter does not exist at the time of the sale, it cannot be transferred and its non-existence makes the contract void.[45]

The subject must be in the full ownership. If something is not fully owned, the contract that takes the place becomes void. In addition, the subject must be in physical possession of the owner when he transfers it to another person.[46]

Further necessity in Islamic contract law is that the sale must be instant and absolute. The sale of goods at a future date or event is void except for exceptional conditions that allowed by Islamic Law of contracts as salam or istisna transactions.[47]

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[43] Arzim Associates Chartered Accountants & Chartered Islamic Finance Professionals, *The Islamic Commercial Law Principles*, Kuala Lumpur, 2007.

[44] Muhammad Ayub, *Understanding Islamic Finance*, John Wiley & Sons Ltd, 2007, pp. 99-127

[45] Razali Hj Nawawi, *Islamic Law on Commercial Transactions,* CERT Publication Sdn. Bhd., Kuala Lumpur, 2009, pp. 59-100.

[46] Nawawi, *Islamic Law on Commercial Transactions,* CERT Publication Sdn. Bhd., Kuala Lumpur, 2009, pp. 59-100.

The common rule related to deliverability is that the subject matter must exist at the time of contract and must be owned and in possession by the seller before it can be transacted. The delivery of the subject of sale must be certain, not depending on a possibility or chance.[48]

4. Defining the Futures Contracts: Principles And Application[49]

A futures contract in general involves an agreement to buy and sell a specified quantity of something at a specified future date.[50] The price is variable, determined competitively by demand and supply on the trading floor or through a computer-based marketplace. A futures market is a market in which people buy and sell things for future delivery. Futures markets perform the economic function of managing the price risk associated with holding the underlying commodity or having a future requirement to hold it. The futures market is a risk transfer mechanism whereby those exposed to risks shift them to someone else; the other party may be someone with an opposite physical market risk or a speculator.[51]

A futures contract is in essence very comparable to forward contract which is homogeneous with respect to contract size, maturity, product quality, place of delivery, etc.[52] Futures contracts are traded on exchanges that intercede the transactions of all buyers and sellers. Given that numerous buyers and sellers transact through an exchange,

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[47] Muhammad Ayub, *Understanding Islamic Finance*, John Wiley & Sons Ltd, 2007, pp. 99-127

[48] Abdurrahman Raden Aji Haqqi, *The Philosophy of Islamic Law of Transactions*, CERT Publication Sdn. Bhd., Kuala Lumpur, 2009.

[49] Illustration of the application of a futures contract from real practice: Appendix 1

[50] Andreas Jobst, *Derivatives in Islamic Finance*, In Syed Salman Ali (ed), *Islamic Capital Markets: Products, Regulation and Development*, Jeddah, Saudi Arabia: Islamic Research and Training Institute, 2008, pp. 97–124

[51] Muhammad al-Bashir Muhammad al-Amine, *Risk Management in Islamic Finance: An Analysis of Derivatives Instruments in Commodity Markets*, Boston: Brill's Arab and Islamic Laws Series 1, 2008.

[52] Comparison Between Futures and Forward Contracts: Appendix 2

the problem arising due to multiple coincidence will be solved.[53] Furthermore, futures prices are regard as fairer since the prices are realized by the interaction of many buyers and sellers, which is important due to elimination of the situation where one party can impose a price upon another. As for counterparty risk, this is solved by the exchange itself being the guarantor for each trade by being the buyer to each seller and the seller to each buyer.[54]

The main role of exchange is to minimize the risk it bears, which is the potential default risk. This exchange achieves by two processes, one known as „margining" and the other as „marking to market". The exchange requires each party to deposit initial deposits, known as initial margins; when losses occur, it will require the party whose position is losing to pay up as the losses occur. This is known as a margin call. Marking to market means that the gain or loss in each contract position resulting from changes in the price of the futures (or option) contracts at the end of each trading day is added or subtracted from each account balance.[55] Another unique feature of futures is the ability of the buyers and sellers to reverse out of their positions before delivery or maturity. Therefore, in commodity futures physical delivery hardly ever takes place, as compared to forward contracts where delivery does take place.[56]

The main purpose of the futures market is to hedge risks. Thus futures markets do not arise if the price of the commodity is not uncertain. Uncertainty about prices arises from uncertainty about the supply and demand of commodities. Thus, even though most seasonally produced agricultural commodities are grown during some part of the year

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[53] Sherin Kunhibava, *Derivatives in Islamic Finance*, Kuala Lumpur: International Shariah Research Academy for Islamic Finance (ISRA), Research paper no. 7, 2010.

[54] Obiyathulla Ismath Bacha, *Derivative Instruments and Islamic Finance: Some Thoughts for a Reconsideration.* International Journal of Islamic Financial Services 1, no. 1, 1999.

[55] Muhammad Fahim Khan, *Islamic futures and their markets: with special reference to their role in developing rural financial markets*, Jeddah: Islamic Research and Training Institute, Research paper no 32, 1996.

[56] Muhammad al-Bashir Muhammad al-Amine, *Futures trading contracts in commodity markets: An Islamic analysis*, unpublished doctoral thesis, International Islamic University Malaysia, 2001.

around the world, supply is uncertain because the quantity of the harvest may be affected greatly by weather conditions.[57]

According to the Nevi Danila,[58] following can be listed as main advantages and disadvantages of futures contracts.

- ❖ Advantages:

i. The futures contracts present less initial costs than other similar instruments, due that you only have to deposit guarantee or margin an underlying asset of greater value.
ii. The future markets can be used as instruments to cover the risks derived from the fluctuations of cash prices before expiration.
iii. The existence of an organized stock market and of standardized contracting terms gives liquidity and offers to the participants the possibility of closing positions on a date before the expiration.
iv. The participant's parts on the contract don't assume any risk of insolvency; the clearinghouse guarantees the liquidation of the contract.

- ❖ Disadvantages:

i. In a similar way as to what happens in the case of the term contracts, with the futures we are exposed to the risk that our vision of the contract is not correct.
ii. If you use the futures contracts as covering instruments you will lose the potential benefits of the movement in future prices.
iii. Being the contracting terms standardized, there doesn't exist futures contracts for all the instruments nor for all the merchandise and they might not cover exactly all the cash positions.

[57] Muhammad al-Bashir Muhammad al-Amine, *Risk Management in Islamic Finance: An Analysis of Derivatives Instruments in Commodity Markets*, Boston: Brill's Arab and Islamic Laws Series 1, 2008.
[58] Nevi Danila, *Derivatives: An Islamic Perspective*, Journal of International Finance and Economics 9, no. 3, 2009, pp. 83-90.

5. Islamic Contract Law Perspective on Future Contracts

In his book and papers[59] Mohammad Hashim Kemali looks into arguments and permissibility of future contracts in Islamic law from the point of conservative scholars (علمـاء). They have clearly criticized the future contracts and have emphasized the following important issues in their dispute: (i) futures contracts are based on goods that are not present at the time of contract, therefore it is not a valid sale, rather paper transaction; (ii) it is contract of sale in which the seller does not have possession of the item he actually sells, (iii) futures fall short of the condition of قبـــض, or taking ownership of the item preceding possible resale; (iv) in future contracts there is delay from both sides in bargain to a future date, which turns futures into the sale of one debt for another بالـــدين لـــدين ا بيـــع; and (v) since in the futures contract the goods are absent and not possessed there is high possibility of excessive speculation which is closely related to gambling.

6. Arguments Against the Use of Futures Contracts

6.1 " لا تبع ما ليس عندك "

Literally, the above written Arabic phrase represents the Hadith which stated: “Sell not what is not with you”. Islamic contract law clearly states that the subject matter of sale must exist[60] and be owned by the seller at the time of contract.[61] A future contract, which is essentially selling goods without possession, repudiates the principles of this Hadith.

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[59] Mohammad Hashim Kemali, *Islamic Commercial Law: An Analysis of Futures and Options,* Cambridge: the Islamic Texts Society, 2000.
Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading*, Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.
Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.

[60] Nabil Saleh, *Definition and Formation of Contract under Islamic and Arab Laws,* Arab Law Quarterly 5, no. 2, 1990, pp. 101-116.

[61]While discussing the subject matter of the contract of sale, Al-Kasini, an Hanafi scholar, rules that the goods must be already in existence at the time the contract of sale is concluded and that the sale of a not-yet-existing object is void. He elaborates his view saying: “There are several conditions for the contract of sale to be validly concluded. The first condition is that the subject matter must be in existence. The sale of non-existent [goods] and the sale of anything, which is susceptible to the hazard of non-existence, is void. Examples can be found in the sale of offspring of a future-born animal and the sale of a fetus of an animal

Taking into consideration the written Hadith, Muslim conservative jurists have consequently passed prohibitive judgments on futures. However, the Hadith has invoked a variety of interpretations from the علمـاء and it is necessary to determine its importance by looking not only at its words but also at its underlying rationale and intent.

According to Al-Sancani, Ibn al Humam, and Ibn Qudamaheld[62] sale of what the seller does not possess is forbidden, even for future buying and delivering. The seller must have possession of the object of sale when selling it. In the case that seller does not possess the object, sale could not be concluded, even if the seller obtains ownership of object afterward. The only exception, according to mentioned scholars, in this case is the "salam" sale, where ownership is not a precondition. This opinion is also held by the Organization of the Islamic Conference (OIC) Islamic Fiqh Academy.[63] Furthermore, Article 197 of the Mejelle, the Ottoman Civil Code (elaborated between 1869 and 1875 and based on Hanafe Fiqh), provides that „the thing sold must be in existence" and Art. 205 further provides that: "the sale of a thing which is not in existence is void".[64]

In other hand, Hanafe scholars put emphasize on the seller's effectiveness (فعاليـــة) of the sale rather than on seller condition of validity (صـحة شـرط). Their opinion validates a genuine sale by an unauthorized person (فضولي) who does not have possession of the object but sells it nevertheless. Consequently, the sale is legitimate but not effective, and becomes effective upon obtaining the owner's consent.[65]

The Maliki scholars highlighted that the seller's effective control and ability to deliver is to be taken in consideration rather than ownership or possession. "What is not with you" reflects "a particular object that is not in one's ownership and one's power to deliver"

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before its birth, of which the former is considered the sale of a non- existent [object] whilst the latter involves the hazard of non-existence".

[62] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.

[63] Islamic Fiqh Academy, *Resolutions and recommendations of the Council of the Islamic Fiqh Academy 1985-2000*, Jeddah: Islamic Research and Training Institute, 2000.

[64] *The Mejelle, English translation of Majallah el-ahkam-i-adilya and a complete code on Islamic civil law*, Translated by Tyser, C.R., Demetriades, D.G. & Effendi, H.I. (n.d.). Petaling, Malaysia: The Other Press.

[65] Mohammad Hashim Kemali, *The Permissibility and Potential of Developing Islamic Derivatives as Financial Instruments*, IIUM Journal of Economics and Management 7, no. 2, 1999, pp. 73-86.

they said. It is likely that the seller has the object but is not able to deliver it, or that the seller possesses the object but has no ownership on it.[66] In both cases, the seller would dispute mentioned Hadith. In Ibn Taymiyya elaboration of Hadith, accent is on the seller's incapability to deliver, which than leads to risk and uncertainty (المخـاطر و الغـرر). Sale of "what is not with you" in this case does not only refer to the sale of what is currently not in buyer possession but also inability of seller to deliver goods.[67]

Imam Shafi[68] uttered that seller may sell what he currently does not possess provided that it is not a specific object, for delivery of a specific item cannot be guaranteed if the seller does not own it.

Lastly, in their moderate view, Ibn Qayyim and al Mubarakfūri[69] expressed that this Hadith refers on the sale of specific objects, not the sale by description of goods that are readily available in the market.[70]

6.2 Sale Prior Taking Possession قبـــض

The word "قبض" denotes taking and holding something in one's hands.[71] In its juristic application, "qabd" refers to lawful custody and ownership in a proprietary capacity, even if it does not entail the material operation of holding.[72] The seller has obligation to bring the goods sold, and the buyer have to pay the price. The buyer, though, is not indebted to

[66] Mohammad Hashim Kemali, *Prospects for an Islamic Derivative Market in Malaysia*, Thunderbird International Business Review 4, no. 5, 1999, pp. 523-540.
[67] Mohammad Hashim Kemali, *Trading Commodity Futures: An Islamic Perspective*, Paper presented at the International Conference on Law and Commerce "Law and Commerce in New Millennium: Adapting to Changing Legal and Business Environment, International Islamic University, Kuala Lumpur, 2002.
[68] Mohammad Hashim Kemali, *Islamic commercial law: an analysis of futures*. The American Journal of Islamic Social Sciences 13, no. 2, 1996, pp. 197-224.
[69] Mahdi Zahraa and Shafaai M. Mahmor, *The validity of contracts when the goods are not yet in existence in Islamic law of sale of goods*, Arab Law Quarterly 17, no. 4, 2002, pp. 379-397.
[70] Ibn Qayyim opinion is rather positive for futures contracts. He stated that the sale of a not-yet- existing object is not necessarily invalid.
[71] Mohammad Hashim Kemali, *Islamic Commercial Law: An Analysis of Futures and Options*, Cambridge: the Islamic Texts Society, 2000.
[72] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis.* Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.

accept the goods or take ownership, as it is his right, which he may or may not decide to put into effect.[73]

One condition of a legitimate sale in Fiqh is that the buyer should not sell the goods purchased until they are in his ownership. When elaborating this decree, Muslim scholars have relayed to the authority of the Hadith. Prophet (s.a.w.s.) said: "He who buys foodstuff should not sell it until he has received it." Another version of Hadith stated that Prophet (s.a.w.s.) said: "He who buys foodstuff should not sell it until he has taken possession of it.[74]

The core rationale of this assessment is to determine whether futures trading can be legalized within the specified conditions of the Hadith and whether hesitation of the scholars in combination with the conservative contract of sale are equally applicable to futures contracts. As for the Hadith basic foundation, the Hidayah[75] states that the Prophet (s.a.w.s.) forbidden the sale of items, particularly consumable ones that the seller did not own, because of ambiguity and uncertainty over their delivery.[76] All leading jurists have held, consequently, that one cannot sell foodstuff before taking ownership of it.
According to Shafis, one cannot sell anything (e.g., foodstuff, land, or a garden), before taking possession.[77] Hanifis and Hanbali stated that ownership is not a requirement in the sale of real property, as there is generally no fear of damage and loss. Their moderate position emphasized that possession is not required for the sale either of foodstuffs and real property if ownership of the goods is conveyed in term of gift or inheritance, as these does not entail financial exchange and the seller is not committed to paying a price to someone else.[78]

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[73] Mohammad Hashim Kemali, *Prospects for an Islamic Derivative Market in Malaysia,* Thunderbird International Business Review 4, no. 5, 1999, pp. 523-540.
[74] Mohammad Hashim Kemali, *Islamic commercial law: an analysis of futures.* The American Journal of Islamic Social Sciences 13, no. 2, 1996, pp. 197-224.
[75] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.
[76] Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading,* Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.
[77] Mohammad Hashim Kemali, *The Permissibility and Potential of Developing Islamic Derivatives as Financial Instruments*, IIUM Journal of Economics and Management 7, no. 2, 1999, pp. 73-86.
[78] Mohammad Hashim Kemali, *Trading Commodity Futures: An Islamic Perspective*, Paper presented at the International Conference on Law and Commerce "Law and Commerce in New Millennium: Adapting to Changing Legal and Business Environment, International Islamic University, Kuala Lumpur, 2002.

According to the al-Kasani (Hanafi), a valid sale can be concluded prior to the seller's taking possession but that it will remain in abeyance until "qabd" has taken place.[79]
Imam Malik restricted this Hadith application to food grains only, which means that non-food grain items (e.g., cotton, palm oil) may be sold prior to taking possession. Furthermore, Maliki also validated the sale of foodstuffs in lump sum (juzafan), that is, without weighing and measuring, prior to taking possession. For liability for loss and destruction in this case is transferred to the buyer at the moment of contract and not upon taking possession.[80]

Ibn Taymiyah differed from the common position by elaborating the notion of "qabd" to its denotation. He stated that neither the Arabic language nor the Shariah has given a specific meaning to qabd. Implication varies from object to object, and the manner in which it occurs is not always the same.[81] Ibn Qudama stated that qabd in all things refers to an appropriate manner of taking possession. The Shariah stipulated qabd, but the manner in which it is accomplished is determined by custom.[82] Lastly, Ibn Qayyim held that sale prior to taking possession is lawful and illustrated this by the sale, for example, of a person of his share in inheritance before taking possession, or what a person might have received by bequest as well as a woman's sale of her dower.[83]

6.3 Sale of One Debt For Another بيع الدين بالدين

There is consideration and dispute that futures contracts precede over postponed and unpaid debts. A debt is usually formed by a trader who enters the market either as buyer or seller without any material exchange of values.[84] Various categories of sales have been

[79] Sherin Kunhibava, *Derivatives in Islamic Finance*, Kuala Lumpur: International Shariah Research Academy for Islamic Finance (ISRA), Research paper no. 7, 2010.
[80] Nuradli Ridzwan Shah Mohd Dali and Sanep Ahmad, *A Review of Forward, Futures, and Options From The Shariah Perspective. "From Complexity to Simplicity"*. Paper presented at Seminar Ekonomi & Kewangan Islam (SEKI) conference, ESSET Kuala Lumpur, 2005.
[81] Seif I. Tag El-Din, *The Question of an Islamic Futures Market*, IIUM Journal of Economics & Management 12, no.1, 2004.
[82] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.
[83] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.
[84] Obiyathulla Ismath Bacha, *Derivative Instruments and Islamic Finance: Some Thoughts for a Reconsideration.* International Journal of Islamic Financial Services 1, no. 1, 1999.

integrated under sale of debts (bay al-dayn), and it has been continually argued as to whether some of them do actually meet the criteria as sale of debts. Fiqh notion of bay al-dayn referred to "transactions over debts in the open market without any guarantees".[85]

Generally, bay al-dayn predicts sale over a due debt linking either two, or sometimes, three parties.[86] The essential underlying principle of the forbiddance of bay al-dayn was over ambiguity in its settlement. It is naturally possible to involve in bay al-dayn with purpose to delay a payment of a bad debt or one in which the debtor merely wanted a further impediment due to his incapability to pay on time. Successive volatile price changes also could contribute to the uncertainty.[87] In the future market condition is very different, where all transactions are completed over definite debts. The scholars did argued, passing the judgment which elaborates that since the buyer in futures does not pay the price to the seller as well as does the latter take delivery, they transact over debts and indulge in bay al-dayn, which is prohibited.[88]

Nazih Hammad has recapitulated the disputes against bay al-dayn in the following five points: (i) there is no valid legal benefit in it, (ii) it becomes a means to riba, (iii) it may lead to divergence and argument between the parties; (iv) it leads to gharar, and (v) the risk in it is excessive.[89] Hammad and his follower Tijani have deplored three of these to be less than accurate and not relevant to futures, and have discussed only two, namely the absence of a lawful benefit, and extraordinary risk. Afterward it is proved in some points that bay al-dayn does serve a useful purpose, a conclusion which many have upheld.[90] With respect to the point over extraordinary risk contained in bay al-dayn and in futures,

[85] Islamic Fiqh Academy, *Resolutions and recommendations of the Council of the Islamic Fiqh Academy 1985-2000*, Jeddah: Islamic Research and Training Institute, 2000.
[86] Hanudin Amin, *An Analysis of the Classical and Contemporary Juristic Opinions on Bay Al- Dayn*, Labuan e-Journal of Muamalat and Society, 2007, pp. 31-43.

[87] Hanudin Amin, *An Analysis of the Classical and Contemporary Juristic Opinions on Bay Al- Dayn*, Labuan e-Journal of Muamalat and Society, 2007, pp. 31-43.
[88] Seif I. Tag El-Din, *The Question of an Islamic Futures Market*, IIUM Journal of Economics & Management 12, no.1, 2004.

[89] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.
[90] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.

Hammad and Tijani have held that "the cautious operational measures of the clearing house guarantees over fulfillment of contract, daily clearance procedures and margin taking have eliminated or minimized the risk over the parties' inability to fulfill their obligations".[91]

Ibn Qayyim has elaborated that not all diversities of bay al-dayn are forbidden. According to him, the prohibited variety is one which entails the sale or exchange of one deferred debt for another.[92] The reason given is that bay al-dayn of this kind prolongs the liabilities of the parties for no useful purpose. Ibn Qayyim's assessment of the source confirmation on bay al-dayn furthermore led him to the conclusion that "there is neither explicit nor implicit text in the Shariah on its prohibition".[93] Oppositely, the doctrines of Shariah indicate its acceptability. Ibn Taymiyya has also indicated that bay al-dayn, basically consists of one deferred counter value for another, neither of which is taken into possession.[94] The Prophet (s.a.w.s.) did not prohibit payment of one debt in exchange for other both of which are established and proven, especially if it involves only the debtor and not a third party. In this case, clearance absolves both sides of their debts, and this is clearly permissible. Several scholars have tried to illustrated bay al-dayn through salam saying that an outstanding debt could not be assigned into the price of a salam contract as this will amount to bay al-dayn.[95]

The Maliki have also advocated the legality of certain types of bay al dayn prior to delivery and qabd when the debts involved within do not appear from the exchange of

[91] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.
[92] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.
[93] Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading*, Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.
[94] Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading*, Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.

[95] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.

food goods and useable goods, and the transaction is also free of gharar.[96] They argued that there is no excessive gharar in deferring both counter values compared to the deferment of one of them only. If one of the counter values has been delivered while the other is deferred to a future date, or when both are so deferred, the level of risk would be the same and no additional gharar is likely when both are deferred.[97]

It could be concluded then that bay al-dayn, which is involved in futures, is in the nature of the completion of outstanding obligations and of debt repayment by the debtor.

According to Kamal Hashim[98] this is clearly permissible and conforms to the Qur'an norm on the fulfillment of contracts:

يَا أَيُّهَا الَّذِينَ آمَنُوا أَوْفُوا بِالْعُقُودِ… "O you who have believed, fulfill [all] contracts".[99]

Holly Qur'an also addresses the concept of debt in Surah Al – Baqarah:

وَلْيُمْلِلِ الَّذِي عَلَيْهِ الْحَقُّ وَلْيَتَّقِ اللَّهَ رَبَّهُ وَلَا يَبْخَسْ مِنْهُ شَيْئًا

"Let him (the debtor) who incurs the liability dictate, and he must have Taqwa of Allah, his Lord, and diminish not anything of what he owes".[100]

Allah's statement indicates that the debtor should dictate to the scribe what he owes, so let him fear Allah. In this case the duty and requirements of contract falls entirely on debtor. Only one counter value has been involved. Based on this it could be concluded that only one counter value could be delayed.[101]

6.4 Speculations, Uncertainty and Gambling With Futures المصر و الغرر

A widespread disapproval of futures speculation is that it causes a volatile price movement that has for outcome significant privation to those engaged in more fruitful

[96] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.

[97] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.

[98] Mohammad Hashim Kemali, *Islamic Commercial Law: An Analysis of Futures and Options*, Cambridge: the Islamic Texts Society, 2000.

[99] Quran 5:1.

[100] Quran 2:282.

[101] I would like to express my sincere appreciation to Prof. Dr. Zainal Azam Abdul Rahman who provided me with particular input and elaboration.

quest.[102] Extensive exposure is given to the relatively notable manipulations that cause many to conclude that speculation is synonymous with gambling. Speculators have lead to some shocking events throughout history. Some early instances of manipulation could be seen in America in 1980, all of which resulted in price volatility. Since then, balance has returned to the market and this, aided by the introduction of regulatory and punitive legislation, has diminished the prospects for such manipulation.[103]

Furthermore, existing data do not confirm the suspicion that futures trading are dominated by large speculators. Data may vary from market to market, but, regardless of market, the total holdings of large speculators' long and short positions are less than 20 percent of the total holdings of small traders. Large speculators probably constitute less than 2 percent of the total futures trading population. Major price movements are usually caused by basic changes in the supply or demand for a given item and only rarely by a group of speculators creating a self-fulfilling prophecy. Statistical analysis shows that the volatility of futures prices is approximately the same as that of equity prices. What makes futures trading more prone to speculative risk taking is the high degree of leverage that results from low margin requirements. This low margin facility is not available in the stock market and is the main factor that is accountable for the high volume of speculative trading in futures.[104]

Ibn Taymiyya pointed out that if a sale contains gharar and involves the usage of the property of others, it is the same as gambling, which is clearly forbidden. Unlawful usage or devouring of the property of others takes two forms: usury (riba) and gambling (maysir).[105] The Qur'an has forbidden both, and the Sunnah has only explained and elaborated upon the Qur'an. He also mentioned that gharar sales, which the Prophet forbade, generally partook in gambling. There were certain types of sales that were common among the Arabs and subsequently forbidden by the Prophet on these

[102] Sherin Kunhibava, *Shariah Parameters of Islamic Derivatives in Islamic Banking and Finance*, ISRA International Journal of Islamic Finance 1, no. 1, 2009, pp. 147-150
[103] Sherin Kunhibava, *Derivatives in Islamic Finance*, Kuala Lumpur: International Shariah Research Academy for Islamic Finance (ISRA), Research paper no. 7, 2010.
[104] Sherin Kunhibava, *Derivatives in Islamic Finance*, Kuala Lumpur: International Shariah Research Academy for Islamic Finance (ISRA), Research paper no. 7, 2010.
[105] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.

grounds.[106] Ibn Taymiyya therefore attempted to establish a common denominator between gharar and gambling, and that is the devouring and unlawful appropriation of the property of others. A commercial transaction cannot be equated with gambling unless it is accompanied by this factor. He based this conclusion on Qur'an 4:29, where unlawful devouring of the property of others is declared forbidden and Muslims are encouraged to conduct "trading by mutual consent".[107] Unlawful devouring is a broad Qur'anic concept that includes gambling, fraud, usurpation, bribery, and profit gained from unlawful transactions. The text under discussion was revealed concerning the touch-and-throw sales, consisting usually of clothes, in which the deal was struck when the buyer touched the material or when it was thrown in his/her direction, and sale of yet-to-be-born animals.[108]

Ibn Taymiyya stated that if such sales became final prior to the buyer's viewing the object, it involved risk taking and gambling, for the object may be good and to the buyer's liking or not. If the buyer is bound by the sale without actually knowing about the object, this would be gambling. But if both parties have seen the cloth and one tells the other that the deal is done, this is a conditional sale that resembles a "give-and-take sale" and contains no element of gambling. If one of the parties involved received its due but the other did not and the latter remained open to risk in a way that frustrated and nullified his right, the sale would contain gharar and gambling simultaneously. Evidently, there is no misappropriation of another's property in futures, for the buyer in such a contract is engaged in a transaction aimed at making profit through trading and not through the dishonest appropriation of another's property. Speculative risk taking in commerce, which involves investment of assets, labor, and skill, is not forbidden; what is forbidden is excessive gharar and gambling. Financial risk taking is likely to involve gambling if it

[106] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.
[107] Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading*, Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.
[108] Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading*, Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.

is staged and created for its own sake, but not if it is incidental to beneficial activity and trade.[109]

Classic descriptions of qimar and maysir also suggest the involvement of two parties in a combative game played for the sole purpose of winning at the expense of one's opponent. One party's gain is equivalent to the other's loss. The gain accruing from such a game is unlawful, as is the act of playing it, for it diverts one's attention from productive occupation and virtuous conduct.[110] Speculation in futures does not necessarily involve a combative game played in order to beat an opponent or to acquire someone property. The speculative risk undertaken in futures bears a greater affinity to commercial risk taking for profit rather than gambling, qimar, and maysir.[111] Mohammad Hashim Kemali elaborated that the exchange authorities and the government must be cautious in order to ensure that commercial speculation is genuinely reflective of the natural flow of market forces. Imposing quantitative limits on daily trading volume and position limits, as is normally practiced in futures markets, is one way to contain speculation within acceptable bounds. But this is a matter that can best be dealt with through house rules and operative floor procedures by the exchange authorities. On the other hand, legislative guidelines should seek to regulate contractual relations between the parties, brokerage activities, and disciplinary procedures in serious violations.[112]

7. Islamic Justification of Futures Contracts

According to Mohammad H. Kamali to endorse the people's wealth through trade is very positive and contributes in "maslaha".[113] In his argumentation he questioned illicit view of

[109] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.
[110] Mohammad Nejatullah Siddiqi, *Riba, Bank Interest and Rational of its Prohibition*, Jeddah: Islamic Research and Training Institute, Visiting Scholars' Research Series, no. 32, 2004.
[111] Mohammad Hashim Kemali, *Prospects for an Islamic Derivative Market in Malaysia,* Thunderbird International Business Review 4, no. 5, 1999, pp. 523-540.

[112] Mohammad Hashim Kemali, *Islamic Commercial Law: An Analysis of Futures and Options,* Cambridge: the Islamic Texts Society, 2000.
[113] Mohammad Hashim Kemali, *Commodity futures: an Islamic legal analysis*. Thunderbird International Business Review 49, no. 3, 2007, pp. 309-339.

futures passed by Fiqh. He based his argument on fact that decision was primarily brought for earlier times and that negative judgments on futures trading without clear Shariah evidence is practically the same as to acting contrary to "maslaha". The basic position of Shariah is prohibition in the realm only of "cibadat", and it is permissibility in "mucamalat" and commerce.[114] According to him, since there is no important verification on the prohibition of futures, then its acceptability in Shariah is recognized. An operation is legitimate from the Shariah viewpoint when it does not infringe a crucial rule, its free of interest and gambling, and does not contribute in excessive gharar.[115] When these necessities are met, the transaction in question is valid and may be performed. However, in conclusion he said that Islamic finance need to remain engaged, in a continued progression to develop more advanced safeguards against abuse, excessive speculation, and gharar.[116]

Muhammad F. Khan advocates that the Prophet (s.a.w.s) said "he who makes a future sale should do that for a specific quantity, specific weight, and for a specific period of time". In addition, he states that the motive for allowing future sale is that the product is a public necessity and a payment is settled at the beginning of the contract.[117] However, in the forward and futures markets, the payment is settled at the end of the contract. Therefore, there is strong argument that forward and futures contradict the Shariah rules.
In reference to public necessity, scholars have allowed "bai salam" sale. Basic definition of bai salam is "the sale of what one does not have, but can be brought into existence, such as generic products".[118] Apart from this, it has one condition, buyer has to pay the

[114] Mohammad Hashim Kemali, *Fiqhi Issues in Commodity Futures*, ed. by Munawar Iqbal and Tariqullah Khan, Financial Engineering and Islamic Contracts, New York, 2005, pp. 20-57.
[115] Mohammad Hashim Kemali, *The Permissibility and Potential of Developing Islamic Derivatives as Financial Instruments*, IIUM Journal of Economics and Management 7, no. 2, 1999, pp. 73-86.
[116] Mohammad Hashim Kemali, *The Continued Domination of Taqlid in Islamic Commercial Law: A Case Study of Future Trading*, Islamic Thought and & Scientific Creativity 6, no 3, 1995, pp. 7-37.
[117] Muhammad Fahim Khan, *Islamic futures and their markets: with special reference to their role in developing rural financial markets*, Jeddah: Islamic Research and Training Institute, Research paper no 32, 1996.
[118] Seif I. Tag El-Din, *The Question of an Islamic Futures Market*, IIUM Journal of Economics & Management 12, no.1, 2004.

price at the time of contracting, and the seller has an obligation to deliver the product at a future date.[119]

In other hand Imam Hanafi gave support for futures related to manufactured products. This is called "bai istina".[120] He advocates some flexibility in terms of the completion from both ends. Following above mentioned, completion can be deferred to a future date. The reason for this flexibility is that there will be no room for speculation in price variations, because the products cannot be easily found in the market place. [121] However, it can be debatable that futures contracts do not have same application as bai salam and bai istina. Thus, futures contracts are not acceptable in the Islamic culture.

Imam Maliki also authorized delay of the counter value for three days and for more than three days in some cases. This is permitted as long as the intention is to deliver and take delivery of the asset and is not speculation. Therefore, the emphasis is not on ownership or possession, but fairly on the seller's efficient control and ability to deliver. In this case, a short sale is permitted as long as the objects are not fungible goods, which can be replaced and substituted.[122] Mohammad H. Kamali furthermore argues that if the goods and their counter value are delivered on a specific date in the future, there will be no risk.[123]

In the cooperate outline, the meaning of futures contract is that two parties negotiate on a future transaction, where the seller agrees to deliver the commodity in a future date to the

[119] Seif I. Tag El-Din, *The Question of an Islamic Futures Market*, IIUM Journal of Economics & Management 12, no.1, 2004..

[120] Abdul Rahim Al-Saati, *Sharia Compatible Futures,* Journal of King Abdulaziz University: Islamic Economics 15, no 1. 2002, pp. 3-25.

[121] Abdul Rahim Al-Saati, *Sharia Compatible Futures,* Journal of King Abdulaziz University: Islamic Economics 15, no 1. 2002, pp. 3-25.

[122] Mohammad Hashim Kemali, *Trading Commodity Futures: An Islamic Perspective*, Paper presented at the International Conference on Law and Commerce "Law and Commerce in New Millennium: Adapting to Changing Legal and Business Environment, International Islamic University, Kuala Lumpur, 2002.

[123] Mohammad Hashim Kemali, *Prospects for an Islamic Derivative Market in Malaysia,* Thunderbird International Business Review 4, no. 5, 1999, pp. 523-540.

buyer and the buyer agrees to pay money to the seller at that time.[124] Moreover, in the "Jo'alah" viewpoint, the futures contract is defined as a contract in which the buyer proclaims that if the seller delivers the product at a determined time in the future, he will deliver the money to him. The futures contracts in the two frameworks above are permissible.[125] Ibn Taymiyyah implies that agreed upon requirements between parties are binding to them based on the principle of the freedom of contractual requirement, thus in a forward contract, the parties can make requirements of the postponement for both the asset and its counter value.[126]

Ali Salehabadi & Mohammad Aram believe that deployment of future instruments are of necessity because national budgeting. As a result national development programs can be planned and implemented with a higher degree of accuracy. Futures, according to them, could be precisely applicable for safe guarding against negative effects of price fluctuation either in oil (such as a major producer and exporter) or in wheat and sugar (as a major importer and consumer).[127]

8. Conclusion

The best way to start concluding remarks on presented paper is to quote former prime minister of Malaysia Tun Dr. Mahathir Mohamad who said: "They may promise good returns but as we have seen in the end abuses of financial systems will bring about disaster".[128] Similarly, after performing detailed research on performance and application of derivatives in Islamic Finance, Dr. Samir Abdel Hamid Radwan at the end of his book

[124] Obiyathulla Ismath Bacha, *Derivative Instruments and Islamic Finance: Some Thoughts for a Reconsideration.* International Journal of Islamic Financial Services 1, no. 1, 1999.
[125] Mohammad Saleh Ali Ayyash, *Shariah Alternatives to Non-Shariah Elements in Modern Commodity Futures Trading*, in In Syed Salman Ali (ed), *Islamic Capital Markets: Products, Regulation and Development*, Jeddah, Saudi Arabia: Islamic Research and Training Institute, 2008, pp. 147-179.
[126] Nuradli Ridzwan Shah Mohd Dali and Sanep Ahmad, *A Review of Forward, Futures, and Options From The Shariah Perspective. "From Complexity to Simplicity"*. Paper presented at Seminar Ekonomi & Kewangan Islam (SEKI) conference, ESSET Kuala Lumpur, 2005.
[127] Ali Salehabadi and Mohammad Aram, *Islamic Justification of Derivative Instruments*, International Journal of Islamic Financial Services 4, no. 3, 2002.
[128] Islamic Finance News Daily, *Tun Mahathir's Speech at the Opening Ceremony of the 5th International Shariah Scholars Forum*, Organized in conjunction with the Global Islamic Finance Forum, Kuala Lumpur, Malaysia, 2010.

noted: “I swear in God's name that to the best of my knowledge, based on the research conducted to prepare for the book, my finding is that derivatives, as they are, are far from being Shariah compliant”.[129] Furthermore, it could be useful to present question to, and answer from, great Mufti Taqi Usmani related particularly to Islamic Futures. The Mufti has been provided with following scenario and asked following questions:

“Two individuals, A and B enter into a contract on January 1 under which A would sell a stock of company X at a price of $100 to B after an expiry of six months. B has an obligation to purchase at this price irrespective of the market price on June 30. (i) Is this contract permissible in Shariah? (ii) Can this contract or the rights and obligations of A and B be transferred by either of them to a third party C? (iii) If the object of transaction is any commodity, or gold, silver or currency and not stocks, as in the case above, in what way is the validity or otherwise of the contract affected? It may be noted that the non-transferability of rights and obligations severely limits the possibility of speculation on Futures Exchanges. A commonly held belief is that Futures contracts are prohibited when they are used for speculation. Does this imply that Futures contracts are permissible when these are used for hedging?[130]

His answer was following “(i) this is an example of a futures transaction. The futures transaction as in vogue in stock and commodities markets today is not permissible for two reasons. Firstly, it is a well recognized principle of the Shariah that sale or purchase cannot be affected for a future date. Therefore, all Forward and Futures transactions are invalid in Shariah. Secondly because in most of the Futures transactions, delivery of the commodities or their possession is not intended. In most cases, the transactions end up with the settlements of difference of prices only, which is not allowed in the Shariah. (ii) As futures are not permissible, no rights or obligations can emanate there from. Therefore the question of transferring these rights and obligations does not arise. (iii) futures transactions as explained above are totally impermissible regardless of their subject

[129] Samir Abdel Hamid Radwan, *Al-Mushtaqqat al- Maliyyah: dirasah muqaranah bayna al-nuzum al-wadi'yyah wa ahkam al-shariah al-islamiyyah,* Dar al-Nashr li'l Jamiaat, Cairo, 2005. I would like to express my sincere appreciation to Prof. Dr. Zainal Azam Abdul Rahman who provided me with particular input and translation.

[130] Taqi Usmani, *What Shariah Experts Say: Options, Futures and Swaps*, International Journal of Islamic Financial Services 1, no.1, 1999, pp. 36-39.

matter. Similarly, it makes no difference whether these contracts are entered into for the purpose of speculation or for the purpose of hedging".[131]

Essentially, futures and other derivatives are matters of disparity among scholars. The large majority of scholars, among them members of OIC Fiqh academy and Fiqh academy in Mecca, hold derivatives to be impermissible. Reasons for such verdict may be summarized in three groups, firstly, derivatives involve oppressive and prohibited elements like gharar, speculations and gambling, future contracts are large paper transaction not genuine purchases or sales, sale what the seller does not own, sale of debt for debt, selling prior possession (without any physical transfer or delivery), subject matter is unacceptable, etc. Furthermore, conservative scholars claimed that derivatives cannot be driven out as any traditional contract in Shariah. Lastly, derivatives cause great harm to people, causing price distortion (price is not determined by market forces) and financial crises. For these reasons they are forbidden.

If majority of scholars clearly agreed that derivatives should be prohibited, further question could be raised does Islamic finance needs derivatives contracts and their risky, uncertain and speculative way of performance. Looking from the input and output point of view, this uncertain and speculative behavior of futures contracts had led to discovery of various hedging devices. If Shariah has clearly defined the basic principles of Islamic contracts, which prohibits uncertainty and speculation, does Islamic finance really needs hedging devices? The reality is that risk management is entrenched in the Islamic law of contract and financial transactions such that if they are really applied as endowed, there is essentially no actual need to elaborate the concern of risk in the manner it is practiced in the conventional model. Thus, the principal question to address is whether all that need to be pursued in mode of Maqasid Shariah are essentially realized. Additionally, some conservative scholars have voiced their serious consternation at the conduct(s) and manners Islamic finance has been performed of late. They are particularly questioning a "blind" following of conventional financial engineering. Recent mortgage market

[131] Taqi Usmani, *What Shariah Experts Say: Options, Futures and Swaps*, International Journal of Islamic Financial Services 1, no.1, 1999, pp. 36-39.

collapse, to a great extent based on financial derivatives, distressed the fundamentals of conventional finance. In other hand, Islamic finance was extremely resilient, particularly owing to Shariah and its principles (Maqasid Shariah). If Islamic finance confidently follows their conventional peers in development and applications of future contracts and hedging instruments, shell the next financial crisis come from Islamic world? In view of this, and in the light of the Shariah principle of permissibility that makes all commercial transactions permissible in the absence of a clear prohibition, the rulings of not only the Mecca based Fiqh Academy but also of many Muslim scholars who have proscribed futures contracts disallowed is a most discouraging form of imitation. This firm opinion is founded on the analysis that futures contracts do not fulfill the requirements of the conventional Islamic law of contract.

From above discussion, it could be concluded that contemporary trading in derivatives is impermissible as it includes prohibited categories of sale of debts, riba and it is a field in which artificial finance industry builds it basis. However, taking into consideration the need of Islamic finance for efficient hedging methods, there is believe that use of some derivatives for mere hedging purposes may be accepted provided some important adjustments.

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Appendix 1

Sample and Application of Future Contract[132]

Contract size:	25 metric tones
Delivery months:	current and the next five succeeding months, and therefter alternate months up to twelwe months forward.
Price Quotation:	Malaysian Ringgit per metric ton.
Minimum Price Fluctuation:	RM 1.00 per metric ton.

Daily Price Limits: RM 100 per metric ton above or below the Settlement Prices of the preceding day for all month. Limits are expanded when the Settlement Prices of all three quoted months, which immediately follow the current month, in any day are at limits as follows:

Day	Limit
First	100
Second	150
Third	200

Daily price limits will remain at RM 200 when the preceding day's settlement prices of all three quoted months immediatelly following the current month settle at a limit RM 200.

Repotable Position: 100 or more open contracts, either long or short, in any one-delivery month

Speculative Position: 500 contracts net long or net short, for any delivery months combined.

Transaction Limit: Each single transaction shall not exceed twenty lots.

Last Trading Day: A contract month experies at noon of the fifteenth of the month; if the fifteenth is a nonmarket day, it expires the preceding business day.

Tender Period: First business day to the twentieth day of the delivery month; if the twentieth is a nonmarket day, the preceding day.

Contract Grade and Delivery Points: Crude Palm Oil of good merchantable quality, in bulk, unbleached, in Port Tank Installations located at the option of the seller at Port Kelang, Butterworth/ Prai and Pasir Gudang. Free Fatty Acids (FFA) of Palm Oil delivered into Port Tank Installations shell not exceed four percent and from Port Tank Installations shall not exceed five percent moisture and impurities shall not exceed 0.25%.

Delivarable Unit: Twenty – five metric tons, plus or minus not more than two percent. Settlement of weight differences shall be based on the simple average of the daily Settlement Prices of the delivery month from: (a) the first business day of the delivery month to the business day immediately preceding te last day of trading, if the tender is made on the last trading day or thereafter

Trading Hours: Malaysian Time, on each business day
10:30 a.m. – 12:30 p.m.
3:00 p.m. – 6:00 p.m.

[132] Muhammad al-Bashir Muhammad al-Amine, *Risk Management in Islamic Finance: An Analysis of Derivatives Instruments in Commodity Markets*, Boston: Brill's Arab and Islamic Laws Series 1, 2008.

Appendix 2

Comparison Between Futures and Forward Contracts[133]

Item	Futures	Forwards
1. Market Place	Specific market place that is reserved to listed members only	Does not need any specific market
2. Mode of Contract	Through open outcry	The parties have the right to conclude the contact as they wish
3. Subject Matter	Confined to commodities of standard specification (lots)	Tailored according to the specific needs of the contracting parties
4. Discharging of Obligation	Possible to discharge obligations by entering into a matching contract	Parties are under obligation to take delivery at the maturity date.
5. Delivery Time	Limited to only brief periods during a year.	According to what agreed upon between the parties
6. Breach of Contract and Claim for Damages	Entangles the individual party with the Futures Exchange and not the party on the other side of the agreement.	The settlement of the dispute will involve the two contracting parties only.

[133] Muhammad al-Bashir Muhammad al-Amine, *Risk Management in Islamic Finance: An Analysis of Derivatives Instruments in Commodity Markets*, Boston: Brill's Arab and Islamic Laws Series 1, 2008.

STATUS DAN KESAN PERUNDANGAN *WA'D :* KES *SELL AND BUY BACK AGREEMENT* (SBBA)

STATUS AND LEGAL IMPACT OF WA'D : CASE SELL AND BUY BACK AGREEMENT (SBBA)

Mira Munira[1]
Talia Yudrieka
Amira Ajeera

Abstrak

Pasaran wang Islam adalah penting untuk melaksanakan fungsi sistem perbankan Islam. Pertama, dalam menyediakan institusi kewangan Islam melalui kemudahan untuk pembiayaan dan pelarasan portofolio jangka pendek, dan kedua, berkhidmat sebagai medium untuk penghantaran dasar kewangan. Instrumen kewangan dan pelaburan antara bank akan membolehkan bank yang memiliki kelebihan kecairan untuk menyalurkan dana kepada bank yang defisit. Dengan itu mengekalkan mekanisme pembiayaan dan kecairan yang diperlukan untuk menggalakkan kestabilan dalam sistem. Menurut garis panduan Islamic Interbank Money Market (IIMM) yang dikeluarkan oleh Bank Negara Malaysia (BNM) pada 18 Disember 1993, salah satu jenis instrumen Pasaran Wang Antara Bank Islam ialah *Sell and Buy Back Agreement* (SBBA) *atau Islamic Repurchase Agreement.* Kajian ini dilakukan dengan tujuan untuk mengenal pasti perkara yang berkaitan dengan transaksi SBBA dalam hal status dan kesan perundangan *wa'd* dimana ianya merupakan suatu elemen paling penting dalam proses pelaksanaan SBBA. Kaedah yang digunakan untuk melaksanakan kajian ini ialah kaedah kajian deskriptif yang kualitatif. Melalui kajian, analisis, dan bukti-bukti yang ada, diputuskan bahawa *wa'd* yang digunakan dalam transaksi SBBA adalah *muwa'adah* dan *mulzim* bagi setiap pihak yang berkenaan serta boleh dikuatkuasakan oleh mahkamah jika ada maslahah. Implikasi daripada kajian ini ialah dapat dijadikan sebagai bahan perbandingan untuk mengkaji lebih lanjut mengenai pelaksanaan *muwa'adah* dalam transaksi SBBA yang dapat dijadikan sebagai panduan untuk penambahbaikan di masa hadapan.

Kata kunci : *Islamic Interbank Money Market (IIMM), Sell and Buy Back Agreement (SBBA), wa'd, muwa'adah.*

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Abstract

Islamic money market is important to perform the functions of the Islamic banking system. First, in providing Islamic financial institutions through access to financing and short-term portfolio adjustments, and second, to serve as a medium for the transmission of monetary policy. Financial instruments and interbank investment would enable the bank has excess liquidity for banks to channel funds to the deficit. Thus maintaining liquidity and funding mechanisms needed to promote stability in the system. According to Islamic guidelines Interbank Money Market (IIMM) issued by Bank Negara Malaysia (BNM) on December 18, 1993, one of the types of instruments Islamic Interbank Money Market is Sell and Buy Back Agreement (SBBA) or Islamic Repurchase Agreement. This study was conducted with the aim to identify areas associated with SBBA transaction in the case of legal status and effect wa'd where it is a most important element in the implementation process SBBA. The method used for this study is descriptive qualitative research methods. Through research, analysis, and evidence available, it was decided that wa'd used in SBBA transaction is muwa'adah and mulzim for each party concerned and may be enforced by the court if there default cases. The implication of this study is that it can be used as a comparison to study more about the implementation of the transaction SBBA muwa'adah that could be used as a guide for future improvement.

Keywords: *Islamic Interbank Money Market (IIMM), Sell and Buy Back Agreement (SBBA), wa'd, muwa'adah.*

1.0 Pengenalan

Pasaran wang Islam adalah penting untuk melaksanakan fungsi sistem perbankan Islam, pertama, dalam menyediakan institusi kewangan Islam melalui kemudahan untuk pembiayaan dan pelarasan portofolio jangka pendek, dan kedua, berkhidmat sebagai medium untuk penghantaran dasar kewangan. Instrumen kewangan dan pelaburan antara bank akan membolehkan bank yang memiliki lebihan kecairan menyalurkan dana kepada bank yang deficit. Hal itu mengekalkan mekanisme pembiayaan dan kecairan yang diperlukan untuk menggalakkan kestabilan dalam sistem. Pada 3 Januari 1994 telah diperkenalkan sebuah institusi dengan nama Pasaran Wang Antara Bank Islam *(Islamic Interbank Money Market/IIMM)*, dimana institusi tersebut menjadi perantara paling cepat untuk menyediakan sumber pelaburan jangka pendek berdasarkan prinsip syariah. Melalui IIMM ini, bank-bank Islam dan bank-bank yang menyertai Skim Perbankan Islam (SPI) akan dapat sepadan dengan

keperluan pembiayaan yang berkesan dan cekap. Menurut garis panduan IIMM yang dikeluarkan oleh Bank Negara Malaysia (BNM) pada 18 Disember 1993, berikut ialah jenis-jenis instrumen Pasaran Wang Antara Bank Islam :

a) Pelaburan Mudharabah Antara Bank *(Mudharabah Interbank Investment)*
b) Penerimaan Wadia *(Wadiah Acceptance)*
c) Terbitan Pelaburan Kerajaan *(Government Investment Isuues)*
d) Nota Kewangan Bank Negara *(Bank Negara Monetary Notes-i)*
e) **Perjanjian Jual dan Beli Balik *(Sell and Buy Back Agreement)***
f) Bond Mudharabah Cagamas *(Cagamas Mudharabah Bonds)*
g) Bill Penerimaan Islam *(Islamic Accepted Bills)*
h) Instrumen Boleh Niaga Islam *(Islamic Negotiable Instrumen)*
i) Sekuriti Hutang Swasta Islam *(Islamic Private Debt Securities)*
j) Perjanjian Ar-Rahnu *(Ar-Rahnu Agreement-i)*
k) Sukuk BNM Ijarah

SBBA ialah transaksi perjanjian jual dan beli balik *(repurchase agreement)* yang berbasiskan Islam (Repo-i) dimana seseorang pihak (penjual) menjual sekuriti Islam kepada pihak lain (pembeli) pada harga yang telah disetujui dan kemudian penjual dan pembeli memasuki suatu perjanjian lain dimana perjanjian yang sebelumnya untuk menjual dan kemudian untuk membeli kembali sekuriti yang diperdagangkan tersebut pada jangka masa hadapan yang ditentukan dan pada harga yang disetujui bersama. Beberapa elemen asas SBBA dapat diringkaskan seperti berikut :

1. Asas Dagangan
   Transaksi SBBA diperdagangkan berdasarkan harga
2. Pemindahan Pemilikan
   Pemilikan atas sekuriti-sekuriti Islam yang dijual dengan SBBA harus berpindah dari penjual kepada pembeli
3. Urusan dan transaksi SBBA
   Pihak-pihak yang bertransaksi boleh menjalankan transaksinya melalui broker wang atau melalui urusan langsung. Kedua-dua pihak hendaklah merundingkan terma-terma SBBA dan saling bersetuju diantara kedua-dua pihak keatas jenis-jenis sekuriti Islam, harga, tempoh perkhidmatan dan tarikh penyelesaian.

Beberapa aspek penilaian resiko hendaklah pertimbangan yang sewajarnya sebelum mengakhiri transaksi SBBA.

Transaksi SBBA akan bermula apabila terdapat sekuriti tertentu yang dijual kepada pembeli pada harga yang disetujui. Pemilikan keatas sekuriti mesti dipindahkan kepada pembeli apabila perjanjian yang pertama telah ditamatkan. Nilai transaksi SBBA mesti sekurang-kurangnya RM50.000.00 (lima puluh ribu ringgit). Transaksi SBBA mempunyai kematangan yang tetap, tempoh maksimum untuk transaksi SBBA tidak boleh melibihi 1 (satu) tahun. Pada tempoh matang, pembeli akan menjual kembali sekuriti Islam yang dibeli kepada penjual pada harga yang disepakati sesuai perjanjian. Dalam pelaksanaan transaksi SBBA, pihak-pihak yang terlibat mestilah :

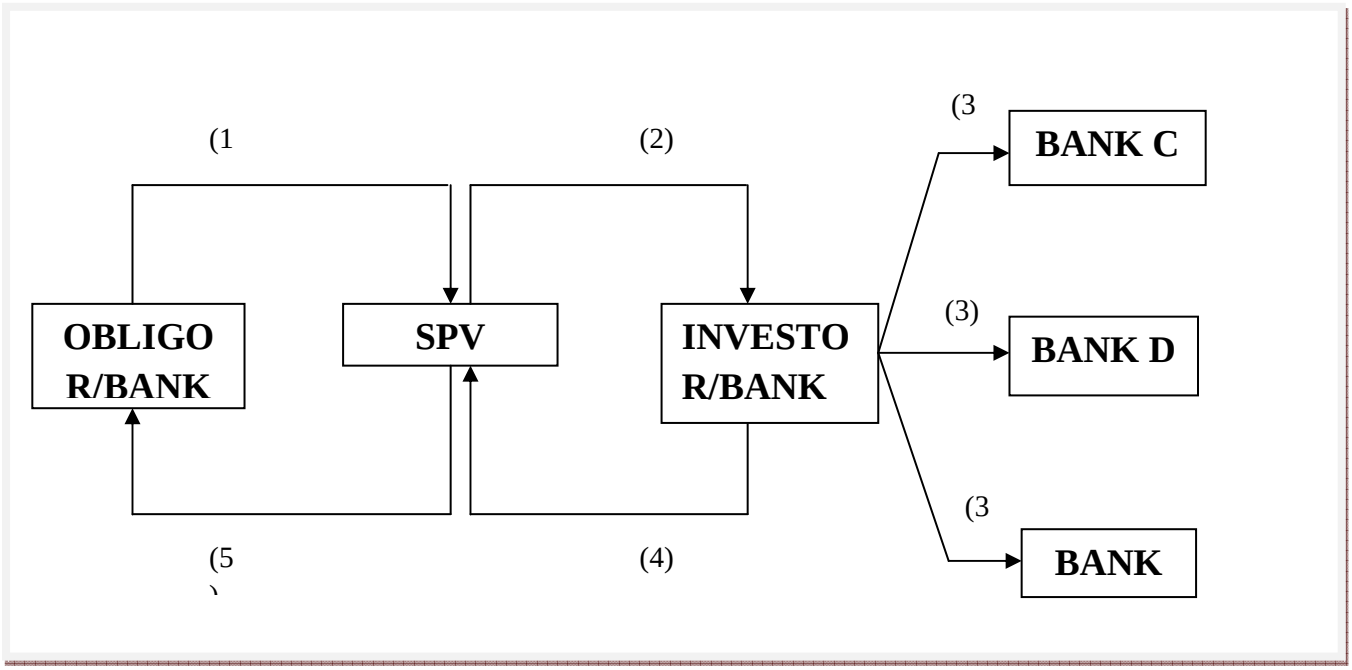
1. Merupakan bahagian daripada IBI (Islamic Banking Institutions)
2. Bagi melaksanakan transaksi SBBA dengan menggunakan *scripless securities* maka :
   a) Ahli RENTAS diharuskan untuk melakukan transaksi melalui Repo Enhanchment Module (REM) dalam RENTAS; dan
   b) Yang bukan ahli RENTAS diharuskan untuk menjaga akun *scripless securities* dengan institusi depositori yang diberi kuasa dalam hal melaksanakan transaksi repo melalui REM di RENTAS.
3. Untuk melaksanakan transaksi SBBA menggunakan *non-scripless securities*, pihak-pihak yang terlibat mesti melaksanakan transaksi diluar REM.

Dalam proses pelaksanaan perjanjian pada transaksi SBBA, pihak-pihak yang terlibat kedalam transaksi SBBA akan memasuki 2 (dua) perjanjian yang berbeza, iaitu sebagai berikut :

1. Perjanjian Pertama – Pihak penjual akan menjual sekuriti Islam nya kepada pembeli pada harga yang disepakati dan tarikh yang ditentukan bersama.
2. Perjanjian Kedua – Pihak pembeli berjanji untuk menjual kembali sekuriti Islam tersebut kepada penjual, dimana penjual juga berjanji untuk membeli kembali sekuriti tersebut pada harga yang disepakati dan pada tempoh hadapan yang telah ditentukan bersama.

Aku janji yang dibuat oleh kedua-dua pihak SBBA iaitu penjual dan pembeli untuk menjual dan membeli semula sekuriti masing-masing pada tempoh matang hendaklah berdasarkan kepada janji. Untuk mengekalkan integriti pasaran dan memastikan kelancaran operasi IIMM itu, semua pihak hendaklah memikirkan untuk melaksanakan tanggungjawab mereka seperti yang dijanjikan.

Rajah terjadinya transaksi SBBA



Keterangan :

Misalnya transaksi ini terjadi untuk instrumen Khazanah Bonds, maka :

(1) Obligor (Bank A) sebagai pihak yang mempunyai *certificate* sukuk khazanah dengan nilai RM1.000.000 dan bertempoh matang selama 10 tahun, ia menawarkan kepada SPV untuk menguruskan *certificate* tersebut

(2) SPV akan menguruskan dan menjualkan *certificate* tersebut kepada investor (Bank B). Investor (Bank B) akan melabur melalui *certificate* tersebut dan akan menjadi pemegang *certificate* selama 10 tahun kehadapan

(3) Selama *certificate* berada pada investor (Bank B), apabila ia memerlukan kecairan dana, maka ia boleh menjualkan sebahagian mahupun keseluruhan dari *certificate* tersebut kepada Bank lain (Bank C, D, dan E), pada tahap ini terjadilah transaksi SBBA melalui terbentuknya *wa'd* yang disepakati oleh kedua-dua pihak yang terlibat, iaitu dimana investor yang memerlukan kecairan dana kemudian menjual *certificate* tersebut kepada Bank lain selama tempoh

kurang dari 1 tahun. Selama itu, Bank C,D, dan E akan memperoleh keuntungan atas kepemilikan sementara pada *certificate* tersebut. Setelah tiba pada tempoh matang, maka *certificate* akan dimiliki kembali oleh Bank B.

(4) Setelah tiba pada tempoh matang iaitu 10 tahun, maka investor (Bank B) akan mengembalikan semula *certificate* sukuk khazanah tersebut kepada SPV.

(5) SPV akan mengembalikan *certificate* sukuk khazanah kepada obligor (Bank A) sebagai pemiliknya.

Secara amnya dibawah prinsip syariah, suatu kontrak adalah berbeza daripada janji. Setiap mereka mempunyai implikasi perundangan tersendiri. Dalam suatu kontrak, pihak-pihak yang terlibat ialah terikat kepada terma dan syarat daripada kontrak tersebut, dan mereka yang melanggar kontrak akan diwajibkan membayar pampasan. Sebaliknya, dalam sebuah janji, tidak ada ikatan yang mengikat pihak yang berjanji untuk memenuhi janjinya, oleh itu, tiada pampasan yang dikenakan ke atasnya jika ia melanggar janji. Dalam amalan kewangan Islam semasa, terdapat beberapa elemen janji, seperti perjanjian penjualan dan pembelian balik (SBBA). Oleh itu, suatu mekanisme janji dalam amalan mestilah diperiksa dengan teliti bagi mengelakkan adanya kemungkinan pelanggaran janji yang dilakukan oleh pihak yang berjanji yang akan mengakibatkan kerugian kepada pihak penerima janji.

Penggunaan janji atau *wa'd* dan sejauh mana orang yang berjanji atau ber-*wa'd* terikat dengan janjinya telah pun dibincangkan oleh para ulamak semenjak awal perkembangan fiqh Islam, juga oleh para ulamak di kurun-kurun pertengahan. Semenjak perkembangan institusi kewangan dan perbankan Islam di kurun kedua puluh masehi, isu penggunaan *wa'd* telah dibincangkan semula dengan lebih hangat lagi. Ianya telah dibincangkan secara serius di dalam beberapa perbincangan ulamak sama ada di peringkat dalaman sesebuah institusi kewangan Islam mahupun di peringkat antarabangsa. Ia telah menjadi salah satu agenda perbincangan dalam Muktamar al-Masrif al-Islami (konferen bank Islam) yang pertama di Dubai pada tahun 1979 dan yang kedua di Kuwait 1983. Kemudian ianya telah dibincangkan lagi secara khusus di persidangan Akademi Fiqh O.I.C yang kelima pada tahun 1988 dan di persidangan ke-17 pada 2006. Isu *wa'd* juga tidak ketinggalan untuk dibahaskan di dalam perbincangan-perbincangan Nadwah al-Barakah dan juga persidangan al-Majlis as-Shar'iy bagi badan piwaian Syariah antarabangsa AAIOFI. Penggunaan

wa'd menjadi begitu penting dalam banyak kontrak dan instrumen kewangan Islam semasa. Bahkan barangkali tidak keterlaluan jika dikatakan bahawa *wa'd* telah menjadi suatu '*device*' utama produk kewangan Islam semasa bagi menyaingi dan 'menyamai' produk kewangan konvensional. Persidangan yang banyak ini juga memberi gambaran kepada kita bahawa isu *wa'd* dan sejauh mana keterikatan seseorang dengan *wa'd*-nya adalah suatu isu yang masih belum begitu stabil dan selesai dari segi ijtihad fiqh semasa.

2.0 Permasalahan Kajian

Kajian kes ini bertujuan untuk mengkaji apakah status dan kesan perundangan keatas suatu janji *(wa'd)* dalam aplikasi instrumen *sell and buy back agreement* (SBBA), dimana *wa'd* ialah merupakan perkara penting yang menjadi penentu kejayaan dan keshahihan transaksi SBBA. Dalam kajian kes ini pengkaji hanya akan membahas mengenai SBBA secara umumnya dan melihat dari segi *wa'd* pada khususnya. Pendekatan kajian kes dilakukan dengan cara mengkaji pelaksanaan *wa'd* dalam transaksi SBBA.

3.0 Kajian Lepas

Secara umum "Sell Buy Back Agreement" (SBBA) di dalam instrumen perbankan Islam hampir sama dengan instrumen perbankan konvensional iaitu "Repurchase Agreement" (REPO) akan tetapi cara pelaksanaanya berdasarkan patuh syariah. Seperti yang diketahui bahawa dalam REPO di perbankan konvensional adalah satu perjanjian dimana penjual sekuriti menjual sekuriti kepada pembeli pada harga yang telah dipersetuji dan pembelian balik sekuriti daripada pembeli pada harga yang dinyatakan pada masa hadapan. Menurut Bacha (2007), SBBA adalah suatu instrumen di dalam pasaran wang Islam. Perjanjian dua hala dimana pejual dalam SBBA menjual aset kepada pembeli pada harga yang telah dipersetujui. Setelah itu, kedua-dua pihak terlibat di dalam perjanjian yang berasingan dimana pembeli berjanji untuk menjual semula aset tersebut kepada penjual pada harga yang telah dipersetujui.

Perkara utama yang membentuk SBBA ialah *Wa'd* (janji) bukanya kontrak. Kontrak ialah perkara yang mengikat pihak yang terlibat secara perundangan yang memenuhi

segala keperluan (Razali, 2008). Sedangkan *wa'd* adalah sesuatu istilah yang kerap berlaku dalam Al-Quran. Kata kerja *wa'ada* membawa maksud perjanjian tetapi boleh juga digunakan sebagai ugutan. Kata nama *wa'id* digunakan khusus untuk ugutan. Perkataan seperti dengannya ialah *aw 'ada* (ibn Faris Zakariyya,2001).

Perkataan *al-wa'd* dari segi bahasa dan istilah fuqaha' bermaksud "pernyataan oleh seseorang tentang sesuatu tindakan yang akan dilakukan pada masa hadapan yang ada kaitan dengan individu lain, tidak kira sama ada tindakan itu baik atau sebaliknya"(Hammad, 1995). Secara teknikalnya, *wa'd* tidak mempunyai definisi yang tertentu, akan tetapi dia boleh dijelaskan sebagai komitmen yang dibuat oleh seseorang kepada orang lain untuk menjalankan sesuatu tindakan tertentu atau tawaran melakukan sesuatu oleh seseorang yang bermanfaat untuk orang lain (Razali, 2008).

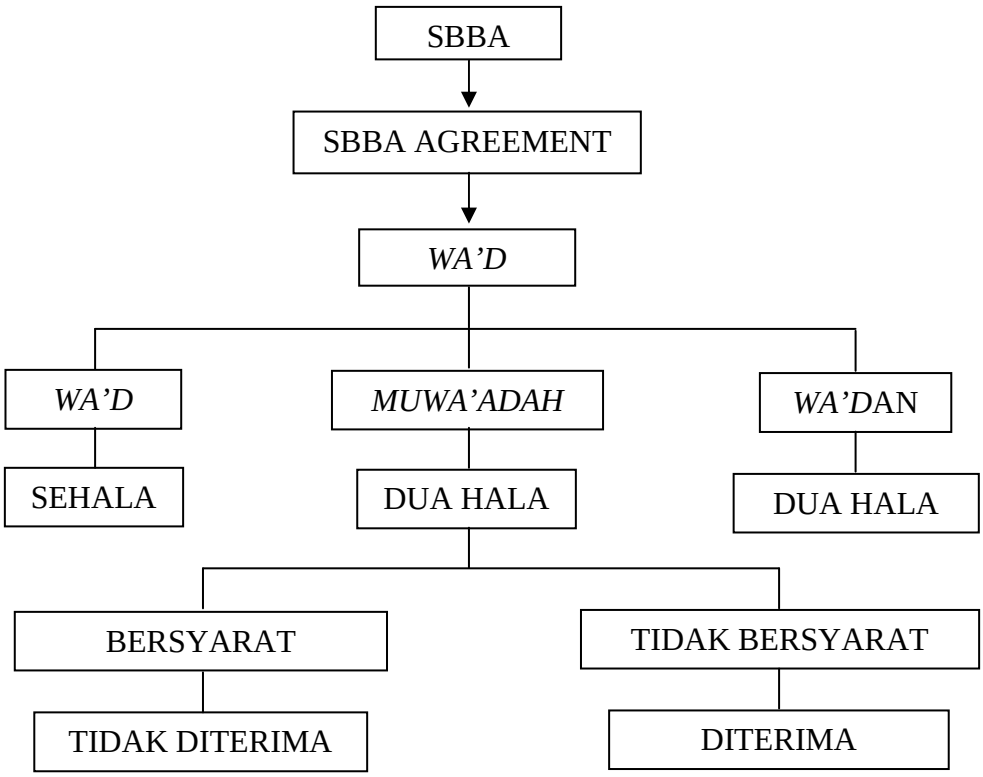
Menurut Imam Maliki jika janji tertentu terikat kepada sebab walaupun tanpa sebarang komitmen dari pihak lain, ini bermakna janji itu menjadi mengikat. Majoriti mahzab Maliki mengatakan bahawa janji mesti dipenuhi jika telah dibuat sebagai suatu alasan didalam kontrak. Sedangkan ada sebahagian dari mahzab Maliki tidak sependapat dengan pandangangan ini, Ibnu Qasim mengatakan bahawa keadaan bergantung kepada situasi yang diwujudkan dimana janji itu dipegang, dan pelaksanaanya menjadi suatu kewajiban (Razali, 2008).

Akademik Fiqh Islam Arab Saudi telah memutuskan bahawa konsep *wa'd* adalah wajib bukan sahaja di mata Tuhan, tetapi juga di mahkamah undang-undang" dan jika *wa'd* dibuat di dalam transaksi komersial dan janji satu pihak maka ini akan menyebabkan kerugian di pihak yang dijanjikan. Pihak yang dijanjikan (promisee) juga mempunyai hak untuk menuntut ganti rugi dari janji hutang jika terdapat pelanggaran dari *wa'd* tersebut.

Struktur *wa'd* berganda atau sering dikenal sebagai Muwadah telah digunakan dalam kontrak yang terdapat dalam konteks ekonomi Islam yang berasakan patuh syariah. *Muwa'adah* adalah janji dua hala dan boleh diterima dalam keadaan seperti Murabahah dengan syarat bahawa janji dua hala adalah sebagai pilihan sekurang-kurangnya oleh satu orang (Majallah Majma' al-Fiqh al-Islam, n.d). Jika janji dua

hala tidak menawarkan pilihan, maka ini tidak boleh diterima kerana janji dua hala yang mengikat di dalam Murabahah adalah sebanding dengan jualan yang biasa dimana ia memerlukan penjual dalam mengawal pejualan barangannya
(Y-Sing, 2009).

4.0 Rangka Kerja Teori : Wa'd dan Muwa'adah



Bagi menggantikan REPO konvensional, *Sell and Buy Back Agreement* (SBBA) merupakan transaksi pasaran wang secara Islam. Ia merupakan sebuah perjanjian dua hala di mana, penjual SBBA akan menjual asetnya kepada pembeli SBBA pada satu harga yang dipersetujui. Setelah itu, kedua-dua pihak akan terlibat dengan perjanjian yang berasingan di mana pembeli akan berjanji untuk menjual balik asset tersebut kepada penjual pada harga yang dipersetujui dan penjual akan berjanji untuk membelinya kembali (Bacha, 2008).

Justeru itu, dapat dilihat bahawa berlaku dua *wa'd* (perjanjian) dalam transaksi jual dan beli balik aset. Iaitu *wa'd* si pembeli untuk menjual balik dan *wa'd* penjual untuk membeli balik asset. Menurut (Nurdianawati 2010), dalam transaksi komersial, sebuah *wa'd* (perjanjian) membawa dua konotasi; tawaran daripada penawaran

disebut sebagai janji, dan penerimaan oleh pihak yang ditawar juga merupakan sebuah lagi janji.

Dalam aplikasi *muwa'adah*, iaitu perjanjian dua hala yang melibatkan dua pihak, sekurang-kurangnya satu pihak mempunyai pilihan untuk meneruskan janji itu atau tidak (Majallah Majma' al-Fiqh al-Islami, n.d). Sekiranya pilihan tidak diberikan, perjanjian yang mengikat kedua-dua pihak itu akan membentuk kontrak jualan yang memaksa penjual untuk menjual aset dan hal ini adalah tidak dibenarkan (Ismail Wisham, 2011). *Al-wa'dan* ialah dua janji yang diberikan secara unilateral *(two unilateral pomises)* oleh satu pihak kepada pihak yang lain, dan begitu juga sebaliknya, dan dua janji ini tidak saling berkaitan dan perlaksanaanya adalah bergantung kepada dua syarat *(conditions)* yang berbeza (Aznan Hasan, 2008).

Kedudukan sama ada sebuah perjanjian itu mengikat atau tidak mengikat merupakan persoalan yang utama dalam membincangkan kesan perundangan *wa'd.* Makna 'mengikat' (*binding*) dalam konteks perjanjian ialah, tertakluk dan boleh dikuatkuasakan sama ada dalam aspek syariah ataupun perundangan. Dalam kes *wa'd*, isu 'mengikat terbahagi kepada dua iaitu mengikat sebelah pihak sahaja atau mengikat kedua-dua pihak.

Maka, timbul beberapa persoalan yang menjadi pokok perbincangan kes ini :

- Apakah jenis perjanjian *(wa'd)* yang sesuai digunakan dalam aplikasi SBBA? Adakah ia nya *wa'd* biasa atau *muwa'adah*?
- Adakah *muwa'adah* dalam SBBA ini mengikat atau tidak mengikat dalam kesan perundangan?
- Apakah terdapat syarat yang diletak dalam SBBA, memandangkan *muwa'adah* yang dibenarkan ialah *muwa'adah* tanpa syarat,

5.0 Metodologi Kajian

Kajian deskriptif adalah suatu bentuk penelitian untuk mendeskripsikan kejadian-kejadian yang ada, samaada kejadian alamiah mahupun kejadian buatan manusia. Kejadian tersebut dapat berupa bentuk, aktivitas, karakteristik, perubahan, hubungan,

kesamaan, dan perbedaan antara kejadian yang satu dengan yang lain (Sukmadinata,2006:72). Kajian deskriptif merupakan suatu kajian yang berusaha mendeskripsikan dan menafsirkan sesuatu, misalnya pandangan yang berkembang, proses yang sedang berlaku, akibat atau impak yang terjadi, atau mengenai kecendrungan yang sedang terjadi. Kajian deskriptif menekankan kepada aspek siapa, apa, bila, dimana, dan bagaimana dalam sesuatu perkara. Fuchan (2004:447) menjelaskan bahawa kajian deskriptif adalah kajian yang dibina untuk memperoleh informasi tentang status suatu kejadian saat kajian dilakukan. Menurut Malhotra (2002), terdapat dua sub kategori dalam kajian deskriptif iaitu kaedah *cross-sectional* dan *longitudinal.* Dalam kajian ini, pengkaji menggunakan kaedah *cross-sectional* dimana pengumpulan data dilakukan sekali sahaja kerana ianya lebih mudah dijalankan serta melibatkan kos yang murah berbanding dengan kaedah *longitudinal.* Data kajian ini diperolehi daripada buku-buku, jurnal-jurnal, mahupun maklumat terkini yang berkaitan dengan tajuk penyelidikan. Dalam melakukan pengumpulan data, deskripsi, analisis dan hasil akhir kajian akan ditampilkan dalam bentuk uraian kata-kata dan tidak dalam bentuk angka. Oleh itu, kaedah kajian yang digunakan oleh pengkaji adalah kaedah deskriptif kualitatif.

6.0 Penemuan

Apakah jenis perjanjian *(wa'd)* yang sesuai digunakan dalam aplikasi SBBA? Adakah ia nya *wa'd* biasa atau *muwa'adah*?

SBBA adalah Perjanjian dua hala yang terdiri daripada dua perjanjian yang berasingan yang disepakati oleh kedua-kedua pihak yang bertransaksi SBBA. Perjanjian pertama ialah penjual berjanji untuk menjual aset kepada pembeli pada harga yang telah dipersetujui manakala perjanjian kedua pula ialah perjanjian dimana pembeli berjanji untuk menjual semula aset tersebut kepada penjual pada masa yang hadapan yang telah disepakati dan pada harga yang dipersetujui. Definasi SBBA tersebut telah jelas menunjukkan bahawa transaksi SBBA melibatkan perjanjian dua hala yang berasingan. Merujuk kepada definisi *muwa'adah* yang ditulis oleh Dr. Aznan Hasan dalam Muzakarah Cendikiawan Syariah Nusantara 2008 ialah, dua janji yang diberi secara **timbalbalik *(bilateral)*** oleh dua pihak, satu kepada yang lain, sama ada janji tersebut dibuat secara bersyarat atau tidak. Manakala definisi *wa'*d pula ialah Suatu janji secara **sahala *(unilateral)*** yang diberikan oleh satu pihak

kepada suatu pihak yang lain untuk melakukan sesuatu perkara, seperti janji untuk menjual atau membeli. Berdasarkan definisi tersebut, maka disimpulkan bahawa perjanjian yang digunakan dalam melaksanakan transaksi SBBA ialah merupakan perjanjian dua hala atau timbalbalik *(muwa'adah)*, bukan *wa'd* biasa.

Adakah *muwa'adah* dalam SBBA ini mengikat atau tidak mengikat dalam kesan perundangan?

Janji boleh digambarkan sebagai sejenis kehidupan komunikasi yang boleh digunakan setiap hari samaada dalam fungsi formal mahupun tidak formal. Ia bergantung kepada penggunaan janji itu sendiri samaada sebagai elemen dalam komunikasi perundangan dalam tempoh kontrak tertentu atau sekadar perbualan biasa. Konteks penggunaannya adalah penting untuk menentukan status janji atau samaada beberapa keterikatan perundangan perlu dikenakan ke atasnya atau tidak. Janji adalah bukan sekadar menyatakan kebenaran niat baik pihak yang berkontrak, tetapi juga untuk menjaga pihak tersebut daripada berubah fikiran. Malah, kontrak terbentuk dengan janji-janji apabila kedua-dua pihak memberiikan cadangan mereka dan yang lain menerima dalam tetapan kontrak yang sama. Seksyen 2 akta kontrak 1950 menyatakan :

> Apabila orang yang menerima cadangan itu menunjukkan perkenannya keatas cadangan tersebut, maka berarti bahawa cadangan itu disetujui, ketika cadangan tersebut disetujui maka ia akan berubah menjadi janji.

Jika salah seorang daripada pihak-pihak tersebut melanggar janji itu, pihak yang tidak bersalah boleh membawa guaman pihak lain kerana janji boleh dikuatkuasakan di mahkamah undang-undang. Peraturan ini dikenali sebagai diktrin pertimbangan, dimana undang-undang tidak akan menguatkuasakan janji satu hala, tetapi menjanjikan ditukar dengan sesuatu yang mempunyai nilai untuk menjadi sah di sisi undang-undang kontrak (Gamage dan Kedem, 2006). Pelanggaran janji dalam kontrak bermakna bahawa pihak yang berjanji tidak melaksanakan kewajipannya seperti yang dijanjikan kepada pihak lain. Dalam undang-undang biasa, jika salah satu pihak enggan melaksanakan janjinya, pihak lain yang berkontrak mempunyai hak untuk menamatkan kontrak tersebut. Seperti yang dinyatakan dalam seksyen 40 Akta Kontrak 1950 :

> Apabila salah satu pihak dalam kontrak telah enggan untuk melaksanakan, atau kurang upaya sendiri daripada melaksanakan janji secara sepenuhnya, maka janji tersebut boleh menamatkan kontrak, melainkan jika pihak tersebut telan menandakan dengan perkataan atau perlakuan mengenai persetujuannya untuk meneruskan kontrak.

Disamping itu, mana-mana janji yang terkandung di dalam kontrak mestilah dilaksanakan oleh pihak-pihak yang berjanji. Tetapi dalam sebahagian kes, pihak yang berjanji juga boleh mengambil seseorang yang kompeten untuk melaksanakan janji tersebut. Namun, jika janji tersebut dilanggar dibawah keadaan tertentu, hanya pihak-pihak yang berkontrak seperti pihak yang berjanji dan yang menerima janji boleh mendakwa atau didakwa. Janji yang terjadi diantara pihak penerima janji dengan pihak ketiga adalah tidak dapat dikuatkuasakan di mahkamah undang-undang. Seperti yang dinyatakan pada seksyen 42 Akta Kontrak 1950 :

> Apabila pihak penerima janji menerima prestasi janji daripada pihak ketiga, dia tidak boleh selepas itu menguatkuasakan terhadap pihak yang berjanji tersebut. Oleh itu, jika salah satu pihak melanggar janji yang mengandungi dalam kontrakm kontrak ini adalah dikuatkuasakan di mahkamah undang-undang untuk melindungi kepentingan pihak yang tidak bersalah, melainkan jika pihak yang tidak bersalah memberii persetujuan untuk meneruskan kontrak.

Berdasarkan praktis dalam sistem perbankan Islam, sebuah janji biasanya mengikat kedua-dua pihak kerana beberapa sebab:

- Pertama, sistem perbankan ialah sistem yang dipantau secara sistematik. Maka, setiap janji yang dimungkiri akan memberii kesan buruk kepada reputasi institusi kewangan yang terlibat.
- Kedua, semua transaksi secara normalnya disokong oleh dokumen yang lengkap seperti sistem perkomputeran atas talian untuk mengurangkan kesilapan yang akan membawa kepada salah faham.

- Ketiga, transaksi perbankan melibatkan harta atau wang yang berjumlah besar. Maka, adalah tidak sempurna sebuah transaksi besar dibuat atas perjanjian yang tidak mengikat.
- Keempat, perjanjian yang dimungkiri dalam transaksi perbankan melibat kerugian material ke atas pihak yang menerima janji.(M.Nor Adila, 2010)

Pendapat yang mengatakan *muwa'adah* adalah mengikat (*mulzim)*:

> "Muwaadah pada asalnya adalah mulzim bagi kedua-dua pihak dari segi agama, dan tidak mulzim secara perundangannya (qadhaan), walau bagaimanapun jika ada keperluan umum (hajah ammah) bolehlah muwaadah dijadikan mulzim secara undang-undang atau secara uruf industri antarabangsa."
> (Resolusi Akedemi Fiqh Antarabangsa 2006)

> "Memutuskan bahawa muwaadah (janji dari kedua-dua pihak) adalah mulzim bagi setiap pihak yang berkenaan dan boleh dikuatkuasakan oleh mahkamah jika ada maslahah."
> (Muktamar Perbankan Islam pertama di Dubai 1979)

> "…bahawa janji itu adalah lebih baik jika sekiranya dalam keadaan mulzim sama ada bagi satu pihak atau kedua-dua pihak. Walau bagaimanapun keputusan terakhir adalah terpulang kepada penasihat syariah setiap bank itu sendiri."
> (Muktamar Perbankan Islam yang kedua 1983)

Pendapat yang mengatakan *muwa'adah* tidak mengikat:

"Konsep *wa'd* adalah mulzim jika dilakukan oleh satu pihak, walau bagaimanapun muwaadah yang mulzim dari dua pihak adalah tidak dibenarkan. Contohnya dalam Piawai (1) tentang perniagaan mata wang no.2/9/a, Piawai (5) tentang jaminan no. 7/8/2, Piawai (8) tentang Murabahah no 2/3/1 dan 2/3/3, Piawai (9) tentang Ijarah no 8/1 dan 8/2, Piawai (12) tentang Syirkah

no 3/1/6/2, no5/1,no5/7, Piawai (20) tentang jual beli komoditi di pasaran tersusun no 5/2/3/2." (Piawaian AAIOFI)

Muwa'adah dalam SBBA ialah *muwa'adah* yang mengikat *(binding)*, ianya juga dibuktikan dengan remedi yang ditetapkan dalam *Guidance Notes on Sell and Buy Back Agreement* pada klausa 15 oleh Bank Negara Malaysia yang menyatakan bahawa sekiranya berlaku kemungkiran atau tidak memenuhi janji dalam transaksi SBBA, maka pihak yang menderita kehilangan atau kerugian dapat menuntut pampasan daripada pihak yang ingkar. Pada tempoh matang, pihak penjual SBBA berhak untuk menuntut pampasan bagi kerugian yang ditanggung yang timbul daripada kelalaian pihak pembeli dalam memenuhi janjinya, dan begitu pula sebaliknya.

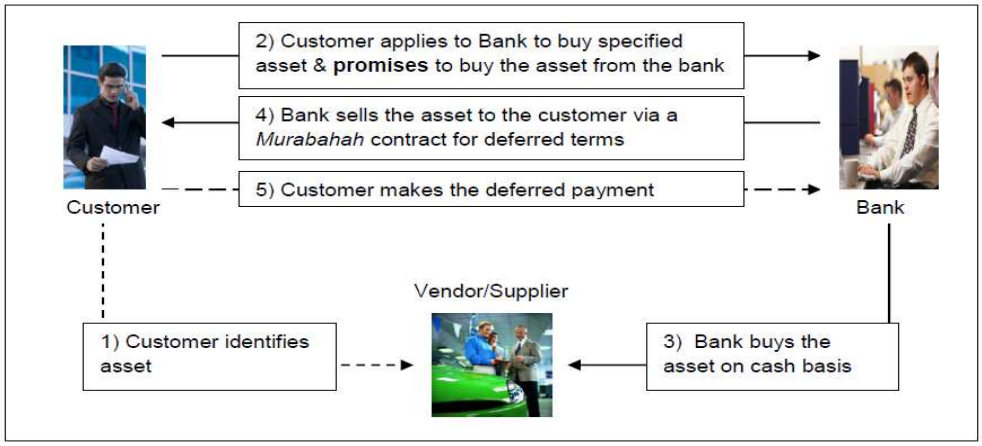
Sebuah janji mutlak yang tidak tertakluk kepada sebab-sebab tertentu dan tidak memberi kesan kerugian kepada pihak lain. Tidak sah disisi undang-undang. Suatu janji menjadi mengikat dan boleh dikuatkuasakan kerana ia boleh menjejaskan kepentingan pihak lain yang mungkin menanggung kerugian jika janji itu tidak dipenuhi. Janji untuk membeli barang-barang yang mulanya telah dipesan oleh pihak yang berjanji kepada pihak penerima janji, akan menjadi mengikat dan boleh dikuatkuasakan dalam mengelakkan *gharar* (unsur yang tidak diketahui) dalam perkara-perkara janji. Janji dua hala *(muwa'adah)* disifatkan dibenarkan hanya jika terdapat pilihan untuk membatalkan janji yang boleh dijalankan oleh mana-mana pihak. *Wa'd* memiliki implikasi langsung dalam menentukan kepatuhan syariah khususnya untuk produk perbankan Islam. Kedua-dua pihak mesti memahami sifat dan akibat daripada pelanggaran. Hak pihak penerima janji akan dilindungi dengan baik dalam kedua-dua undang-undang syariah dan sivil, dan juga dikuatkuasakan di mahkamah undang-undang.

Berdasarkan kajian, pendapat dan resolusi yang dinyatakan di atas, pendapat yang menyatakan bahawa *muwa'adah* adalah mengikat (*mulzim)* adalah lebih kuat. Hal ini kerana, janji yang dibuat akan memberii kesan kepada kedua-dua pihak, merangkumi implikasi reputasi, dan kerugian material. Secara perundangan, perjanjian dua hala ini adalah mengikat bagi menjaga hak semua pihak. Maka, sekiranya berlaku perlanggaran janji, kes tersebut boleh dibicarakan secara adil di mahkamah.

Dalam kes *Sell and Buy Back Agreement* (SBBA), perjanjian yang dibuat juga merupakan perjanjian dua hala (*muwa'adah)* menurut Bacha (2008). Justeru itu, *wa'd* yang diletak oleh penjual sekuriti untuk membeli balik dan *wa'd* yang diberikan oleh pembeli untuk menjual kembali sekuriti tersebut adalah mengikat kedua-dua pihak dalam erti kata lain, adalah *mulzim.*

Apakah terdapat syarat yang diletak dalam SBBA? Memandangkan *muwa'adah* yang dibenarkan ialah *muwa'adah* tanpa syarat.

Kemestian untuk melaksanakan *muwa'adah* ialah perjanjian tersebut mestilah memberikan pilihan untuk mana-mana pihak membatalkan perjanjian yang dibuat. Bagi melihat aplikasi *muwa'adah*, transaksi *Murabahah* boleh dijadikan perbandingan. Di dalam kontrak *Murabahah*, perjanjian dua hala yang mengikat dibandingkan dengan jualan normal di mana, penjual memiliki pemilikan ke atas barang yang telah dijual.



Sumber: Nurdianawati (2008)

Rajah : Operasi Murabahah Jualan utuk Tempahan Belian

Berdasarkah Rajah, *muwa'adah* dapat dilihat dalam transaksi kedua dimana pelanggan memohon Bank untuk membeli asset tertentu dan berjanji untuk membelinya daripada bank. Institusi perbankan yang terlibat akan menyediakan dokumen yang menyatakan perjanjian pelanggan untuk membeli asset tersebut kelak. Walaubagaimana pun, bagi memastikan transaksi tersebut sah secara syariah, beberapa peraturan telah diletakkan di dalam dokumen perjanjian tersebut:

a) Dokumen perjanjian untuk membeli yang ditandatangani oleh pelanggan mestilah tidak melibatkan perjajian dua hala yang mengikat kedua-dua pihak.[2]
b) Perjanjian pelanggan untuk membeli dan perjanjian-perjanjian lain yang mengikat tidak dilibatkan dalam transaksi murabahah. Perjanjian tersebut hanya menjadi jaminan bahawa pelanggan akan membeli asset yang dikehendakai daripada institusi perbankan.[3]
c) Perjanjian dua hala antara kedua-dua pihak hanya dibenarkan jika terdapat pilihan untuk mana-mana pihak membatalkan janji.[4]
d) Kedua-dua pihak perlu saling bersetuju untuk meneliti terma perjanjian dalam konteks bayaran secara tangguh,tambahan untung, dan lain-lain pada bila-bila masa sebelum perlaksanaan transaksi murabahah.[5]

Berdasarkan keempat-empat peraturan yang ditetapkan oleh Majlis Penasihat Syariah terhadap transaksi Murabahah tersebut, peraturan ketiga amat menarik perhatian untuk dibandingkan dengan *muwa'adah* dalam SBBA. Syarat itu menyebut bahawa perjanjian dua hala antara kedua-dua pihak hanya dibenarkan jika terdapat pilihan untuk mana-mana pihak membatalkan janji. Justeru itu, aplikasi *muwa'adah* dalam *murabahah* diambil sebagai *ilah* bagi aplikasi *muwa'adah* dalam SBBA.

Mana-mana pihak dalam *Sell and Buyback Agreement* (SBBA) yang melanggar perjanjian akan dikenakan penalti sebagai ganti rugi. Maka, ganti rugi ini merupakan denda kerana tidak menepati janji. Justeru itu, kajian kes ini mempersoal penalti yang akan dikenakan sama ada merupakan sebuah pilihan atau sebuah syarat. Dalam transaksi SBBA, pihak pembeli secara tidak langsung membuat perjanjian untuk menjual kembali sekuriti yang dibeli. Sekiranya dalam tempoh matang pihak pembeli tidak mahu menjual kembali, dan mahu membatalkan janjinya untuk menjual sekuriti tersebut, keputusannya haruslah dihormati. Tambahan pula ia telah memiliki pemilikan terhadap sekuriti tersebut. Namun, dalam implimentasi SBBA kini,

[2] Item 2/3/1 of the Shari‟ah standards No. (8), 2008

[3] Item 2/3/2 of the Shari‟ah standards No. (8), 2008

[4] Item 2/3/3 of the Shari‟ah standards No. (8), 2008

[5] Item 2/3/4 of the Shari‟ah standards No. (8), 2008

kegagalan pihak pembeli untuk menjual balik dilihat sebagai pengkhianatan dan denda dalam bentuk penalti dikenakan ke atasnya. Bertitik tolak daripada denda penalti tersebut, dapat dirumuskan bahawa *muwa'adah* dalam SBBA adalah bersyarat. Ini kerana, penalti itu ditafsirkan sebagai ugutan bahawa pihak pembeli tidak mempunyai pilihan selain menjual kembali sekuriti tersebut.

Seperti yang telah dijelaskan sebelumnya, bahawa SBBA ialah merupakan instrumen yang sama dengan REPO, namun berbeza daripada asas kepatuhan terhadap syariah. Repo dari sudut pandang konvensional dapat diartikan sebagai suatu perjanjian dimana salah satu pihak menjual suatu sekuriti atau aset lainnya kepada pihak lain, dan kemudian berjanji untum membeli semula aset atau sekuriti yang sama dari pihak tersebut pada masa hadapan yang disepakati dan pada harga pembelian semula yang sama dengan harga jual nya ditambah dengan pulangan yang diperolehi selama masa repo. Beberapa perkara yang terjadi dalam proses transaksi repo ialah :

- Pihak penjual akan memperoleh dana daripada penjualan asetnya
- Pihak pembeli akan mendapatkan hak perundangan keatas aset yang diterimanya setelah ia melakukan pembayaran.
- Pihak pembeli memegang aset tersebut sebagai cagaran
- Apabila pihak penjual mungkir keatas pembelian aset semula, maka pihak pembeli boleh mencairkan aset tersebut untuk memulihkan sebahagian atau keseluruhan jumlah daripada wang tunai
- Disamping itu kerana pihak pembeli memiliki aset cagaran, pihak pembeli boleh menggunakan semula aset tersebut semasa tempoh repo dengan menjual aset tersebut, menawarkan repo kepada pihak ketiga, atau mencagarkan nya kepada pihak ketiga.
- Pihak pembeli mestilah membeli semula aset tersebut pada tempoh tamat repo, agar dapat menjual semula aset tersebut kepada pihak penjual.

Justeru itu berdasarkan maklumat diatas, dapat dilihat bahawa repo konvensional bersifat tidak amanah dan hanya mendahulukan kepentingan satu pihak sahaja. Hal inilah yang mewujudkan krisis *subprime* sehingga mengakibatkan krisi ekonomi global pada 2007. Pinjaman atas pinjaman yang diberikan mengakibatkan timbulnya

ekonomi yang rapuh yang disebut sebagai *bubble economy*. Pinjaman *subprime* atau gadai janji adalah berisiko untuk kedua-dua pemberi hutang dan penerima hutang kerana kombinasi kadar bunga yang tinggi, sejarah kredit yang buruk, dan kekeruhan situasi kewangan yang sering dikaitkan dengan pemohon *subprime* (Karmila, 2010).

Dalam konteks SBBA pula, aplikasi *muwa'adah* yang digunakan ialah untuk menjaga kepentingan kedua-dua pihak yang terlibat. Jika dibandingkan dengan repo, penggunaan *muwa'adah* dalam SBBA adalah penting untuk menjamin sekuriti yang digunakan dapat kembali semula kepada pemilik asal dan mengurangkan kemungkinan terjadinya kegagalan *(default)*.

7.0 Kesimpulan

Kajian kes ini cuba menjelaskan asas *wa'd* yang digunakan dalam transaksi SBBA dengan mengenalpasti apakah status dan kesan perundangannya. Berdasarkan kajian-kajian lepas mengenai *wa'd* dan SBBA, keputusan kajian cuba untuk menjawab tiga persoalan yang timbul. Persoalan pertama, Apakah jenis perjanjian *(wa'd)* yang sesuai digunakan dalam aplikasi SBBA, adakah ia nya *wa'd* biasa atau *muwa'adah*? Persoalan Kedua, adakah *muwa'adah* dalam SBBA mengikat atau tidak mengikat dalam kesan perundangan. Persoalan ketiga, apakah terdapat syarat yang diletak dalam SBBA, memandangkan *muwa'adah* yang dibenarkan ialah *muwa'adah* tanpa syarat. Berdasarkan soalan pertama, keputusan kajian ialah bahawa perjanjian *(wa'd)* yang sesuai digunakan dalam aplikasi SBBA ialah *muwa'adah*. Keputusan kajian untuk soalan kedua pula menyatakan bahawa *muwa'adah* yang digunakan dalam SBBA ialah *muwa'adah* yang mengikat. Manakala keputusan kajian untuk soalan ketiga menyatakan bahawa terdapat syarat dalam *muwa'adah* yang diaplikasikan dalam SBBA. Kajian kes ini juga dapat memberi gambaran bahawa SBBA lebih baik daripada REPO dengan adanya penggunaan *muwa'adah*. Hal ini kerana, *muwa'adah* yang digunakan dalam SBBA sangat menjaga aspek moral kedua-dua pihak berbanding REPO. Menurut kami, kajian lanjut perlu dibuat, kerana memandangkan masih ada beberapa persoalan lagi yang belum terjawab berkaitan dengan SBBA, seperti :

1. Daripada *muwa'adah* yang digunakan tersebut, apakah manfaat ekonomi dari segi kedua-dua pihak?

2. Apakah *muwa'adah* akan berbeza jika aset sandaran yang digunakan berteraskan hutang dan bukan hutang?

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BANKING EFFICIENCY, MARKET DISCIPLINE PRESSURE AND MACROECONOMIC EXPOSURE: AN ANALYSIS OF BANKING SECTOR OF PAKISTAN

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Abstract

The purpose of this study is to determine the relative importance of the factors affecting the banking efficiency. We have investigated the impact of market & other discipline variables and macroeconomic factors, like exchange rate exposure and GDP (Gross domestic product) on the cost efficiency of banks. The results of cost efficiency have shown that foreign banks are more efficient vis-à-vis local banks. The market discipline variable has positive impact on the cost efficiency of the banks. In other discipline variables, ROA is positively impacting which implies that banks are more cost efficient with large value of ROA. The exchange rate exposure is negatively affecting the cost efficiency. The impact of GDP is positive and statistically significant. Overall economic development of the country positively affects the cost efficiency of the banks.

Keywords: Banking Efficiency, Market Discipline Pressure, Banking Sector of Pakistan, GDP, Exchange rate exposure

1.0 Introduction

Efficiency of commercial banks is issue of prime importance for academicians and practitioners. The commercial banks are essential for economic stability of country by playing a vital role for public and private sector as economic growth can be achieved by utilizing the existing resources of the banks in appropriate and efficient way. Policy makers implement their financial policies like, monetary policy through banks. Commercial banks also provide loans to governments for the economic development of the country and also help in the industrialization of the country by providing loans to the corporate sector and SMEs. Actually banks provide links from surplus units to deficit units of the economy with efficient cost.

Efficiency of commercial banks is actually the relationship of different combinations of outputs and inputs of the banks to achieve optimum level. The optimum level can be achieved under the objective of inputs minimization, while producing the same level of outputs and outputs maximization with same level of inputs.Efficiency of commercial banks is alsoa measure for evaluation of internal performance.For policy makers, the efficiency is necessarily important because banks provide base for macroeconomic stability.

Efficiency of commercial banks is a comparative term that the efficiency for particular year may be compared with another year. Efficiency of banking sector also creates a signal for all stake holders, like depositors, market investors, policymakers, tax authorities, corporate sector, financial analysts and the academic researchers for whom the performance and efficiency of banking sector is of key importance. The measurement of efficiency provides help to depositors in their decision making about their savings. While for policymakers, these measurements are necessary so as to take remedial measures to overcome any distress in the economy.The previous literature discussed these two important stake holders as discipline pressure for the management of banks as their efficiency is witnessed and corresponding action will take place according by customers. The depositor pressure is also called market discipline as discussed by Ushida and Satake (2009).

Moreover, Isik and Hassan (2002) declared that the low recovery of efficiency of Turkish banks. The authors attributed this inefficiency to unstable operated conditions for banks in Turkey, instability of macroeconomic and financial system under which these banks are operated. These studies however discover the new domain of research in the area of banking efficiency, that the macroeconomic indicators like gross domestic product, inflation exchange rate exposure, foreign direct investment etc. are also significant for the efficiency of banks. Researchers might investigate the effect of macroeconomic variables to ascertain the efficiency of the banks, as unstable macroeconomic and political situations cause inefficiency for banks. Arguably, among the macroeconomic variables previous literature cover the impact of interest rate change frequently but the impact of

GDP and Exchange rate exposure is not evidenced. This study is attempting to locate deterministic role of GDP and Exchange rate for banking efficiency.

The purpose of this study is to robust and locate the deterministic importance of factors affecting the banking efficiency. To show more insight, the cost efficiency of conventional foreign banks has been compared with conventional local banks. We have determined the impact ofmarket discipline & other discipline variables and macroeconomic factors, like exchange rate exposure and Gross domestic product GDP on the cost efficiency of banks.

The rest of the paper is divided into four sections. Section one discusses the prologue of the research. Section twois covering the literature review of previous studies. Third section is discussing the methodology of the research and the underlying models. Lastly, section four consists of result and discussion.

2.0 Literature Review

The results and findings from previous literature have been discussed in this section and try to identify the gaps and novelties in estimating methodologies and explanatory theories.

The stream of the literature showed that early models of banking efficiency had the focus on developed economies especially on United States and Europe; major contribution was made by many studies like Ferrier and Lovell(1990); Berger and Humphrey(1991). Sufficient literature regarding banking cost efficiency exists in recent years for developing countries most prominent studies with respect to developing countries conducted by Berger and Humphrey (1997) and Bikkerand Haaf (2003). In fact, increasing trends of globalization, trade liberalization and integration of financial markets diverts the attention of the researchers towards exploration of banking efficiency in developing and emerging economies around the globe.

Mainly two distinct estimation techniques i.e. stochastic frontier and Data Envelopment Analysis (DEA) have been employed to assess the banking efficiency for many years. And two types of efficiency remain under the focus of researchers the first one called "technical efficiency" while the other termed as "economic efficiency". The earliest term "technical efficiency" is considered a component of latter term "economic efficiency" and identified it as a broader term as compared to technical efficiency.

The technical and allocative efficiencies are the two parts of cost efficiency. Technical efficiency means the ability of firm (bank in this case) to produce more output with a given level of input, this is called technical efficiency by output side. By technical efficiency input side means to produce the same level of output with less input (Farell, 1957). More technically, if a firm produces one unit of output with the same level of input or it can produce the same level of output by marginally decreasing in input can be called technically efficient firm. Allocative efficiency measures the best optimal level to which input is used at best proportion (Farell, 1957).

The banking industry is an imperative part of the financial system in any country. Hence, the evaluation of its efficiency is significantly important (Sathye, 2005). Various researchers empirically found, criticize and support each other's findings based on scale and scope efficiency. Berger and Humphrey (1991) argued that in banking industry X-efficiency is more important than scale and scope efficiency. X- Efficiency means that "cost of producing observed output if both technical and allocative efficiencies are assumed relative to observed cost". Moreover, In particular, cost efficiency is very imperative for evaluation of banks efficiency. Cost efficiency refers that how much a particular firm or bank minimizes its cost for producing the same level of output under same conditions that are produced by best practices firm in the sample and analyze that how much its cost is close with respect of best practice firm (Ariff & Can, 2008). In this regard cost efficiency provides estimation to the banks that what will be minimum cost for producing the same amount of outputs (Hassan et al., 2009).

Measuring banking efficiency in developing and emerging countries was not an easy task as to estimate the efficiency of banks in developed and industrialized countries. Economic and political instability and rapid reforms in developing and emerging countries made a difficult and challenging task for researchers to measure the banking efficiency. Likewise, Ikhide (2000) argued on the basis of findings from measuring the efficiency of Namibian banks with the former postulating that the Namibian banks are not efficient. Haoet al. (2001) investigated the efficiency of Korean banks and has the opinion on the basis of their findings that the financial liberalization reforms of 1991did not spur improved cost efficiency in Korean banking industry. And the better performance was associated to assets growth and low expense ratios.

Moreover, Isik and Hassan (2002) make an attempt to measure the efficiency of Turkish banks and concluded that all the Turkish banks are characterized by low recovery of efficiency. The authors attributed this inefficiency to unstable operated conditions for banks in Turkey, instability of macroeconomic and financial system under which these banks are operated. These studies however discover the new domain of research in the area of banking efficiency, that the macroeconomic indicators like gross domestic product, inflation, foreign direct investment etc. are also significant for the efficiency of banks. Researchers might investigate the effect of macroeconomic variables to ascertain the efficiency of the banks. As unstable macroeconomic and political situations cause inefficiency for banks reported by the researchers.

Gruben and McComb (2003) discussed and reported that uncertain and unstable macroeconomic environment conditions had impacted the banking efficiency. Moreover, the value of financial institutions is affected by unforeseen fluctuations in exchange rate. Like many enterprises, banking institutions are also exposed to exchange rate fluctuations. Exchange rate movements influence the overall performance efficiency of banks through foreign exchange transactions and other banking operations. The banks suffer from exchange rate risk even though they are not involved in these activities in terms of foreign competition, demand of the loan and other banking prevailing conditions. Previous studies suggest that exchange rates are deemed to be vital source of

volatility for banks and multinationals and accounts for four times more volatile than interest rate and ten times as inflation so the exchange rate exposure is important among the macroeconomic variables. Previous literature had not highlighted the impact of Exchange rate exposure on banking cost efficiency for developing countries.

Efficiency of public sector banks and domestic & foreign private banks also remain a debatable issue and to date inconclusive with the wide range of gaps and differences in estimation and empirical findings. Some researchers have the view that public sector banks are more efficient while a large number of studies are in support of the efficiency of domestic private and foreign banks. Ataullah, Cockerel, and Le, (2004); Shanmugan and Das, (2004) declared on the grounds of their findings of the study conducted on Indian domestic and public sector banks, that the public sector banks in India are more efficient than domestic and foreign private banks. Higher efficiency of public sector banks might be due to strong and strict rules and regulation and their infrastructure of implementation in the country. Discussed earlier that some views in support of higher efficiency of private sector banks than public sector banks are also found in the literature, the findings of diPatti and Hardy (2005) suggested that efficiency of banks in post period of privatization is higher, and for the passage of time efficiency of privatized banks decreased after privatization.

Effect of disciplinary pressure by market investors and depositors on bank management to improve the efficiency of bank added a new direction in the literature particularly in previous decade. Fueda and Konishi(2007) pointed out that depositor's response to various risk measure taken by the banks under the different type of insurances. They found a significant depositors decline in full insurance coverage period than in during the limited insurance coverage and the deposit withdrawals induces the bank mangers towards aggressive restructuring. Further, they also examine that magnitude of decline of the depositors is affected by degree of public confidence on financial system and extent of enforcement of regulation by central bank. In the same year, Spiegel and Yamori (2007) examined the determinants of regional Japanese banks pricing to market decisions and their impact on the intensity of the depositor discipline. They found significant

evidences of depositor discipline among banks that elected to price to market, also concluded that depositor discipline was more intense for the subset of banks that adopted market price accounting.

Uchida and Satake (2009) using the data of post banking crises period for Japan declared that the banks which have more outstanding deposits are more cost-efficient, and some effect on profit efficiency is also found. They concluded that depositors, the primary source of funds for banks have an influence on disciplining bank management in efficient use of inputs. In banking sector, there are defined rules and regulations from the controlling authority i.e. Central bank and in the presence of defined regulations, need for intervention and governance from other stakeholders reduces. The findings of this study are consistent with those in earlier studies that stress the importance of depositors in the market discipline mechanism in Japan. Due to complex banking systems and risk management practices regulators in recent years have begun to concentrate on market discipline. However, for Pakistan this research remains thin and inconclusive as for as the market discipline and macroeconomic variables are concerned. Consequently, this study is attempting to locate deterministic role of market discipline with GDP and Exchange rate as vital macroeconomic factors for banking efficiency.

3.0 Methodology

3.1 Sample

We used the annual balance sheet and income statement data. The data for all banks was taken from annual balance sheets, published by State Bank of Pakistan. The sample time period is ranged from Jan, 2001 to Jan, 2008. REER and GDP were also taken from database of state bank of Pakistan about macroeconomic variables. The data comprised of unbalanced cross sectional panel data. We have taken following variables of our research interest.

DEPOSITR: ratio of deposits outstanding to total assets,

ROA: Return on assets

MARGIN: interest margin = (loan interest income/loans outstanding) – (deposit interest expenses/deposits outstanding),

LOANDEPR: (loans outstanding)/(deposits outstanding)

BANKSIZE: log(assets)

SUBLOANR (subordinated bonds/total assets),

GDP: Gross Domestic Product

REER: Real effective exchange rate

3.2 Model

In the literature, various techniques have been used to determine the efficiency of financial sectors. The available methods for measuring the efficiency of commercial banks are financial ratios, parametric test and non parametric test. For the purpose of analysis, we used DEA (data envelopment Analysis) that is non parametric test.DEA was first developed by Charnes, Cooper and Rhodes (1978) on the sample of nonprofit organization and later it was extended to the banking sector by Sherman and Gold (1985). The assumption of Charnes et al (1978) in their original paper was constant return to scale and their model was input oriented. Banker, Charnes, cooper (1984) proposed a variable to scale model.

Banker et al (1984) extended the CRS model and proposed the VRS model. This assumption CRS is suitable for the banks at that situation when all banks are operating at optimal point means all banks avail economies of scales.

In Pakistan, as discussed above, the macro economic factors are the hurdles for the banks to achieve economies of scale. For Pakistani banks it is necessary to evaluate their efficiency both under constant return to scale and variable return to scale assumption. As documented by different researchers like (Akmal & Saleem, 2008; Pasiouras, 2006).

According to our literature various models of efficiency are measured by different researchers in their studies. In this study, we measured the efficiency of conventional banks in Pakistan under cost efficiency model.Under this model conventional banks act

as cost minimizer an objective to minimize their cost for obtaining specified amount of output.

3.3 Cost Efficiency and its Determinants

Cost efficiency prevail with the condition that the banks are both technically and allocatively efficient. For cost efficiency prices of inputs are used. We measured cost efficiency under constant return to scale (CRS) and variable return to scale(VRS).

For this specification the prices of inputs are used along with inputs. Here the price of employees is obtained by dividing the administration cost incurred by a bank in time t by number of employees that bank have in particular time t.

$$\text{Price of employees} = \frac{\text{Administration expenses}}{\text{Number of employees}}$$

This type of price of employees is found by various researchers like (Ahmad & Gill, 2007).

The price of second input that is operating fixed asset is obtained by dividing non markup interest expenses incurred by the bank in time t by total value of operating fixed asset of the bank in time t.

$$\text{Price of operating fixed asset} = \frac{\text{Non markup interest Expenses}}{\text{Operating fixed Asset}}$$

This type of price of operating fixed asset is found by (Isik & Hassan, 2002)

The price of third variable that is Deposits & Borrowing from another financial institution is obtained by dividing interest expenses incurred by the bank in time t by the total value of deposits &borrowing that bank in time t from another financial institution.

$$\text{Price of Deposits \&borrowing} = \frac{\text{Interest expenses}}{\text{Value of Deposits \&Borrowing}}$$

This type of price of Deposits & borrowing from another financial institution is found by researchers like (Isik & Hasan, 2002) found interest expenses divide by value of deposits.

To determine the effect of market discipline & other discipline and macroeconomic variables on cost efficiency,both CRS and VRSassumptions are considered. For this Tobit regression model are used.

$Y_{jt} = \beta 0 + \beta 1 DEPOSITR_{jt} + \beta 2\ ROA_{jt} + \beta 3\ MARGIN_{jt} + \beta 4 LOANDEPR_{jt} + \beta 5 BANKSIZE_{jt} + \beta 6\ SUBLOANR_{jt} + \beta 7\ GDP_{t-1} + \beta 8\ REER_{t-1} + \beta 9\ DForeign_{jt} + \beta 10\ Dlocal_{jt} + \mu_{jt}$ .....(1)

DEPOSITR: ratio of deposits outstanding to total assets,
ROA: Return on assets
MARGIN: interest margin = (loan interest income/loans outstanding) – (deposit interest expenses/deposits outstanding),
LOANDEPR: (loans outstanding)/(deposits outstanding)
BANKSIZE: log(assets)
SUBLOANR (subordinated bonds/total assets),
GDP: Gross Domestic Product
REER: Real effective exchange rate
DFORGIN: Dummy for foreign bank
DLOCAL: Dummy for local bank
Y: Cost efficiency obtained by bank in time t

Where, Betas are slope or parameters in the Tobit regression model. This model is modified for cost efficiency under VRS and CRS. Tobit model is developed by Tobin (1958) which isappropriate when the dependent variable is in proportion or in percentage form.

4.0 Results

The value of Pseudo R-square is .34 and high R-squared implies that the fit of the model is good. Firstly, we will discuss the results under VRS assumption. The results discussed

in table 2 demonstrated that coefficient of DEPOSITR is positive and statistically significant at 1% level. This result is consistent with ushida and satake (2009) that the banks with large deposits are more cost efficient. And depositors put significant pressure on bank management to be cost efficient as market discipline. In other discipline variables, ROA is also positive and statistically significant. This implies that banks are more efficient with large value of ROA. This result is in line with Ahmad & Gill (2007).

Table 2: Cost efficiency of banking sector with determinants

Dependent variable	CE VRS	t- value	p-value	CE CRS	t-value	p-value
ROA	1.769	2.28	0.03	3.16	4.77	0
DEPOSITR	0.439	3.32	0.001	-0.0081	-0.08	0.935
MARGIN	0.399	3.3	0.001	-0.012	-0.21	0.832
LOANDEPR	0.0000414	2.59	0.01	-0.0000125	-1.51	0.132
BANKSIZE	0.1044	9.56	0	-0.008687	-0.72	0.473
SUBLOANER	0.3072	1.68	0.094	-0.1972	-1.89	0.061
REER	-0.0092	-1.41	0.158	-0.0166	-3.14	0.002
GDP	-0.0915	-1.09	0.275	0.3099	4.63	0
DFOREIGN	0.1951	2.75	0.006	0.1942	3.38	0.001
DLOCAL	-0.015	-0.25	0.8	-0.01536	-0.32	0.753
CONS	1.553	1.42	0.158	-2.61	-3	0.003
log liklehood	-13.4			-77.35555		
# observations	269			269		

MD: market discipline variables

DEPOSITR: ratio of deposits outstanding to total assets,

OD: Other discipline variables

ROA: Return on assets

MARGIN: interest margin = (loan interest income/loans outstanding) – (deposit interest expenses/deposits outstanding),
LOANDEPR: (loans outstanding)/(deposits outstanding)
BANKSIZE: log(assets)
SUBLOANR (subordinated bonds/total assets),
MACRO: Macroeconomic variables
GDP: Gross Domestic Product
REER: Real effective exchange rate
DFORGIN: Dummy for foreign bank

The coefficient of MARGIN is positive with value of .399 which implies that the cost efficient banks are earning more interest income as compare to others. This result is also in line with Ariff & Can (2008). The impact of LOANDEPR is weak but positive in direction. The results for BANKSIZE coefficient depicts that the large size banks are more cost efficient as they can achieve economy of scale. This result is in line with Pasioras (2007). Both macroeconomic variables are statistically insignificant under VRS assumption. The results of dummy variable for ownership structure showed that ownership affects the cost efficiency of the banks. And in Pakistan the foreign banks are more efficient.

Under the CRS assumption, the value of Pseudo R-square is 0.72 and high R-squared implies that the explanatory power of the model is good. The results discussed in table 2 demonstrated that coefficient of DEPOSITR is not statistically significant. In other discipline variables, ROA is also positive and statistically significant. This implies that banks are more efficient with large value of ROA. The banks ultimately declare large amount of profits if they are more cost efficient. This finding is very much in line with the empirical evidence. The coefficient of SUBLOANER is negative with value of -.1972 which implies that the large amount of subordinated loans decrease the efficiency of the banks.

The impact of macroeconomic variables is vigilant under CRS assumption. The exchange rate exposure is negatively contributing towards the cost efficiency of the bank. This

result has demonstrated that the depreciation of local currency negatively hits the cost efficiency of the banks. Similarly, the impact of GDP is positive and statistically significant for the Pakistani banking sector. Overall economic development of the country positively affects the cost efficiency of the banks. The results of dummy variable for ownership structure demonstrated that ownership affects the cost efficiency of the banks. And in Pakistan the local banks are less efficient as compare to foreign banks. This result is also validating the results of Ariff & Can, (2008).

5.0 Conclusion

The purpose of this study is to determine the relative importance of the factors affecting the banking efficiency. The cost efficiency of conventional foreign banks has been compared with conventional local banks. We have explored the impact of market & other discipline variables and macroeconomic factors, like exchange rate exposure and Gross domestic product GDP on the cost efficiency of banks.The results of cost efficiency have shown that foreign banks are more efficient as compared to local banks. This result validates previous findings that the span of control and efficient procedures might be the reason for foreign banks efficiency. The market discipline variable is also have positive impact on the cost efficiency of the banks as depositor creates more pressure on the management to perform well and decrease their cost for same level of operations. Usida and satake (2009) also found that banks with more outstanding deposits are more efficient in terms of cost efficiency. As a result, the market discipline is proved to be the important predictor of cost efficiency. In other discipline variables, ROA is positively impacting the cost efficiency which implies that banks are more efficient with large value of ROA. This finding is in line with Ahmad & Gill (2007). The impact of macroeconomic variables is also vigilant under CRS assumption. The exchange rate exposure negatively affected the cost efficiency as the depreciation of local currency negatively hit the cost efficiency of the banks. Similarly, the impact of GDP is positive and statistically significant for the Pakistani banking sector. Overall economic development of the country positively affects the cost efficiency of the banks.This study

has some strong implication for policymakers, tax authorities, corporate sector, financial analysts and the academic researchers for whom the cost efficiency is of prime importance. This study may also have implications for managers governing the banking institutions for achieving the better efficiency.

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CHARITY-BASED INSTITUTIONS AND POVERTY ALLEVIATION: REVISITING THE ROLE OF *WAQF* IN THE MODERN ECONOMY

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Abstract

This paper discusses the role of *Waqf* institution in poverty alleviation. The paper is analytical with presentation based on desk research with a view to adding to the existing literature on the subject and synthesizing opposing views on the socio-economic role of *Waqf* and the process of its revitalisation in the modern time. The paper posits that the history of *Waqf* is very rich with impressive achievements in serving the poor in particular and enhancing the welfare of the Muslim communities in general. However, with the falling of several parts of the Muslim world to the military and cultural colonisation during the nineteenth century, the institution of *Waqf* suffered a serious setback. It degenerated in many Muslim societies from its past glory. The paper further suggests that the institution of *Waqf* could now be used to mobilize additional resources for poor sections of the society to address socio-economic issues such as education, skills and micro entrepreneurial development, health care and care of HIV/AIDS infected population, and water and sanitation facilities in rural areas among many other things. The paper concludes that to activate and revitalise the *Waqf* system in Muslim societies and communities, there is a dire need for reform in their management formulars and to address the unsettled issues inherent in the institution.

Keywords: *Islam; MDGs; Poverty; Waqf; Zakah*

1.0 Introduction

The global financial crisis of 2007 through 2008 that hit at many economies of the world, leaving its perils on the ever-increasing level of world poverty has further heightened the effort of governments in both developed and developing nations to continually search for better ways and means of alleviating poverty. The search become even more critical in consideration of the plan of many governments

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especially in the developing nations to achieve the Millennium Development Goals (MDGs) at the centre of which; comes poverty alleviation by 2015. The institution of *Waqf* (endowment) is among the several instruments instituted by Islam to alleviate poverty and enhance welfare in the society. *Waqf* (plural *Awqaf*), which stands for holding an asset and preventing its consumption for the purpose of repeatedly extracting its usufruct for the benefit of an objective representing righteousness and/or philanthropy for as long as its principal is preserved, provides the material infrastructure and creates a source of revenue for use in, among others, social and economic welfare enhancing activities both at family, community and state levels.

Waqf as an important institution of Islamic civilization aims at taking care of the needs of the society that are otherwise ignored in the process of economic growth and development. The major social and economic objectives of *Waqf* include heart reconciliation between the haves and the have-nots, satisfaction of the basic economic needs of the poor, defense of the Muslim *Ummah* and its ideology, solving dangerous problems such as poverty, unemployment and catastrophes (Ahmed, 2004; Kahf, 2007). From the golden age of Islam through the end of *Ottoman* Empire, the voluntary institution of *Waqf* had supplemented the state in fulfilment of its obligation towards the provision of public goods, including what many contemporary economists and political sociologists consider as part of the domain and responsibility of governments such as health, education and defence (Kahf, 2007).

However, while the altruistic and philanthropic nature of Muslims has facilitated the establishment, growth and development of *Waqf* institution in the early generations of Muslim, thereby contributing significantly to the overall welfare of the Islamic society, establishment of revenue streams *Awqaf* to facilitate sustainable growth and development remains sadly lacking in most modern Muslim communities. This is despite the fact that the numerous education, health, food, investment and other socio-economic needs of Muslim communities, which the Government may not be able to provide cannot be catered for through Zakah fund (even where Zakah is efficiently collected and disbursed), given its restricted use, and therefore, communities will have to depend on voluntary donations like *Waqf* to pursue some of their needs in the modern economy.

This paper discusses the poverty alleviation role of *Waqf* institution in modern economy. The paper is analytical with presentation based on desk research with a view to adding to the existing literature on the subject and synthesizing opposing views on the socio-economic role of *Waqf* and the process of its revitalisation in the modern time. The paper is organised in five sections as follows. Section two gives the conceptual framework of *Waqf*. Section three discusses the socio-economic role of *Waqf* in poverty alleviation. Section four discusses the process and challenges of establishing and managing *Waqf* Trust Funds and section five summarises and concludes the paper.

1.1 Concept of *Waqf*

Waqf is a voluntary act of charity that comes under the general terms of *Sadaqah* (voluntary charity) and *Infaq* (voluntary spending for the sake of Allah). Linguistically, *Waqf* means stand still, hold still, not to let go (Ahmed, 2004). Technically, Kahf (1998) sees it as holding an asset and preventing its consumption for the purpose of repeatedly extracting its usufruct for the benefit of an objective representing righteousness and/or philanthropy for as long as its principal is preserved by its own nature - as in land - or from arrangements and conditions prescribed by the *Waqf* founder.

Making a *Waqf* is considered a virtuous and meritorious act. The Prophet (Peace and blessing of Allah be upon him) encourages Muslims to create ongoing charity that will continue to generate benefits/revenues for use in the targeted objectives as reported in many authentic Hadiths. Throughout Islamic history and in all lands inhabited by Muslims, *Waqf* had had a formidable presence. The real innovations in the idea of *Waqf* came in the early Islamic period in Madinah and after the first generation of Muslims, it grew by leaps and bounds, and its endowment became a pillar in the religious, social, cultural, scientific, economic and political life of Islamic society to the extent that for every conceivable enterprise of social benefit there was a *Waqf* covering mosques, education at all levels, hospitals and other health care facilities, orphanages, houses and food for the poor, the blind and battered/abused women, wells, aqueduct and fountains, public baths, watchtowers, bridges, cemeteries, salaries, pensions, guest houses, libraries, books and animal welfare (Ali,

2009).

In the history of Islam, the first known *Waqf* is the mosque of *Qubaa* in Madinah, which was built upon the arrival of the Prophet (Peace and blessing of Allah be upon him) followed by the purchase of the land and construction of the mosque, known today as the Prophet's mosque. According to Kahf (2007), mosque and real estates confined for providing revenues to spend on mosques' maintenance and running expenses are in the category of *religious Waqf*, which in any Muslim society adds to the social welfare of the community because it helps satisfy the religious needs of people and reduces the direct cost of providing religious services for any future generation.

On the recommendation of the Prophet (Peace and blessing of Allah be upon him), a second kind of *Waqf* know as *philanthropic Waqf*, which is aimed at supporting the poor segment of the society and all activities that are of interest to people at large such as public utilities, libraries, scientific research, education, health services, care of animals and environment, lending to small businessmen, parks, roads, bridges, dams, etc was established. According to Kahf (2007) and Ahmed (2004), philanthropic *Waqf* began by the Prophet's (Peace and blessing of Allah be upon him) calling on people to alleviate the water-shortage related suffering of their brothers through buying the popular well of *Rumah* and making it into a *Waqf* free to whoever takes water, a task accomplished by Uthman bn Affan (May Allah be pleased with him). The Prophet (Peace and blessing of Allah be upon him) also advised Umar (May Allah be pleased with him) to make *Waqf* of his most precious land in Khaybar. The land was made a *Sadaqah* that could neither be sold nor given as a gift, and the fruits from the far were to be distributed to the poor and kinships, to liberate slaves, to provide for guests and the wayfarer, and some reasonable quantity to its custodian.

Kahf (2007) documents another form of *Waqf* called *posterity or family Waqf*. According to him, this kind of *Waqf* started when Umar bn al-Khattab (May Allah be pleased with him) decided to document in writing his *Waqf* in Khaibar and invited some of the Prophet's companions (May Allah be pleased with them) to attest the document. Thereafter, many companions who owned real estate made certain *Waqf*, some of whom stipulated as part of the conditions that the fruits and revenues of their

Waqf must first given to their own children and descendants and only the surplus, if any, should be given to the poor. It is argued that the family *Waqf* is charitable in essence because it gives income/usufruct to persons free of charges and improves the welfare of future generation.

In addition to the fore mentioned, the literature documents a type of *Waqf* called *cash Waqf*. Cash investment *Waqf* dates back to as early as the turn of first century of Hijrah, as related by Imam Malik and Bukhari in their books. Ahmed (2004) explains that cash *Waqf* had two forms: first, cash was made into *Waqf* to be used for free lending to the beneficiaries and second, cash was invested and its net return is assigned to the beneficiaries of the *Waqf*.

Waqf as an important institution of Islamic civilization aims at taking care of the needs of the society that are otherwise ignored in the process of economic growth and development. It is an institution that helps social development keeps pace with economic growth in the society. The major social and economic objectives of *Waqf* include heart reconciliation between the haves and the have-nots, satisfaction of the basic economic needs of the poor, defense of the Muslim *Ummah* and its ideology, solving dangerous problems such as poverty, unemployment and catastrophes (Ahmed, 2004; Kahf, 2007). The motivation of establishing such a socio-economic activity is to control the desire for personal accumulation at any cost by encouraging socially orientated behavior; and to reduce socio-economic differences by providing support to the have-nots to bring them closer to the haves (Dogarawa, 2009).

It is this motivation that has kept the institution of *Waqf* not only alive and active throughout Islamic history but also made it to contribute significantly to various social causes such as health, education, research and meeting needs of less privileged/poor sections of the society. During the *Ottomans* for example, the financing of health, education and welfare was entirely left to the *Waqf* system. The system even flourished during that empire so much so that a person would have been born into a *Waqf* house, slept in a *Waqf* cradle, eaten and drunk from *Waqf* properties, read *Waqf* books, been taught in a *Waqf* school, received his salary from a *Waqf* administration, and when he died, placed in a *Waqf* coffin and buried in a *Waqf* cemetery (Baskan, 2002).

The significance of *Waqf* in historical Muslim societies of the past is evident from information available on the size of this institution. In some countries, the institution reached one-third or more of total cultivable land and other properties. This large investment in the social sector, according to Ahmed (2004) succeeded in transforming the society and empowering the poor segments of it. Education, offered almost only by the institution in those days, enabled the poor to move up the economic ladder and obtain high levels of economic and political power. The history of *Waqf* is therefore, very rich with impressive achievements in serving the poor in particular and enhancing the welfare of the Muslim community in general.

1.2 Decline of *Waqf* Institution

Muslims have commonly followed the practice of *Awqaf* donations throughout the ages all over the Muslim world to the extent that *Awqaf* properties make up a considerable proportion of the social wealth in several Muslim countries (Ali, 2009). Kahf (2007) notes that *Waqf* management was relatively simple in the early days of Islam because there was no separation between the *waaqif* (donor) and *mutawalli* (manager) and therefore, agent/principal conflict of interest that would require alignment was not there. For example, the second caliph of Islam, Umar ibn Al-Khattab (may Allah be pleased with him) appointed himself as the manager of the *Waqf* property he donated, and in his bequest, he wrote that a person from his family not his successor should take over the management of the *Waqf* after him. In some cases of course, donors would appoint non-descendants to manage their *Waqf* with close monitoring.

With the passage of time however, couple with increasing number of vast and complex *Waqf* properties, assigning management of *Waqf* properties to non-descendant started gaining ground. It then became necessary to align the interest of the manager with that of the donor. Soon thereafter, *Waqf*, as a voluntary sector, started facing widespread and rampant accountability related problems such as abuse, mismanagement, maladministration and neglect. Consequently, Governments found it necessary to take over management and administration as well as trusteeship of *Waqf* property (Osman, 2010) due to either loss of or difficulty to locate deeds of *Awqaf* in the old records and archives of local courts, and the centuries of old problem of

corruption and mismanagement by judges and *Waqf* managers respectively. *Fuqaha* and other social leaders strongly resisted the takeover but without success.

The shift of *Waqf* management to government started with the establishment of *Waqf* Administration by the Ottoman Empire in 1826, which led to the liquidation of most Islamic *Awqaf* of that time. Unfortunately, the state on its side did not spare the property from misappropriation and serious abuse. With the falling of several parts of the Muslim world to the military and cultural colonisation during the nineteenth century, the institution of *Waqf* suffered a serious setback. It degenerated in many Muslim societies from its past glory. According to Khan (2007), the current state of Awqaf has two remarkable features. Firstly, there is a huge stock of *Awqaf* property lying in various parts of the world (Muslim as well as non-Muslim) which have been abandoned and are no more operative. Secondly, not only that considerable number of *Awqaf* properties inherited from the past is lying idle, but also the new *Awqaf* are not coming up particularly to alleviate hardships faced by the poor despite potential capacity among the wealthier population in Muslim countries and communities.

The demise of *Waqf* has since left a vacuum in the area of public services, which the State has been unable to fill easily in many Muslim countries, though both the 'idea' and its ‘doctrine’ remain influential and there are clear signs of its reinvigoration. The main factor thwarting the emergence of new *Awqaf* institutions is the absence of legal protection to the Awqaf property. The legal system of property rights in many Muslim countries is not only weak but also whatever system exists is not properly enforced. These weaknesses in the system of property rights are detrimental to the growth of private sector as well as third sector and *Awqaf* development.

1.3 Role of *Waqf* in the Modern Economy

Waqf institution has, of recent, been recognised as an inclusive, non-elitist and religiously as well as socio-cultural authenticated economic system that has the potential to enrich Islamic civilization and contribute to establishment of economic and social institutions of the modern society in line with its developmental role. Effort is now been geared toward developing a modern Waqf model that could respond to contemporary challenges of benchmarking and performance-based management. As

an institution capable of promoting good governance and a viable tool for poverty eradication through the use of modern techniques of management, *Waqf* is receiving considerable attention with a view to making its management come to term with modern economy realities.

Ahmed (2004), Khan (2007) and Kahf (2007) stressed that the institution of *Waqf* in the contemporary socio-economic set-up should be seen as an additional source to support programs relating to poverty alleviation. They argued that the past history of *Waqf* suggests that the institution can now be used to mobilize additional resources for poor sections of the society to address socio-economic issues such as education, skills and micro entrepreneurial development, health care and care of HIV/AIDS infected population, and water and sanitation facilities in rural areas. Some modern economists even advocated the use of *Waqf* in structuring and operating Islamic insurance and Microfinance given its central role in poverty alleviation (Kahf, 2007). Additionally, the institution can maintain a fund, which if properly invested, can be utilized in periods of famine and other crisis to help extreme poor to survive the crisis or the famine. In the context of countries with extreme poverty, the institution can help people in extreme poverty facing starvation, death and diseases.

In view of the challenge of modern economy, *Waqf* is viewed as a vibrant and dynamic socio-economic tool capable of diversifying to accommodate various forms tangible and intangible properties that will add to public welfare. Thus, it is recently suggested that *Waqf* of usufruct such as driving a car on the toll way, passing through bridge or using a parking lot for some hours during Friday or Eid prayers; and financial rights such as patent and other talent rights, newspaper, magazines, periodicals and other objects that have repetitive character, educational software and many other intangible properties that have become important business in the modern days should be included in the principle of *Waqf*. That way, Muslims would be able to better realize its potential.

According to Siddiqi (1996), it is not far-fetched to assume that the role of *Waqf* in the modern economy is likely to increase in countries with Muslim minorities than where the majority of the population is Muslim. The reason for a more active role for *Waqf* in the former lies in the realisation that, with a state which is at best indifferent

to their religion and to many of their special socio-economic needs, Muslims have to use *Waqf* for the fulfillment of these needs and for the protection and promotion of Islam. Establishing *Waqf* outfit in countries where the economic system is not Islamic and the political system does not officially recognise Islam as the dominant religion or where Muslims are in the minority will therefore go a long way in alleviating poverty and ensuring growth and development.

1.4 Reviving *Waqf* Institution

Since the beginning of the 1990s, governments of several Muslim countries on the one hand have taken bold steps to change the style of administering *Waqf* properties and activities by establishing some agency to take charge of *Waqf* (Ahmed, 2004). On the other hand, religious and other voluntary organisations such as Non-governmental Organisations (NGOs), especially in non-Islamic Muslim majority and minority countries, are taking steps to revitalise the institution of *Waqf*. This effort is however faced with serious challenges.

The challenges include how to make the institution vibrantly working in consideration of the fact that the economic system of most countries of the world today is not Islamic, and thus, government or its agencies are not playing the role of providing conducive atmosphere and enabling environment for establishment and effective management of *Awqaf*. Also, there is the challenge of how best to resolve many unsettled issues in the jurisprudence of *Waqf* that relate to permissibility or otherwise of temporary *Awqaf* and the possibility of extending activities of *Waqf* to cover usufruct and financial rights. Furthermore, there is the challenge of mounting enlightening programmes that will educate especially Muslim rich who are mostly not well informed about the socio-economic role of *Awqaf* in every Muslim society. Tackling these challenges requires the collective effort of all stakeholders: government, scholars and advocates, NGOs and Muslim rich.

The effective role that state can play in this respect is that of creating an enabling environment, providing supporting legal framework and protecting property rights through effective enforcement of law. In addition, government should encourage, facilitate and contribute to the dissemination of information and advocacy about

Waqf, its importance, role and *modus operandi*; make appropriate policies that will guarantee good governance and efficient management of *Waqf* endowments, and use control and inspection mechanisms to ensure full accountability. Where Muslims are the minority, Governments of such countries should assist credible NGOs to spearhead the effort to revitalise and reinvigorate *Waqf* through appropriate legislations and policy guidelines.

It is believed that creating awareness among the affluent members of society as well as Muslims abroad about the need and usefulness of establishing *Waqf* institutions in Muslim minority countries with extreme poverty and partnering with international Islamic organisation such as Islamic Development Bank (IDB) or financial institutions can mobilize a lot of funds for the establishment of *Awqaf* for fighting poverty. IDB for example, has always been conscious of the poverty incidence in its member countries and particularly in Sub-Saharan African member countries and of its obligations to play its role to help the countries in their fight against poverty. According to Khan (2007), IDB has launched during 2000-2001 a special program on strengthening *Zakah* and *Awqaf* institutions as a means for building capacity to alleviate poverty. It has also provided financing to help some member countries to revitalize some of their *Awqaf* property that were lying idle and unutilized. Further, it has established a Trust Fund known as World Waqf Foundation (WWF) to achieve a number of objectives with respect to the development of *Awqaf* in IDB member countries and in Muslim communities in non-member countries. The objectives include: establishing and supporting educational, health and social institutions and programs, contributing to the alleviation of poverty so as to enable people of the world to overcome hardship and build their capabilities, and providing relief aid in the form of goods and services.

In this regard, Islamic scholars have the duty to inform members of their communities, particularly the rich about the position of *Waqf* endowment in the Islamic social system and the socio-economic role it played throughout the history of Islam, and to mobilise them to make contribution toward fighting illiteracy, poverty, illness and handicap in their communities through the system of *Waqf*. In addition, Islamic scholars, advocates and intellectuals have the combine duty to make Muslims

aware of the importance of philanthropy, call and mobilise them toward responsiveness, initiative and support.

Proper management of *Waqf* is necessary to increase the efficiency and productivity of *Waqf* properties on the one hand, and on the other hand, to ensure accountability and prudent stewardship, the lack of which in the past contributed immensely to the collapse of the institution. Many contemporary economists however, argued that direct involvement of state in organising and managing the institution of *Waqf* may not lead to an optimal mobilization of resources from these institutions. There are serious apprehensions expressed in different national and international fora about the governance issues among the public and hence a factor leading to reluctance of the public to hand their charity funds to government institutions.

Efficient management is therefore, a serious challenge facing *Waqf*. In view of the mismanagement and misappropriation that *Waqf* properties faced by custodians and states respectively over the years, Kahf (2007) and Abdul-karim (2007) suggest that for the successful management of *Waqf* among Muslim communities in the contemporary economy (i) preference should be given to NGO organizations as custodians over individuals in order to ensure continuity; (ii) organisations engaged in *Waqf* management should be properly registered to be able to function as custodians of *Waqf*; (iii) Muslims, in their various communities, should lobby for special legislation to govern *Waqf* activities in order to win the confidence of donors; and (iv) donors and beneficiaries of *Waqf* should emphasise on efficiency, accountability and transparency in the management and administration of *Waqf* properties.

2.0 Conclusion

History has shown that when societies get too unequal bad things happen. They either become economically inefficient or they become subject to social unrest. In many cases both happen simultaneously. However, the societies as a whole have not prospered. They have been subject to continual poverty and revolution and much of the development that has taken place is in the hands of foreign investors. The wealth of the few has been maintained at a high cost to the majority leading to indelible perils especially at the event of financial crisis.

Islam stands for complete eradication of absolute poverty and organisation of economic life in a manner that the basic needs of all human beings are met. To ensure fulfillment of the basic needs of all, Islam enunciates the principle of the poor having a 'right' in the income and wealth of the well-off members of the society through the system of *Waqf*. *Waqf* has been used to provide the material infrastructure and create a source of revenue for use in, among others, social welfare enhancing activities both at family, community and state levels. This is not merely the matter of theoretical principles that are far removed from being able to reform reality. The Muslims applied these principles in their societies and achieved results, which are a source of historical pride and glory.

To activate and revitalise the *Awqaf* system in Muslim societies and communities, there is a dire need for reform in their management formulars and to address the unsettled issues inherent in the institution. This requires high level of credibility and commitment from the side of voluntary organisations, and cooperation from the side of people while banking on legislative support from the government. In addition, flexibility in *Waqf*'s processes and procedures that will make its establishment much easier and benefits more realizable are required; and motivational measures that will make its management efficient are needed.

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INOVASI PEMBENTUKAN PARAMETER ISTIBDAL DALAM PEMBANGUNKAN HARTA WAKAF ; SATU ANALISIS

Hisham Bin Sabri[1]

Abstrak

Kontrak wakaf adalah penjana kepada pembangunan ekonomi umat Islam. Ia menjadi salah satu instrumen penting bagi membantu kemajuan dalam pelbagai sektor dalam sesebuah komuniti dan negara. Namun begitu, terdapat juga harta wakaf yang tidak dapat dimanfaatkan secara optimum. Ia disebabkan beberapa halangan sama ada berpunca dari faktor geografi, struktur fizikal aset wakaf tersebut, nilai ekonomi hartanah wakaf dan berlaku keperluan untuk menjaga kepentingan umum (*maslahah 'ammah*). Sehubungan itu, penulis telah membuat cadangan dalam menginovasikan parameter Istibdal. Ia berperanan dalam menjadikan panduan kepada pemutus dasar pengurusan wakaf di negeri-negeri. Parameter ini juga boleh dijadikan tapak untuk menilai keperluan melaksanakan istibdal pada masa hadapan. Namun begitu, pelaksanaan istibdal ini perlu dilakukan dengan penuh waspada bagi mengelakkan sebarang ketidakpatuhan syariah. Oleh itu, pelaksanaannya perlu dipantau serta mendapat kebenaran daripada pihak kadi/hakim/pihak berkuasa/mufti. Bahkan, penulis berharap bahawa parameter istibdal ini akan menjadi asas kepada penyelesaian masalah pembangunan hartanah wakaf di Malaysia.

Katakunci: wakaf, konsep istibdal dan pembentukan parameter

Pendahuluan

Konsep wakaf adalah mengutamakan kebajikan umat Islam. Ia adalah satu proses perpindahan milik dari seseorang individu untuk dijadikan sebagai *infaq fi sabilillah*. Harta itu akan berpindah kepada hak Allah s.w.t. untuk selama-lamanya. Walaubagaimanapun, Allah s.w.t. telah menjanjikan pahala yang berlipat kali ganda kepada hambaNya yang melaksanakan tuntutan berwakaf. Namun begitu, penulis mendapati bahawa terdapat hartanah wakaf yang tidak dapat dibangunkan atas beberapa sebab tertentu. Ia telah menyebabkan kerugian yang banyak kepada umat Islam kerana

[1] Universiti Sains Islam Malaysia

hartanah tersebut tidak dapat dimanfaatkan. Maka, adalah wajar agar pihak yang bertanggungjawab perlu mendalami kaedah istibdal yang diperkenalkan oleh para ulamak dalam mengimarahkan hartanah wakaf di negara ini. Sehubungan itu, penulis mencadangkan pembentukan parameter Istibdal yang bersesuaian demi memartabatkan keagungan insitusi wakaf.

Definisi Wakaf dari perspektif bahasa

Menurut kamus dewan ianya bererti suatu pemberian yang boleh digunakan oleh umat Islam atau dipanggil juga sebagai derma. Di samping itu, penggunaannya hanya berkaitan dengan hal-hal yang melibatkan agama Islam .Contohnya tanah yang diperuntukkan untuk pembinaan masjid ataupun kubur umat Islam[2] . Manakala definisi wakaf dari perspektif bahasa Arab pula menyatakan bahawa ianya mempunyai dua pengertian yang berbeza. Pertamanya ialah memberhentikan[3]. Istilah ini juga digunakan dalam ilmu tajwid dengan menghentikan bacaan sama ada untuk berhenti terus ataupun untuk mengambil nafas baru bagi meneruskan pembacaannya.

Definisi Wakaf dari perspektif syariah

Wakaf adalah satu kontrak yang berasaskan kepada penjanaan sektor ijtima'ie. Ia adalah sangat penting bagi membantu golongan yang memerlukan bantuan sama ada di kalangan orang Islam dan bukan Islam. Kontrak wakaf juga adalah proses pembekuan harta demi menjaga kelangsungan pemilikan harta umat Islam. Secara umumnya apa yang dimaksudkan dengan pembekuan ialah sebarang harta yang disebutkan sebagai harta wakaf tidak layak lagi untuk dijual beli atau dipindah milik dan bersifat kekal[4]. Namun perincian mengenai takrif wakaf di kalangan para ulamak akan dikupas berdasarkan pandangan fuqaha' di dalam empat mazhab yang muktabar.

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[2] Kamus Dewan. 1992. Terbitan Dewan Bahasa Dan Pustaka. Hlmn.: 1456.

[3] Ibn Manzur. 1997. *Lisan al-ᶜArab*. Terbitan Dar Ihyaᶜ al-Thurath, Beirut. Jil-13. Hlmn.: 373.

[4] al-Sharbiniyy, Mohammad Khatib bi tahqiq Adil Ahmad Abdul Mawjud. T.th. *al-Iqna' fi Hal alfaz Abi Shuja'*. Terbitan Dar al-Kutb al-Ilmiyyah, Beirut. Jil-2. Hlmn.: 165.

Selain itu, terdapat juga ulamak yang mendefinisikan wakaf sebagai penyerahan harta yang dapat diambil faedah daripadanya untuk kegunaan orang ramai. Manakala orang yang telah menyerahkan hartanya tidak boleh memilikinya semula kerana ia telah berpindah milik kepada Allah s.w.t. di samping kegunaannya boleh dinikmati oleh orang ramai. Contohnya, seorang pemilik harta berkata : " *Aku mewakafkan tanah kepunyaanku ini untuk kegunaan bersama*". Apabila perkataan ini dinyatakan oleh pewakaf, maka berdasarkan pemutusan hukum syarak, ia tidak boleh lagi dijual dan faedahnya hendaklah digunakan oleh pihak yang dinyatakan sahaja iaitu penerima manfaat wakaf[5].

Menurut Imam Mohammad Khatib al-Syarbiniy definisi wakaf ialah menahan sesuatu barangan yang boleh dipergunakan dengan mengekalkan bentuk fizikalnya mengikut peraturan-peraturan yang telah dibenarkankan oleh syarak[6]. Sehubungan dengan itu, penahanan yang dimaksudkan ialah tidak boleh berlaku perpindahan milik kepada pihak lain kecuali diletakkan kepada pengawasan pihak bertanggungjawab atau pemegang amanah yang dilantik. Secara umumnya, apa yang dimaksudkan dengan pembekuan ialah sebarang harta yang disebutkan sebagai harta wakaf tidak layak lagi untuk dijual beli atau dipindah milik dan bersifat kekal[7].

Selain itu, wakaf juga didefinisikan sebagai seseorang yang menghentikan hak milik sesuatu harta dan menahan diri daripada menggunakannya dengan cara menyerahkan harta itu kepada mutawalli berdasarkan syarat yang ditetapkan. Berdasarkan definisi tersebut, kita dapat mengetahui bahawa prinsip 'kekal' merupakan syarat sesuatu harta itu diwakafkan. Ia melibatkan pengekalan dari segi sifat, tujuan, dan kedudukannya.

Namun, dalam konsep istibdal wakaf, kekal tidak menjadi elemen utama malah ia bertentangan secara langsung dengan definisi yang dibuat. Oleh yang demikian, istibdal

[5] Ahmad Ibrahim, Mahmud Saedon Awang Mahmud *et al*. 1998. *Al-Ahkam Jilid 6 (Undang-Undang Keluarga dan Pentadbiran Harta Wakaf).* Terbitan Dewan Bahasa dan Pustaka; Kuala Lumpur.Hlmn.: 157

[6] al-Sharbiniyy, Mohammad Khatib. 1352H/1933M. *Mughni Al-Muhtaj*. Kaherah: Maktabah Al-Halabi. Jil-2. Hlmn.:376.

[7] al-Sharbiniyy, Mohammad Khatib bi tahqiq Adil Ahmad Abdul Mawjud. T.th. *al-Iqna' fi Hal alfaz Abi Shuja'*. Terbitan Dar al-Kutb al-Ilmiyyah, Beirut. Jil-2. Hlmn.: 165.

membincangkan perbezaan pendapat dari ulama' fuqaha yang mana boleh difahami dengan cara membahagikan hukum menurut kriteria harta, sama ada harta itu merupakan harta alih atau harta tak alih. Disini dapat dinyatakan bahwa harta alih merujuk kepada harta yang boleh dialihkan atau diubah dari tempatnya sama ada bentuk dan keadaannya kekal dengan dipindahkan atau berubah bentuknya seperti wang ringgit, barangan perniagaan, haiwan dan lain-lain. Manakala, bagi harta tak alih harta yang tidak boleh dipindahkan atau diubah dari tempat asalnya seperti bangunan, tanah dan sebagainya.

Dalil Wakaf berdasarkan al-quran al-karim

Dalam sumber perundangan Islam, al-quran adalah rujukan utama. Ia menjadi pemegang dasar bagi setiap idealogi dan sumber hukum asas yang harus diikuti oleh semua golongan masyarakat. Kerelevannya boleh digunapakai pada setiap masa dan ketika tanpa sebarang keraguan[8]. Oleh itu, dalam konsep wakaf yang sering diwar-warkan oleh masyarakat dunia dewasa ini, al-quran telah memberikan penjelasan tentang pensyariatannya. Ia diilustrasikan dalam ayat al-quran sepertimana berikut :

"Bandingan (pahala) orang-orang yang membelanjakan harta mereka pada jalan Allah sama seperti sebiji benih yang tumbuh menerbitkan tujuh tangkai dan tiap-tiap tangkai itu pula terdapat seratus biji. Dan (ingatlah), Allah akan melipat gandakan pahala bagi sesiapa yang dikehendakiNya dan Allah Maha Luas (rahmat) kurniaanNya lagi Meliputi ilmu pengetahuanNya "

(Baqarah 2:261)

Berdasarkan ayat diatas boleh dijelaskan bahawa ganjaran besar yang dijanjikan oleh Allah s.w.t. ialah *menginfaqkan* harta mereka dengan penuh ikhlas. Allah s.w.t. telah melipat gandakan ganjaran tersebut sehingga mencapai angka tujuh ratus *hasanat* dan akan menambahkannya lagi kepada sesiapa yang dikehendakiNya. Allah s.w.t. juga

[8] Abdul Karim Zaidan. 1997. *al-Wajiz fi Usul al-Fiqh*. Terbitan Muassasah al-Risalah, Beirut. Cetakan ke-tujuh. Hlmn.:154.

memberikan ganjaran mengikut kepada jumlah *mal* yang di*infaq*kan untuk keperluan umum[9].

Dalil wakaf berdasarkan sunnah al-nabawiyyah

Secara umum, Islam telah mengiktiraf wakaf sebagai salah satu daripada kontrak dalam sistem muamalat. Ia dapat dijelaskan melalui satu sandaran hadis sepertimana yang diriwayatkan bahawa Nabi Muhammad s.a.w. telah bersabda[10] :-

حديث إبن عمر : ((أن عمر أصاب أرضا من أرض خيبر ,فقال يا رسول الله ,أصبت أرضا بخيبر, لم أصب مالا قط أنفس عندي منه ,فما تأمرني؟ فقال :إن شئت حبست أصلها و تصدقت بها فتصدق بها عمر ,على ألا تباع و لا توهب و لا تورث في الفقرأ و ذوي القربى و الرقاب و الضيف و ابن السبيل ,لا جناح على من وليها أن يأكل منها بالمعروف ,و يطعم غير متمول)) . رواه الجماعة

Maksudnya :

Hadis daripada Ibn Umar r.a. berkata bahawa Umar r.a. telah mendapat sebidang tanah di Khaibar. Beliau datang menemui Nabi Muhammad s.a.w. untuk meminta pandangan tentang tanah itu. Katanya "*Wahai Rasulullah, sesungguhnya aku mendapat sebidang tanah di Khaibar di mana aku tidak mendapat harta yang lebih berharga bagiku selain daripadanya sedangkan aku bercita-cita untuk mendekatkan diri kepada Allah S.W.T. Apakah yang hendak diperintahkan kepada aku terhadap tanah ini*". Sabda Rasulullah, "*Jika kamu mahu, tahanlah (bekukan) tanah itu dan sedekahkan manfaatnya*". Maka Umar mensedekahkan manfaatnya dengan cara tanah itu tidak boleh dijual beli, tidak boleh dihebahkan (diberi), dan tidak boleh diwarisi (dipusakai). Tanah itu diwakafkan untuk fakir miskin, kaum kerabat, memerdekakan hamba sahaya, orang yang berjuang di jalan Allah, *Ibnu Sabil* dan tetamu. Tidak menjadi halangan bagi orang yang

[9] Abdullah Bin Ahmad Bin Mahmud al-Nasafi. 2001. *Tafsir al-Nasafi al-Musamma Madarik al-Tanzil wa Haqaiq al-Ta'wil*. Terbitan Dar al-Kutb al-Ilmiyyah, Beirut. Jil.-1. Hlmn: 148.

[10] al-Syawkaniyy, Muhammad bin ᶜAli. 1961M. *Nail al-Awtar Syarah Muntaqa al-Akhbar min Ahadith Sayyid al-Abrar*. Cet. ke-3. Kaherah: Maktabah wa Matba'ah Mustafa Albabi al-Halabi. Jil.-6. Hlmn.:20.

menguruskan (orang yang diberi kuasa atau Nazir) untuk mengambil upah sebahagian daripadanya dengan cara yang baik tanpa menganggap bahawa tanah itu miliknya.

Hadis ini menerangkan bahawa harta yang diwakafkan itu tidak boleh digunakan sewenang-wenangnya. Ia mempunyai beberapa batasan khususnya yang berkaitan tentang jual beli dan penyewaan. Ini dapat dilihat dengan jelas berdasarkan perkataan "الحبس" yang pada hakikatnya membawa erti menegah. Penegahan ini bermaksud tidak menyerahkan harta yang diwakafkan kepada sesiapapun dan menghindar daripada pemilikan ke atasnya kecuali kepada Allah S.W.T sahaja.

Istibdal berdasarkan pandangan Para Fuqaha'

Menurut Imam Malik, istibdal adalah tidak dibenarkan kecuali dalam beberapa keadaan sahaja iaitu jika berlaku perubahan dari harta alih kepada harta tidak alih. Ia juga dibenarkan jika dalam keadaan darurat seperti pembesaran masjid, tanah perkuburan dan jalan umum. Hal ini dibenarkan atas asas jika dihalang kaedah istibdal maka ia akan mendatangkan masalah yang besar kepada masyarakat umum. Sehubungan itu, para ulamak telah bersependapat bahawa istibdal tidak boleh dilakukan kepada semua masjid[11]. Mereka berpendapat bahawa harta wakaf tak alih (iqar) tidak boleh diistibdalkan sekiranya manfaat dari harta tersebut masih boleh digunakan. Namun mereka berpendapat , sekiranya ia mempunyai kepentingan umum (maslahah umum) seperti memperluaskan saiz masjid, kawasan perkuburan ataupun jalan, ,maka isitbdal adalah dibenarkan untuk dilaksanakan[12].

Manakala Ibnu Rushd pula menyatakan, jika harta wakaf berkenaan tidak boleh lagi mendatangkan manfaat, maka ia boleh ditukarkan dengan syarat mendapat persetujuan qadhi atau pemerintah di tempat tersebut. Namun begitu, alasan yang sangat kukuh perlu

[11] Al-Zuhailliy. Al-fiqh al-islami wa adillatuhu. Damsyiq; Dar al-fikr. Vol.8,hlmn.220.

[12] Al-Dardir, Abu Barakat Ahmad Bin Muhammad Bin Ahmad, 1986, Syarh al-Saghir ala Aqrab al-Masalik ila mazhab al-Imam Malik. Cairo; Dar al-Ma'arif, Edisi pertama, hlmn. 126.

diutarakan bagi mengelakkan agar istibdal ini disalahgunakan oleh pihak yang tidak bertanggungjawab.

Selain itu, mazhab syafie pula berpegang teguh dengan hadis yang diriwayatkan oleh Saidina Umar r.a. yang melarang istibdal. Oleh itu, syarat am wakaf iaitu harta berkenaan tidak boleh dijualbeli, dihibah atau diganti adalah menjadi pegangan bagi mazhab ini. Para ulamak dari mazhab ini menyatakan bahawa sekiranya harta yang diwakafkan ialah sebuah masjid, maka konsep istibdal tidak boleh dilaksanakan. Ia sama sekali tidak boleh dijual kepada umum mahupun pihak lain. Mereka berpandangan bahawa harta wakaf (masjid) ini adalah hak milik Allah s.w.t. Sehubungan itu, harta tersebut perlu digunakan untuk tujuan manfaat masjid terdekat. Walau bagaimanapun, jika manfaatnya tidak dapat disalurkan kepada masjid terdekat, maka ia masih perlu dipelihara kesucian harta wakaf (masjid) tersebut sebaik mungkin. Namun begitu, pada masa yang sama, hamparan masjid yang telah lusuh diharuskan untuk jualan. Begitu juga dengan batang kurma yang tiada hasil dan boleh dijual untuk manfaat lain. Sekiranya ia dikekalkan tidak akan mendatangkan manfaat, maka jalan terbaik ialah dengan menjual harta tersebut dan diganti dengan harta yang lebih baik untuk manfaat penerima wakaf[13].

Namun begitu, terdapat pendapat kedua dalam mazhab syafie yang menyatakan bahawa sesuatu harta yang diwakafkan untuk tujuan masjid boleh isitbdal dengan syarat mendapat keizinan dari pihak berkuasa setelah mendapati harta tersebut mengalami kerosakan yang teruk dan tidak boleh diperbaiki lagi. Hukum berkaitan proses istibdal ini juga perlu mendapat kebenaran Sehubungan itu, jika pihak berkuasa memberi keizinan, maka masjid tersebut boleh dirobohkan dan diganti dengan masjid yang baru untuk kegunaan jemaah[14].

Walaupun masyarakat di negara ini merupakan pengamal mazab syafie yang sememangnya tidak membenarkan istibdal, namun dalam pelaksanaan kaedah istibdal

[13] Al-Syarbini,mughni muhtaj. Maktabah Mustaba al-babi al-halabi.mesir . vol.2, hlmn..392.

[14] Al-Ramli. Nihayat. Vol. 5. hlmn.. 394.

yang diperuntukkan di dalam Kaedah-kaedah Wakaf 1983 adalah bertaqlidkan kepada Imam Ahmad Ibnu Hambal (Mazhab Hambali) yang membenarkan istibdal tapak masjid dengan tapak masjid yang lain.

Istibdal dari Perspektif Undang-undang

Enakmen Wakaf Selangor mendefinisikan istibdal sebagai menggantikan sesutu harta wakaf dengan harta lain atau wang yang sama atau lebih tinggi nilainya sama ada melalui gadaian, belian, jualan atau apa-apa cara lain menurut hukum Syarak[15]. Ia juga menjelaskan bahawa tujuan istibdal harta wakaf adalah sama dengan pembentukan saham atau sijil wakaf iaitu sebagai inisiatif bagi menggelakkan pembekuan harta wakaf sekaligus mendorong pembangunan terhadap harta wakaf yang sedia ada.

Selain dari peruntukan Enakmen Wakaf Selangor, negeri Johor juga memberikan takrifan khas berkaitan istibdal. Ia adalah amat penting bagi memudahkan pihak Majlis Agama dalam mencari punca kuasa bagi melaksanakan proses istibdal di negeri Johor. Takrifan yang diberikan ialah satu proses penggantian harta wakaf dengan harta lain yang lebih baik dengan tukaran atau belian atau jualan atau sebagainya menurut hukum syarak[16].

Pembentukan Parameter Istibdal

Konsep istibdal yang diperkenalkan dalam pembangunan wakaf adalah amat signifikan. Ia perlu digunakan dengan sebaik mungkin bagi mengelakkan sebarang penyelewengan ke atas harta wakaf tersebut. Sehubungan itu, penulis telah membuat beberapa cadangan bagi membentuk kaedah parameter yang bersesuaian dalam mempraktikkan konsep istibdal. Sehubungan itu, ia boleh digunapakai oleh pembuat keputusan dalam hal ehwal pengurusan harta wakaf untuk tujuan pembangunan. Cadangan pembentukan parameter ini adalah seperti berikut :-

[15] Enakmen Wakaf Selangor, bil.7 Tahun 1999, Seksyen 2(1).

[16] Kaedah-kaedah Wakaf Johor Tahun 1983.

Parameter Satu

Aset yang hendak diistibdalkan tidak mempunyai hasil yang menguntungkan. Ia boleh dinilai sekiranya harta tersebut yang disewakan mempunyai nilai sewaan semasa yang sangat sedikit. Bahkan, ia juga tidak mampu menampung kos operasi sebenar bagi hartanah wakaf tersebut. Keadaan ini boleh berlaku khususnya di kawasan luar Bandar yang mempunyai nilai pasaran sewaan semasa yang tidak tidak kompetitif. Oleh itu, parameter ini perlu diambil kira bagi menilai semula objektif pewakafan yang dinyatakan oleh syarak.

Parameter Dua

Tidak mengandungi unsur-unsur penipuan dalam jual beli harta wakaf yang diistibdalkan. Perkara ini melibatkan isu yang berkaitan penjualan dan pembelian hartanah wakaf tersebut. Keadaan ini perlu dipantau oleh jawatan kuasa pengurusan harta wakaf di negeri masing-masing. Ia sememangnya tidak akan dilakukan oleh pihak Majlis yang menguruskan harta wakaf tersebut, namun pihak ketiga yang berurusan dalam proses jual beli ini perlu diberikan perhatian yang sewajarnya.

Perkara ini mungkin berlaku sekiranya pembeli aset wakaf mempunyai niat yang salah khusunya dalam mencemarkan imej Islam. Situasi ini mungkin berlaku apabila pembeli berhajat untuk membangunkan pusat loteri atau kedai arak ditempat tersebut. Kesannya akan memberikan impak negatif kepada pihak Majlis Agama Islam.

Parameter Tiga

Aset yang dibeli memberi lebih manfaat dan berkualiti berbanding aset wakaf yang dijual. Sehubungan itum bagi pemilihan aset baru yang hendak dibeli, kebenaran perlu diperolehi terlebih dahulu dari golongan pakar. Ia akan melibatkan pakar syariah, mufti serta ahli ekonomi dan penilai hartanah. Ia bertujuan bagi memberikan pandangan profesional tentang pembelian harta wakaf baru serta membantu pihak Majlis dalam melakukan keputusan yang tepat terhadap harta wakaf tersebut.

Parameter Empat

Harta wakaf berkenaan tidak mampu dimajukan atau tidak memberikan hasil kepada penerima manfaat wakaf. Pelaksanaan harta wakaf yang diniatkan untuk tujuan sewaan rumah dan hasilnya dinikmati oleh penerima wakaf. Namun, rumah tersebut telah mengalami kerosakan yang teruk dan tidak boleh didiami lagi. Maka konsep istibdal ini boleh dibuat dengan menjualkan rumah tersebut dan diganti dengan rumah yang lain.

Parameter Lima

Istibdal juga tidak boleh dilakukan jika penjual/pembeli harta yang diragui kesaksiannya. Ia juga merujuk kepada individu yang sekiranya mempunyai perkaitan dengan mana-mana pihak yang berkepentingan dengan institusi wakaf. Keadaan ini boleh menimbulkan keraguan kerana akan melibatkan pihak yang berkepentingan. Sehubungan itu, ketelusan dan integriti sangat penting dalam menguruskan harta wakaf ini.

Parameter Enam

Aset yang hendak diistibdalkan perlu disesuaikan dengan niat pewakaf. Segala syarat atau penerima wakaf yang diminta oleh pewakaf perlu dipatuhi supaya ia mencapai objektif wakaf yang sebenarnya. Perkara ini boleh diperincikan melalui surat cara wakaf yang dikemukan oleh semua MAIN berkaitan prosedur melakukan wakaf. Sekiranya aset yang diwakafkan diniatkan bagi tujuan penduduk fakir miskin, maka apabila harta wakaf itu diistibdalkan, hasil dari aset wakaf yang baru itu perlu diberikan kepada golongan tersebut sebagai penerima manfaat.

Parameter Tujuh

Istibdal ini seharusnya diputuskan oleh mufti atau hakim yang mempunyai keilmuan yang tinggi. Ia bertujuan agar dapat memberikan manfaat yang sempurna bagi mengelakkan dari sebarang masalah ataupun fitnah terhadap institusi wakaf jika kaedah istibdal iaitu penjualan serta belian harta wakaf dilaksanakan secara berleluasa. Perkara ini sangat penting bagi menjaga keutuhan institusi wakaf pada masa hadapan.

Parameter Lapan

Istibdal berdasarkan kepada kepentingan yang *rajih*. Ia adalah satu daripada keperluan semasa dan menjadi keutamaan keagamaan. Antara keperluan utama dalam masyarakat ialah keperluan ruang untuk mengadakan solat jumaat. Oleh itu, jika masjid yang terdapat kini tidak mencukupi maka pengubahsuaian dan pelaksanaan istibdal boleh dipertimbangkan bersama. Ini disebabkan apabila ruang masjid boleh diluaskan dari sudut penggunaan ruang, ia berupaya menyempurnakan tuntutan wajib solat fardhu jumaat kepada masyarakat setempat.

Parameter Sembilan

Saiz tanah yang terlalu kecil atau kedudukan tanah wakaf yang tidak strategik. Perkara ini boleh berlaku dalam beberapa keadaan seperti seseorang individu yang mewakafkan hartanya tanpa merujuk kepada lokasi asset tersebut. Bahkan, perkembangan setempat yang berhampiran dengan hartanah wakaf juga perlu diambil pertimbangan seperti lot kedai yang diwakafkan berada di kawasan pusat hiburan dan rumah urut. Oleh itu, adalah wajar pertimbangan parameter ini boleh diketengahkan bagi mengelakkan sebarang fitnah dan seterusnya mengoptimumnya nilai hartanah wakaf tersebut.

Kesimpulan

Harta wakaf adalah harta yang diamanahkan oleh Allah. Ia tidak boleh dijual dan dipindah milik kepada mana-mana individu. Ia juga adalah satu amanah yang sangat besar untuk dilakukan oleh pemegang amanah. Justeru itu, ketelusan dalam memperkasakan institusi wakaf adalah sangat penting. Setiap Majlis Agama yang bergerak atas panji Islam perlu senantiasa melakukan perubahan demi memberikan nilai tambah kepada aset wakaf di negeri masing-masing. Parameter istibdal yang diperkenalkan ini diharap dapat memberikan manfaat kepada pihak yang berkenaan untuk dijadikan maklumat sokongan dalam melaksanakan proses istibdal.

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AN EFFECTIVE INVESTMENT TOOL FOR *WAQF* FUND MANAGEMENT: A STUDY IN MALAYSIA

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Abstract

Waqf (endowment) is an Islamic model by which one makes a voluntary, permanent and irrevocable dedication of a portion of one's wealth either in cash or kind, for a certain purpose for certain beneficiaries. Once assets are set aside for *Waqf*, they can never be gifted, inherited or sold. The idea is that the capital remains intact, and the yield of investment is used for the beneficiaries. Hence the concept of sustainability is ensured. Sustainable funds available for long-term social and environmental conservation issues in the region are not growing in proportion to the growth in the scale nor the importance of the issues. Although there is considerable presence for international, assistance and cooperation organizations in the region, their main focus remains on social economic development projects and direct to charity work. Funds that are available for social development or environmental conservation are mostly for short-term projects that do not necessarily create marginal impact. Therefore major durable and stable investments tools must be explored and applied to address these challenges. In fact, *Waqf* fund management in Malaysia is not effectively managed by the authorities' body, and indeed there are many reasons for the ineffectiveness of *Waqf* management fund in this country. Therefore, this paper tries to explore the best and effective tools for managing the *Waqf* fund in Malaysia. The research methodology of this paper is a qualitative research, namely through library-based research and document analysis. The funding shows that the proper investment tools are needed in order to make sure *Waqf* fund are managed properly and effectively.
Keywords: *Waqf, Waqf* Funds, Investment Tools

1. INTRODUCTION

The management of *Cash Waqf* has a unique characteristic that is conceptually different from the management of foundation, charities or donation fund in Western perspective. *Waqf* has a principle of perpetuity that makes it differs from a foundation, charity or

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ordinary donation fund as widely practiced in Western countries. Perpetuity principle means that the principal of *Waqf* should be preserved, but its benefit is available for repeating extraction whether for religious or philanthropic and righteousness purposes. Perpetuity in *Waqf* means that once a property is devoted as a *Waqf*, it remains so that until the Day of Judgment and no one can change it later on. So the property of *Waqf* cannot be sold, transferred or liquidated. The ownership of *Waqf* property lies outside the *Waqif* (person who performs *Waqf*) or *Mutawalli* (person who entrusted to manage) but it belongs to Allah. So the *Waqf* property should be hold, maintained, preserved and prohibited from disposing. In this paper, the management of *waqf* fund in the form of investment tools will be explored in order to ensure the perpetuity of *waqf* fund will be remained unchanged and further developed.

1.1 Definition of *Waqf*

Literally, *Waqf* came from Arabic word which means make endowment of the land and give it to the needy. It is a religious endowment, recognized by *Shariah* as religious, pious or charitable donation (Mustaffa al-Khinn, 1992; al-Sarakhsi, 1986) . *Waqf* is an act of holding certain property and preserving it for the confined benefit of certain philanthropy, and prohibiting any use or disposition of it outside that specific objective (Kahf, 2002). *Waqf* also means make endowment of houses and keep its gains in the way of God. By this we can understand that *waqf* or endowment is to preserve or upkeep the original wealth, whether land or house and give its profit to needy. In term of word or phrase the four eminent Muslim scholars have given different meaning of *waqf* or endowment as follows: -

- Al-Hanafi

"*Waqf* is to preserve and up keep the original wealth that belonged to someone else and gives the profit to the need" (al-Sarakhsi, 1986).

By this we can learn that *waqf* is to preserve and upkeep wealth or something that can give benefit or profit, without being consummated by the original owner and give that benefit or profit to the needy.

- Al-Maliki

"Ownership of the profit from the origin of wealth which was given for endowment and gives it to whoever the endowment was meant for or the needy" (Ibn Abidin, 1966; al-Khatib, 1958).

By this we can understand that *waqf* is giving the right to consummate the profit of wealth that was given for endowment to whoever the endowment was meant for or the needy.

- As-Syafi'i

"*Waqf* is to keep the wealth that can give benefit, and keep it remaining in the same form while the original owner cannot consume it" (al-Khatib, 1958).

We can learn that *waqf* is to keep the wealth that can give benefits to needy, and that wealth remains in the same condition while the original owner cannot consume it.

- Hanbali

"*Waqf* is keeping the original owner from consuming wealth that he had endowed, which produce benefit should remain in the same form" (Ibn Qudamah, 1972).

By this we can understand that *waqf* is wealth that kept from the consummation of the original owner and give its benefit to the poor and needy, and that wealth must remain in the same condition without being consummate by the first owner.

From these four eminent scholars' views we can learn that all scholars agreed that the *waqf* is to keep the origin wealth and used its profit for charity in order to help the poor and needy.

1.2 Pillars of *Waqf*

- The *Waqf* giver (*al-waqif*)

The donor is the person who withholds (blocks) the property, provided that the *waqf* is disposable, that is to say the person should be competent to practice tasks depending on man's sanity. The one who is free, matured (*baligh*), sane or fully responsible *('aqil*), sincere and legally entitled to the wealth when declaring the *waqf* (Mustaffa al-Khinn, 1992; Ibn Abidin, 1966).

- The wealth designated for the endowment (*al-mawquf*)

Wealth to be declared must be physically tangible items such as a house or plot of land. Donor must legally own the declared wealth or property and it must be able to benefits the community and transferable. In principle *waqf* is permanent and there must be a clause in it that perpetuate its objective, such as income of the *waqf* must be given to my daughter and after her death to the poor and needy in a given area or town (Mustaffa al-Khinn, 1992).

- The recipient of the endowment (*al-mawquf 'alaih*)

It can be specific (assigned) recipient whether one person or more. . The unassigned can be an entity, such as the poor, Mujahedeen (warriors), mosques, hospitals, schools, preparing the dead for burial and Quran. The beneficiary party should meet two conditions:-

First: To be competent for ownership whether being assigned or unassigned.
Second: The beneficiary should be charitable field or good deed not for sinful purposes *waqf* for *dhimmis* are allowed, but not for non-Muslims worshipping places. *Waqf* may be granted for non-Muslims that are not in war status with Muslims as they are entitled to *sadaqah* (alms) (Mustaffa al-Khinn, 1992).

- The legal statement of the endowment (*al-Sighah*)

'Aqad is understandable words or writings for any purpose of *waqf* whether general *waqf* or specific *waqf*. It is compulsory to validate the *waqf.* Sometimes an action to denote a *waqf* as known to people, such as making one's house a mosque and permitting people to perform their prayers in it, or assigning a piece of land to be graveyards and allowing people to bury their dead in it also amounts to expression (Mustaffa al-Khinn, 1992). Imam Abu Yusuf considers the declaration by the *waqif* of his intention to create *waqf; sighah* should not be time specific or conditional. *Aqad* statement is of two types:-

- Explicit statement (*lafz sorih*): A clear statement that entails one exact meaning only likes "I give my house to be *waqf* for the poor people". Such as saying I (endowed, blocked, devoted, named), these are clear words that do not have any other meaning but *waqf*. When a person says any of those words the *waqf* shall be valid.
- Implicit statement (*lafz kinayah*): Statements that have more than one meanings like "My property is a charity (*sadaqah*) to the poor people"

2. THE CONCEPT OF *WAQF*

The concept of *waqf* is the charitable purchase/development of an item for the benefit of the community at large. *Waqf is* a form of continuous charity (*sadaqah jariyah*), and the rewards for this type of charity continue even after the donor's death - for as long as people continue to benefit from the *Waqf*. Abu Hurairah (RA) related that the Prophet (SAW) said,

"*After the death of a person, his actions stop, except three things that he leaves behind: first, continuous charity, second, knowledge from which some benefit may be obtained, and then, a virtuous son who prays for him.*" (Muslim)

The continuous charity that the Prophet (SAW) had mentioned is *Waqf.* One example of the first recorded *waqf* is that when a man named Mukhairiq who is in his Will bequeathed seven of his orchards to Prophet (SAW) on his death, the Prophet (SAW) took hold of the orchards and made them a charitable *waqf* for the poor and needy.

Waqf continued to play a key role in the development of Islamic civilizations. Muslims then began to donate their piece of land for mosque. As mosques was the major source of knowledge and education, the *waqf* tradition was then expanded into buildings of center of education, hospitals, public facilities, residential areas, which some are still be used to date (Siti Mashitoh, 2006).

3. DEFINITION OF CASH *WAQF*

- Appropriation of the *Mawquf* (property) with its separation from private ownership and dedication of its usufruct to charitable purpose. So *Cash Waqf* according to upon definition means "the devotion of an amount of money by a founder and the dedication of its usufruct in perpetuity to the prescript purposes" (Magda Ismail Abdel Mohsin, 2008, P.4)
- The dedication of some money from one's possessions and establishing a *Waqf* based on that amount and offering it to the benefit of people generally or allocating it to make use of them by some segments of the community particularly. In this meaning and from theoretical and implemented point of view, some kinds of *Waqfs* have caused disputes.
- Diverting funds (and other resources) from consumption and investing them in productive assets that provide usufruct or revenues for future consumption by individuals or group of individuals.

4. CONCEPT OF CASH WAQF

Cash *waqf* concept is aimed at mobilizing public funds to be pooled as a *waqf* asset (financial capital/endowment) to be managed in such a way that it can generate income

stream besides maintaining its initial value to grow, or at least to preserve its perpetuity, then the income generated from investing the funds will be distributed to the beneficiaries.

Preserving the perpetuity of *waqf* is a very important character in managing *waqf* assets, inclusive of cash *waqf*, because it is an essential characteristic of *waqf*. In this regard, it is very important to design a basis for valuation of this financial *waqf* asset. In addition, due to its financial nature of the asset, it has to take into account of the general price changes, i.e. inflation rates. Based on this concept, it implies that there are three important steps in developing cash *waqf* organization and management;

i. Mobilizing Donation (fund raising method)
ii. Utilizing the pooled funds to generate income (portfolio investment method)
iii. Distributing the benefit/income to the beneficiaries.

Mobilizing funds requires an effective method of fund raising, considering the voluntary nature of *waqf*. In this regard, certification might be considered one simple way. Various nominal values might be issued for each certificate considering affordability of the potential donors to target. In this respect, the value of donation should be set in a way that it considers valuable. This is one important advantage of cash *waqf* concept compared to other types of *waqf*. It can target various segment of a community to participate, due to its flexibility and affordability in donation.

Managing the pooled funds will be the next step. An important principle in managing this financial asset is to apply income generating orientation or to be as productive as possible so that positive income stream can be generated. This principle implies that the funds should be used and invested in productive business ventures. There will be many options to arrange investment portfolio available as medium of allocating funds. This option includes direct investment into real sector through partnerships model (equity investment) with business players, and indirect investment through depositing funds in banking companies, or various security instruments. In this respect, it has to take into account the return and risk nature of each types of investment chosen.

In addition**,** Cash *waqf* emerges as a financial instrument which combines both economic and profit and social motives. The cash *waqf* model is meant to develop and enhance the financial services for micro and medium sized enterprises (MMEs). The investment of cash *waqf* be dedicate to debt financing which has a low risk investment to generate profit and expand the fund of cash *waqf*, and can be expanded to equity financing as well to assist the medium size enterprises in micro credit and micro financing.

A Cash *Waqf* is a *Waqf* whose corpus consists of cash. Initially, segments of the learned class objected to this type of *Waqf* on the grounds that the corpus must be immovable. However, following bitter struggles between generations of pragmatists and moralists, the lure of extending the wealth-sheltering advantages of the *Waqf* to the holders of liquid wealth proved irresistible (Mandeville, 1979). The Ottoman courts approved these endowments as early as the beginning of the 15th century and by the end of the 16th Century they had reportedly become extremely popular all over Anatolia and the European provinces of the Empire (Cizakca, 2004).

5. DEVELOPMENT OF CASH *WAQF*

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The Ottoman courts approved these endowments as early as the beginning of the 15th century and by the end of the 16th Century they had reportedly become extremely popular all over Anatolia and the European provinces of the Empire (Cizakca, 2004). Cash *Awqaf* delivered a return on capital by lending at interest, which itself was a controversial topic. A portion of them operated as money lending operations for the benefit of individuals and families. Even here, however, the distinction between a *Waqf* and a commercial organization was sustained. Whereas moneylenders outside the *Waqf* sector could pool resources within financial partnerships, which they did for short periods and on a small

scale, Cash *Awqaf* could not merge in order to supply credit on a larger scale. This may be seen as the reason why they failed to develop into banks.

In Malaysia, the developments of *Waqf* activities and institutions have increase tremendously. In recent years, ideas have evolved particularly on the contemporary *waqf* activities in Malaysia. For example, JCorp has come up with their innovation on corporate *waqf*. Former Prime Minister of Malaysia Dato' Seri Abdullah Ahmad Badawi has also suggested the establishment of *Waqf* Fund (*Tabung Waqaf Sedunia*)(Siti Mashitoh, 2006) and also establishment of *waqf* Enactment (Negeri Sembilan) 2005 (Siti Mashitoh, 2006.) All these are among new innovation toward modern and contemporary platform for *waqf* development in Malaysia.

Historically, it is presumed that *waqf* institutions existed in Malaya later known as Malaysia, since the advent of Islam in the country around 1500CE (Siti Mashitoh, 2006). The origin and development of *waqf* in the country can be divided into three different periods; pre-colonial, colonization and post-independence. At the latter stage, great efforts have been taken by *waqf* authorities towards developing as well as establishing new types of *waqf* assets. Continuous supports from the government and private agencies also play a key role in enhancing and stimulating this philanthropic institution to achieve its main objective of improving the socio-economic welfare of the people in the country.

Not much information on the development of *waqf* practice during pre-colonial period of Malaya can be obtained. However, Pahang Laws enacted in 1596CE thought to be the first codified laws pertaining to *Waqf* in the country (Mashitoh, 2006). Besides acknowledging Shafi'i rulings in matters relating to *Shariah*, the law also recognizes two types of *waqf* assets; movable and immovable, as well as classifying *waqf* properties into two main categories; public and special *waqf*. In term of *waqf* assets, three mosques, namely; The Kg. Hulu Mosque, Kg Laut Mosque and Sultan Abu Bakar are considered to be among the earliest *waqf* creations in Malaysia (Mashitoh, 2006).

Waqf institutions continued to survive although Malaysia was colonized for more than four hundred years. This practice became widespread, in particular during British occupation in which the implementation of secular policies by the British forced the Muslims to safeguard their religious rites. Muslims were encouraged to donate their lands for the purpose of building mosques and religious schools. Late 19 centuries had seen the development of the traditional *pondok* education in Peninsula Malaya (Ahmad Zaki *et.al*, 2006).

Muslims generously dedicated their assets for the establishment of accommodation for teachers and *pondok* accommodation for students. The trusteeship of *waqf* assets during this period was placed under various parties, for example *penghulus*, the *qadis,* and religious school teachers. As no written documentation was in place, it is difficult to trace the actual number of *waqf* properties including the ownership of *w*aqf assets transferred to the trustee's heirs.

Waqf developments and activities in the post-independence era of Malaysia have been encouraging. All matters relating to *waqf* assets are vested under the State Islam Religious Councils (SRIC), in accordance to Ninth Schedule (State List) of Federal Constitution of Malaysia (Ahmad Ibrahim, 1997). As the sole trustee of *waqf* properties, SRICs are empowered by law to appoint any individual or committee acting as its representative and also use *waqf* assets to generate income through yields and rentals. In contrast to past experience, *waqf* authorities not only develop *waqf* for establishing religious places but also build shop lots and commercial properties on *waqf* lands. To overcome the problem of getting enough funds for *waqf* development projects, various financing mechanisms have been used by *waqf* managers including *hukr, ijaratain, istibdal* and *sukuk musyarakah* (Mohd Tahir Sabit, 2006).

Waqf authorities also introduced the cash *waqf* concept for fund raising purposes and the proceeds channeled *to finance waqf activities. Various types of cash waqf concept such as waqf shares models, takaful* waqf model and corporate cash *waqf* models have been developed by *waqf* authorities in Malaysia (Magda, 2008).

In recent years, various steps have been taken by the government and private companies towards accelerating and stimulating *waqf* developments in the country. The establishment of the Department of *Waqf, Hajj* and *Umrah* in 2004 under the Ministry of Prime Minister Department shows the commitment of Federal Government to consolidate *waqf* activities at national level (www.jawhar.gov.my). Among the main duties of the Department are to coordinate, facilitate and enhance SRIC in administrating and developing *waqf* properties in their respective areas.

In 2008, the *Waqf* Foundation of Malaysia (YWM) was set up to strengthen *waqf* developments in the country. Currently, the foundation actively promotes its *waqf* fund projects and cash *waqf* scheme (www.ywm.org.my). Corporate *waqf* share launched in 2006 by Johor Corporation demonstrates the company's assurance to be one of the leaders in promoting corporate social responsibility via philanthropic *waqf* practice. Kumpulan Waqf An-Nur, a subsidiary of JCorp has been successfully developed a number of clinics known as An-Nur Waqf Clinic in various places and a hospital in Pasir Gudang (www.jcorp.com.my). The initiative taken by JCorp can be used as a model for other private companies to actively involve in promoting, establishing and developing *waqf* properties in Malaysia.

6. *WAQF* AS AN INVESTMENT TOOL

Here some of Islamic funds instruments which can be used for various *waqf* projects. For credit-based financing, the use of build and transfer (*murabahah/al-Bay' Bithamin Ajil*), forward sale (*istisna'/salam*) and leasing (*ijarah thumma al-bay'*), which comprises of build-lease-transfer (*ijarah muntahia bittamleek*) and build-sale-leaseback (*mersad*). Financing *waqf* projects can be done via issuance of Islamic bonds (*sukuk*), which can be carried out through *mudarabah* and *ijarah* structures. Some of these Islamic investment instruments that can be applied in *waqf* projects are as follows:

6.1 Build-lease-transfer (*ijarah muntahia bi al-tamleek*).

Through this instrument, the financier would build the buildings on the *waqf* lands. After completion, the *waqf* institutions would lease these buildings for a period of time, in

which by the end of the tenure, the financier would have recovered its funding and the desired profits. At the end of the lease period, the ownership of the buildings will be transferred to *waqf* either through sale, gift, or mere disposal by way of abandonment.

6.2 Asset-based *Mudarabah*.

Under this mode, the *waqf* institution lets the financier construct a building on *waqf* land, while the developer exclusively manages the project. Upon completion, the building is rented to a third party. The rental is shared between the institution and the developer. The *waqf* institution uses the revenue from the rental of the building to increase its share in the building and to distribute it among the beneficiaries. This mode is suitable to finance "building" and "industrial" types of *waqf* lands because the cost of construction is usually high. The proceeds from the rental of these types of buildings will be sufficient to pay for the high cost of constructing these buildings.

6.3 Securitization of Project (shares and *sukuk*).

Under equity participation financing mode, either via *mudarabah* equity or *musharakah* equity, through a single project *waqf* holding corporation, assets relating to a project can be unitized, with a nominal value for example, RM1 per unit, representing a share in the physical assets of the project. These shares can be sold and purchased easily in the open market by the interested public, hence providing liquidity in the said investment. Concerning *sukuk*, two types of asset-backed bonds can be structured, namely *muqaradah* bonds and *ijarah* bonds. Under *muqaradah* bonds, the *nazir* who is also the *mudarib* or the fund manager, issues bond certificates to the financier in return for cash deposits. These cash deposits are used to carry out development projects on the waqf lands. Unlike equity participation, the financier or the bondholder is only entitled to the benefits or *manfa'ah* of the attached assets, and not to the capital appreciation.

7. CONCLUSION

It is clear that through innovative *waqf* fund systems various parties of a society can reap the benefits including the poorest of the poor section that are not generally reachable by government or other agencies. These practices help in the fulfillment of religious

requirement through performing various activities and mobilizing resources from rich to poor, creating employment opportunity to develop socioeconomic conditions of the poor and whole society as ultimate results. It also help to reform the present institutional setup and their networking relationship throughout the country, with a view to increasing their performance in the direction of the efficient and need based dynamic management of the *waqf* affairs and systems.

The role of *waqf* institutions can be made more prominent by integrating their activities in the overall development plan of the country. In this context, however, there is a need to improve the status of the organizations of *waqf.* This can be done not only by adopting laws that create incentives for their growth and development but also devising appropriate organizational structures and institutional models that can enhance the efficiency of the operations.

In the nutshell, the investment tool for *waqf* fund in Malaysia is very crucial as a way to enhance the economy of our *ummah* by enhancing the financial stability of the citizen of Malaysia. Thus, we must take an aggressive action to leverage the income and welfare of the Muslim *ummah*. There are a few methods that can be implemented in order to strengthen this system. First, we need to outreach the *waqf* fund investment tool system into other states despite Johor (JCorp). Second, with the establishment of Malaysia as the world's first corporate *waqf*, we will be the lead in the revolution of making *waqf* as a serious and professional entity in every country in the universe.

This *waqf* fund investment tool system can also bring all the Muslim around the world a better future. In terms of medical facilities we can serve a free dialysis center in every mosque for the needy, volunteer medical assistance and etc. Besides that, through the fund of *waqf* on land we can build a commercialize mosque that works as a center to gather and do *muamalah* among all Muslims for any occasion such as organizing a wedding, talk, seminars, *musabaqah*, convention and many more. Indeed, there's so much innovative idea that will arise when we unite in the name of Islam and contribute to the *ummah* by using the vehicle of *waqf* fund investment tool system.

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PERBANDINGAN KAEDAH PENGURUSAN PENGAGIHAN ZAKAT OLEH INSTITUSI PERBANKAN ISLAM MALAYSIA[1]

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Abstrak

Pengagihan zakat secara efisien dalam sistem pentadbiran dan pengurusan zakat merupakan penentu untuk mengukur sejauhmana keberkesanan objektif dan matlamat zakat yang diwajibkan dalam Islam. Sebagai sebuah institusi kewangan yang menjalankan operasi perniagaan berlandaskan prinsip Syariah, adalah menjadi kewajipan setiap institusi perbankkan Islam untuk mengeluarkan zakat perniagaan daripada keuntungan operasi perniagaan perbankkan yang dijalankan. Selain daripada diagihkan ke seluruh negeri melalui pusat zakat dan Majlis Agama Islam Negeri, bank juga mengagihkan zakat secara terus kepada beberapa golongan asnaf yang berhak menerima zakat mengikut polisi dan peraturan yang telah ditetapkan. Asnaf *fisabilillah* merupakan salah satu golongan yang berhak menerima zakat sebagaimana yang telah ditetapkan dalam al-Quran. Institusi perbankkan juga memberikan zakat kepada asnaf ini berdasarkan polisi mereka. Justeru, artikel ini akan mengkaji tentang kaedah pengurusan pengagihan zakat kepada asnaf *fisabilillah* dengan membuat perbandingan di antara dua institusi perbankkan Islam. Di samping itu juga, artikel ini akan melihat secara terperinci penetapan dan pemilihan asnaf yang layak menerima zakat khususnya asnaf *fisabillillah* serta jumlah zakat yang diberikan kepada asnaf ini. Diharapkan artikel ini dapat menjadi platform dalam mencetuskan beberapa cadangan bagi memastikan tadbir urus zakat lebih teratur dan berkesan khususnya di institusi perbankkan Islam di samping memastikan zakat yang diberikan kepada asnaf benar-benar dapat mencapai matlamat yang ditetapkan dalam Islam.

Kata kunci : Zakat, Asnaf *Fisabilillah*, Pengurusan, Kaedah, Pengagihan & Bank

1. 0 PENDAHULUAN

Zakat adalah salah satu instrumen ekonomi dan sosial. Ia bukan sekadar berperanan sebagai pemacu dan indikator ekonomi tetapi sekaligus mampu menyeimbangkan keadilan sosial ummah. Atas premis itulah, zakat kekal berperanan sebagai elemen penting dalam kehidupan umat Islam sampai bila-bila. Membayar zakat ialah salah

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satu usaha penyempurnaan ibadah, membersihkan harta dan membersih diri dari kebakhilan. Ia berperanan bukan sekadar memenuhi tuntutan agama tetapi juga tanggungjawab kewangan seseorang individu muslim, badan dan kumpulan yang beridentitikan Islam terhadap masyarakat.

Secara amalan di Malaysia, wang dan harta zakat yang dibayar diagihkan kepada asnaf-asnaf yang layak oleh pusat zakat atau baitulmal. Namun begitu terdapat juga syarikat-syarikat korporat umumnya dan bank-bank khususnya turut membuat agihan wang zakat secara terus tanpa melalui pusat zakat atau baitulmal. Kebiasaannya bank akan mengeluarkan zakat berdasarkan keuntungan tahunan yang mereka perolehi dan membayar terus kepada pusat-pusat zakat atau baitulmal di Majlis Agama Islam Negeri. Walau bagaimanapun, institusi perbankkan juga ada menyalurkan zakat secara langsung kepada golongan asnaf melalui agensi-agensi kerajaan atau bukan badan kerajaan.

Pembayaran zakat yang dibuat oleh institusi perbankan bukan sekadar melaksana tanggungjawab sosial yang diwajibkan tetapi juga dilakukan sebagai satu aktiviti dakwah kemasyarakatan bank. Setiap perbankan Islam mempunyai polisi dalam pengagihan zakat kepada asnaf-asnaf. Ia menjadi satu peraturan dan garis panduan operasi untuk mengira jumlah dan mengagih wang zakat perniagaan bank. Peraturan yang jelas juga penting untuk membolehkan pengurusan zakat di bank dibuat dengan lebih licin, telus dan terbuka. Hal ini jelas menunjukkan bahawa perbankan Islam merupakan badan koporat yang melakukan aktiviti perbankan patuh syariah, melaksanakan tanggungjawab syarak dan aktiviti dakwahnya kepada masyarakat.

Asnaf *fisabilillah* merupakan salah satu golongan yang berhak menerima zakat sebagaimana yang telah ditetapkan dalam al-Quran. Institusi perbankkan juga memberikan zakat kepada asnaf ini berdasarkan polisi mereka. Justeru, dalam artikel ini penulis akan mengkaji tentang kaedah pengurusan pengagihan zakat kepada asnaf *fisabilillah* dengan membuat perbandingan di antara dua institusi perbankkan Islam.

Di samping itu juga, artikel ini akan melihat secara terperinci penetapan dan pemilihan asnaf yang layak menerima zakat khususnya asnaf *fisabillillah* serta jumlah zakat yang diberikan kepada asnaf ini. Oleh itu, penulis akan membuat tinjauan awal

di dua buah perbankan Islam di Malaysia iaitu Bank B dan Bank R sebagai sampel bagi kajian ini.

2. 0 PENGURUSAN AGIHAN ZAKAT OLEH BANK B DAN BANK R

Bank B telah memulakan operasi Jendela Islam (*Islamic Window*) sejak tahun 1994 dan hampir 16 tahun bank ini telah memulakan perniagaan dan pelaburan berteraskan Syariah. Sebagai sebuah institusi perbankan Islam di Malaysia, Bank B sentiasa komited dalam menunaikan tanggungjawab mereka untuk membayar zakat. Bank ini mempunyai pendekatan dan kaedah tersendiri dalam mengeluar dan mengagihkan wang zakat kepada Pusat Zakat atau Majlis Agama Islam Negeri.

Manakala Bank R pula hampir 9 tahun telah menjalankan operasi perniagaan berlandaskan prinsip Syariah. Transformasi daripada sistem perbankan konvensional kepada sistem perbankan Syariah sejak 2003 telah membuktikan bahawa Bank R mampu untuk terus mencatatkan keuntungan yang memberangsangkan saban tahun. Sebagai sebuah institusi kewangan yang menjalankan perniagaan perbankan berlandaskan prinsip Syariah sepenuhnya, adalah menjadi kewajipan Bank R untuk mengeluarkan zakat perniagaan daripada keuntungan operasi perniagaan perbankan yang dijalankan. Selain daripada diagihkan ke seluruh negara melalui Majlis Agama Islam di setiap negeri, Bank R juga menunaikan kewajipan fardu ain ini dengan menyampaikan bayaran zakat itu kepada beberapa golongan asnaf (golongan yang berhak menerima zakat) yang layak. Kaedah pengurusan pengagihan zakat di kedua-dua buah bank akan dibincangkan secara terperinci di dalam artikel ini.

2.1 Jawatankuasa Pengurusan Zakat

Berdasarkan maklumat yang diperoleh penulis hasil daripada temubual bersama Eksekutif Kanan, Jabatan Perbankkan Islam Bank B. Bank B mempunyai Jawatankuasa Pengurusan Zakat yang berperanan dalam mentadbir segala urusan yang berkaitan dengan pengagihan dan pengeluaran zakat kepada asnaf. Jawatankuasa ini terdiri daripada Ketua Pegawai Operasi, Timbalan Pegawai Operasi dan Ketua Jabatan Perbankkan Islam. Semua ahli hendaklah beragama Islam. Modus operandi

Jawatankuasa ini adalah memberikan kelulusan dan menentukan asnaf serta mengenalpasti mereka yang layak menerima zakat berdasarkan permohonan yang diperolehi. Inilah inisiatif yang dapat dilihat dalam Bank B bagi memastikan zakat dapat diagihkan kepada asnaf sebaik mungkin. (Polisi Penentuan Dan Pengagihan Wang Zakat Skim Perbankan Islam Bank B)

Manakala di bawah Bank R, terdapat sebuah jawatankuasa yang dikenali sebagai Jawatankuasa Zakat Perniagaan Bank Rakyat Di Bawah Asnaf (JZPBA) yang bertanggungjawab menentukan kelayakan dan mengawal selia pengeluaran wang zakat yang akan diagihkan sendiri oleh Bank 3/8 daripada jumlah keseluruhan peruntukan zakat. Ahli Jawatankuasa ini terdiri daripada Pengarah Urusan, Pengurus Besar/Penolong Pengurus Besar Operasi Cawangan, Pengurus Besar/Penolong Pengurus Besar Perkhidmatan Korporat/ Setiausaha Bank, Pengurus Besar/Penolong Pengurus Besar Sumber Manusia, Pengurus Besar/Penolong Pengurus Besar Kewangan dan Pengurus Jabatan Perundingan & Pengawasan Syariah. Semua ahli hendaklah beragama Islam. Modus operandi jawatankuasa ini terbahagi kepada dua iaitu Jawatankuasa Zakat Perniagaan Bank R Di Bawah Asnaf dan Urusetia Jawatankuasa Zakat Perniagaan Bank R Di Bawah Asnaf.

Di antara bidang tugas Jawatankuasa Zakat Perniagaan Bank R Di Bawah Asnaf ialah menerima, mengagih dan memantau kewangan zakat perniagaan Bank R di bawah asnaf. Selain itu, jawatankuasa ini juga berperanan menimbang dan meluluskan setiap permohonan zakat serta menyediakan laporan zakat untuk peringkat atasan. Manakala bidang tugas Urusetia Jawatankuasa Zakat Perniagaan Bank R Di Bawah Asnaf pula bertanggungjawab untuk merekod dan mengesahkan senarai-senarai permohonan zakat yang telah diterima, memproses dan menyokong permohonan zakat, menyediakan persiapan untuk membuat pembayarah zakat, memantau perlaksanaan penyerahan wang zakat kepada penerima, memantau baki zakat, menyediakan laporan zakat serta melaksanakan tugas-tugas yang diarahkan oleh Jawatankuasa Zakat Perniagaan Bank R. (Polisi Pengagihan Wang Zakat Perniagaan Bank R)

Modus operandi yang tersusun ini merupakan inisiatif yang dapat dilihat dalam Bank R dalam memastikan zakat dapat diagihkan kepada asnaf sebaik mungkin.

2.2 Polisi Zakat

Pada dasarnya segala urusan agihan zakat di Bank B berpaksikan kepada Polisi dan Peraturan Zakat yang dikeluarkan oleh pihak bank sebagai panduan kepada Jawatankuasa Pengurusan Zakat dalam menguruskan pengagihan zakat kepada asnaf. Polisi ini dinamakan Polisi Penentuan dan Pengagihan Wang Zakat Skim Perbankan Islam yang mengandungi maklumat tentang kewajipan berzakat, kaedah pengiraan zakat perniagaan, kriteria pemberian zakat kepada lapan asnaf, bentuk-bentuk bantuan yang diberikan zakat dan sebagainya. Polisi zakat yang disentralisasikan ini amat penting bagi memberi garis panduan kepada Jawatankuasa Pengurusan Zakat untuk mengagihkan wang zakat kepada asnaf dan memastikan wang zakat tidak dikeluarkan begitu sahaja. (Polisi Penentuan Dan Pengagihan Wang Zakat Skim Perbankan Islam Bank B)

Manakala polisi Bank R pula dikenali sebagai Polisi Pengagihan Wang Zakat Perniagaan yang mana bertujuan untuk memastikan sebahagian zakat yang disimpan daripada keseluruhan zakat yang diwajibkan atas Bank R diagihkan sendiri oleh bank kepada asnaf yang layak. Segala urusan agihan zakat di Bank R berpaksikan kepada Polisi Pengagihan Wang Zakat Perniagaan Bank Rakyat yang dikeluarkan oleh pihak bank sebagai panduan kepada Jawatankuasa Zakat Perniagaan Bank R Di Bawah Asnaf (JZPBA) dalam menguruskan pengagihan zakat kepada asnaf. Secara umumnya, polisi ini menerangkan kategori pengeluaran zakat, penetapan kelayakan penerima, kriteria pengagihan zakat, kuota pengagihan zakat dan sebagainya. Polisi zakat yang disentralisasikan ini amat penting bagi memberi garis panduan kepada Ahli-ahli Jawatankuasa Zakat Perniagaan Bank R Di Bawah Asnaf (JZPBA) untuk mengagihkan wang zakat kepada asnaf dan memastikan wang zakat benar-benar sampai kepada mereka yang layak menerimanya.

Jika dilihat kepada polisi zakat yang disediakan oleh Bank B dan Bank R, ia diadaptasikan hampir sama dengan Manual Pengurusan Agihan Zakat yang dikeluarkan oleh pihak Jawhar dan Panduan Zakat di Malaysia yang dikeluarkan oleh pihak Jakim. Ini jelas menunjukkan polisi zakat yang disediakan relevan digunakan di seluruh Malaysia terutama dalam urusan pengagihan zakat kepada asnaf. (Polisi Pengagihan Wang Zakat Perniagaan Bank R)

3. 0 KAEDAH PEMBAYARAN ZAKAT

Terdapat dua kaedah secara umum Bank B dan Bank R membayar zakat dan mengagihkannya kepada asnaf. Kaedah pertama: Bank B membayar zakat kepada Pusat Zakat atau Majlis Agama Islam Negeri. Manakala kaedah kedua: Bank B mengagihkan zakat terus kepada asnaf iaitu kepada organisasi tertentu manakala Bank R mengagihkan zakat terus kepada individu dan pertubuhan mengikut Asnaf Lapan. Perkara ini tidak menjadi permasalahan di kalangan ulama, kerana konteks yang lebih penting adalah zakat itu ditunaikan dan asnaf mendapat faedah daripadanya.

3.1 Pengagihan Zakat

Kaedah agihan zakat terus kepada asnaf yang digunakan oleh Bank B adalah hanya kepada organisasi walaupun terdapat juga permohonan daripada individu. Sekiranya terdapat permohonan daripada organisasi tertentu yang memerlukan bantuan dan pertolongan mengikut kriteria yang telah ditetapkan, pihak Bank B tidak mempunyai halangan tentang perkara tersebut tetapi ianya perlu melalui penelitian dan semakan daripada Jawatakuasa Pengurusan Zakat. Kebanyakan mereka yang menerima bantuan zakat daripada Bank B adalah dibawah asnaf *fisabillillah.*

Manakala kaedah agihan zakat terus yang digunakan oleh Bank R adalah kepada individu dan pertubuhan yang tertakluk kepada asnaf lapan berdasarkan syarat-syarat umum yang telah ditetapkan. Penetapan polisi pengagihan zakat perniagaan dan syarat-syaratnya merupakan satu garis panduan di dalam menentukan jumlah dan kelayakan setiap individu atau pertubuhan yang layak. Asnaf yang layak menerima pengagihan zakat perniagaan Bank R adalah terdiri daripada asnaf yang lapan sebagaimana yang disebut di dalam al-Quran iaitu fakir, miskin, amil, muallaf, hamba sahaya, orang yang berhutang, *fisabilillah* dan musafir. Walau bagaimanapun, pihak Bank R telah menetapkan *had al-kifayah* bagi golongan fakir atau miskin dan golongan *fisabilillah* yang menuntut di institusi pengajian yang diluluskan Syarak dalam pengagihan zakat. Pihak Bank R telah meletakkan syarat-syarat bagi menentukan golongan fakir atau miskin dan golongan *fisabilillah* yang berkelayakan untuk menerima bantuan dari sumber zakat Bank R. Setiap permohonan akan diteliti

dan disemak oleh Jawatankuasa Pengurusan Zakat. (Polisi Pengagihan Wang Zakat Perniagaan Bank R)

3.2 Kaedah Permohonan

Secara umumnya, tiada kaedah yang khusus bagi permohonan zakat di Bank B. Mereka juga tidak menyediakan sebarang borang khusus untuk diisi oleh pemohon-pemohon sepertimana yang dilakukan oleh pusat zakat mahupun baitulmal Majlis Agama Islam Negeri. Kebanyakan permohonan yang datang ditujukan kepada CEO Bank B atau kepada Jabatan Perbankkan Islam Bank B. Pada kebiasaannya permohonan itu akan dikumpulkan dan diteliti oleh Eksekutif Kanan, Jabatan Perbankkan Islam bersama pegawai-pegawai lain. Mereka akan membuat senarai pendek daripada permohonan yang diperolehi dan akan dibincangkan dalam Jawatankuasa Pengurusan Zakat untuk dibuat pertimbangan dan mendapat kelulusan.

Hal ini berbeza di Bank R, permohonan bantuan zakat boleh dibuat menerusi borang bantuan zakat Bank R secara percuma di setiap cawangan Bank R. Bantuan ini hanya dipertimbangkan kepada golongan yang berhak menerima zakat mengikut asnaf lapan dan pemohon hendaklah menggunakan borang asal sahaja. Kuasa melulus permohonan zakat Bank R diberikan sepenuhnya kepada Ahli-ahli Jawatankuasa Zakat Perniagaan Bank R di Bawah Asnaf (JZPBA) yang dilantik oleh Lembaga Pengarah sama ada melalui mesyuarat ataupun resolusi pekeliling.

4.0 PERBANDINGAN PENGURUSAN PENGAGIHAN ZAKAT KEPADA ASNAF *FISABILILLAH*

Berdasarkan Polisi Zakat yang ditetapkan oleh Bank B, *fisabilillah* bermaksud menegakkan syiar Islam. Pengagihan wang zakat di bawah asnaf *fisabilillah* hanya diberikan kepada persatuan kebajikan Islam yang melaksanakan aktiviti kebajikan atau aktiviti kebajikannya dinikmati oleh ramai orang Islam. Keutamaan diberi untuk membeli peralatan seperti mesin dialisis atau lain-lain yang boleh digunakan oleh ramai orang yang memerlukannya. Jumlah pengagihan zakat kepada asnaf *fisabilillah* adalah tidak terhad. Jumlah yang diberikan mengikut permohonan yang diterima dan

setelah mengambil kira keperluan sesuatu permohonan. Ada kalanya jumlah yang diberikan lebih daripada yang dipohon dan sebaliknya setelah dilakukan penelitian dan penilaian.

Hasil daripada temubual yang dilakukan di Bank B, Bank B juga ada menyalurkan bantuan mega zakat seperti bantuan Van Jenazah kepada surau-surau dan masjid-masjid yang kini berjumlah 14 buah dan program bersamamu TV3 yang mana mereka yang layak diberikan wang zakat berjumlah RM2,500. Selain daripada itu, Bank B juga memberikan zakat kepada UITM dan UIAM bagi menampung program-program yang dianjurkan, membaik pulih surau dan masjid, rumah anak yatim, sekolah dan muallaf Perkim serta lain-lain lagi.

Berbanding peruntukan agihan zakat perniagaan Bank R di bawah asnaf *fisabilillah*, sebanyak 80% daripada daripada keseluruhan peruntukan zakat perniagaan Bank R di bawah asnaf diperuntukkan kepada asnaf *fisabilillah* seperti berikut :

a) Sebanyak 40% akan diagihkan untuk pendidikan sama ada bantuan yang berbentuk sementara atau biasiswa kepada mereka yang layak di bawah asnaf yang diperlukan.
b) 25% diperuntukkan bagi kategori masjid/surau/percetakan/seminar. Percetakan adalah bergantung kepada keperluan seperti percetakan al-Quran, surah Yasin dan buku-buku yang melibatkan dakwah Islamiah. Sumbangan zakat juga akan diberikan kepada seminar-seminar yang dianjurkan untuk memberi kefahaman Islam kepada masyarakat umum khususnya golongan muallaf.
c) Sebanyak 15% diperuntukkan kepada bencana alam.
d) 10% diperuntukkan kepada pembinaan asrama anak-anak yatim/orang tua dan sebagainya.
e) 10% diperuntukkan kepada lain-lain kategori yang sesuai mengikut keperluan syarak.

Termasuk di bawah asnaf *fisabilillah* ialah kursus-kursus dan program-program latihan kemahiran vokasional yang akan diberikan kepada golongan-golongan yang kurang kemampuan bagi meningkatkan taraf hidup mereka. Hal ini jelas, menunjukkan bahawa pengagihan wang zakat kepada asnaf *fisabilillah* di Bank R

mempunyai jumlah pengagihan yang telah ditetapkan berbanding pengagihan wang zakat di Bank B. (Polisi Pengagihan Wang Zakat Perniagaan Bank R)

5.0 PENUTUP

Setelah diteliti perbandingan pengurusan pengagihan zakat di kedua-dua buah Bank iaitu Bank B dan Bank R, ternyata bahawa kedua-dua bank mempunyai perbezaan dari sudut pengurusan pengagihan zakat. Walau bagaimanapun, ia merupakan usaha dinamisme murni yang boleh dianggap sebagai tanggungjawab sosial korporat yang dijalankan oleh pihak Bank B dan Bank R dalam memastikan mereka turut menjadi pemangkin ke arah memacu pertumbuhan pembangunan ummah serta peningkatan taraf ekonomi mereka. Asnaf *fisabilillah* merupakan golongan yang banyak menerima zakat. Walaupun, terdapat perbezaan dari sudut pengurusan pengagihan yang dilaksanakan di Bank B dan Bank R. Namun, apa yang penting objektif menyelesaikan masalah sosioekonomi dan seterusnya meningkatkan taraf kehidupan asnaf zakat terutamanya asnaf *fisabilillah* haruslah dicapai.

Zakat merupakan instrumen utama untuk memperbaiki tahap sosioekonomi ummah dan menjadi nadi kepada infrastruktur pembangunan. Kekuatan pembangunan adalah terletak di atas asas yang kukuh dan sistem zakat inilah merupakan asas kuat kepada seluruh pembangunan dalam Islam. Pengurusan dan pengagihan dana zakat yang berkesan khususnya di perbankan Islam akan menjamin individu, masyarakat dan negara berada dalam keadaan yang selesa, aman, mendapat rahmat dan keberkatan Allah.

Majoriti masyarakat umat Islam tidak mengetahui usaha yang dilakukan oleh Bank B dan Bank R dalam membantu masyarakat khususnya asnaf fakir, miskin dan *fisabilillah* bagi meningkatkan taraf hidup mereka. Ada juga yang beranggapan bahawa bank hanya memikirkan keuntungan dan enggan membayar zakat. Diharapkan dengan sedikit makluman dan tinjauan yang dibuat oleh penulis dalam kertas kerja ini dapat membuka mata masyarakat bahawa kewajipan berzakat ini amat penting untuk membantu umat Islam khususnya di Malaysia.

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TOWARDS UNDERSTANDING FACTORS INFLUENCING TRUST IN A PARTICULAR ZAKAT INSTITUTION

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ABSTRACT

Zakat institutions are under increasing pressure to rebuild zakat payers' trust in them as a result of financial scandals involving Central Zakat Administration (CZA) in Pakistan and cases of violation of Shariah in zakat distribution among zakat institutions in other jurisdictions. However prior behavioural studies on zakat as an institution focused on compliance with zakat on employment income and dissatisfaction of zakat payers towards zakat institutions. Based on exploratory factor analysis four factors; perceptions of board capital, perceptions of disclosure practices and perceptions of stakeholder management practices and model of zakat institution are found to influence zakat payers trust. These findings are important to academicians, policy makers and management of zakat institutions.

Keywords: Financial Scandal, Trust Board, Capital Disclosure, Stakeholder Management

1.0 INTRODUCTION

The world community at the millennium summit, in year 2000, agreed to work together to alleviate extreme poverty in the world. From the reports on economic and poverty situation (Global Monitoring Report, 2006), it is being speculated that the members of Organisations of Islamic Council (OIC) from Sub-Sahara Africa might not be able to meet most of the targets by year 2015 (Statistical, Economic and Social Research and Training Centre for Islamic Countries (SESRTCIC), 2007). The fact that Muslims are estimated to be about 70% of the population in the Sub- Sahara African OIC members states (SESRTCIC,2007), if some of the targets will be realized, the institution of zakat should be allowed to play it poverty alleviation role.

Recent studies have confirmed the potential of zakat institution alleviate poverty in Muslim countries, if zakat is complemented with comprehensive macroeconomic policies that encourage growth and income redistribution (Shirazi and Amin, 2009; 2010; Ahmad, 2004; 2008). The success of zakat as an institution for poverty

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alleviation is contingent upon existence of effective institutional arrangement for pooling individual zakat into a common fund and the degree of trust which zakat payers have that such institutions will distribute the zakat in line with the dictates of Shariah as zakat is a unique charitable act as it is one of the pillars of Islam making it a duty for the payers to ensure strict compliance. Spate of media reports of mismanagement of zakat fund are having negative influence on the behaviour of zakat payers as they tend to be cautious on the selection of agents for distribution of their zakat (Pakistan-Today, 2011). This situation calls for urgent attention to gain more insight into the behaviour of zakat payers.

Studies on the behavioural aspects of zakat are, however, limited (Idris and Ayob, 2001). Idris and Ayob (2001) conduct a study on the dimensions of attitude towards zakat on employment income and their implications on compliance behaviour while Idris, Ali.E.I.E, and Ali J. (2003) discuss the impact of intrinsic factors on compliance behaviour toward zakat on employment income and Nor, M.A.M, Wahid and Nor, N.G.M (2004) focus on the awareness of paying zakat on income among professionals. Ahmad, Wahid and Muhammad (2006) explore factors contributing to dissatisfaction towards zakat institutions whereas Muhammad (2008) studies the perceptions of lecturers on zakat administrations and Wahid, Ahmad and Kader (2008) explore factors influencing dissatisfaction among zakat payers towards zakat distribution. Nur Barizah and Hafiz (2010) study motivations of paying zakat on income. Although prior attempts have shed light on our knowledge of behaviour of zakat payers, but awareness of factors that promote trust in a particular zakat institution we provide a fresh insight into the how zakat institutions can satisfy their core stakeholder.

2.0 OVERVIEW OF THE LITERATURE

2.1 Need for Research on Understanding the Trust of Zakat Payers?

The institution of zakat is an inviolable part of the Islamic belief system. According to Chapra (1992), the prescription of zakat is a clear and unambiguous demonstration of the divine desire to ensure that no one suffers because of lack of means to acquire the essential things of life. All wealthy Muslims are expected to pay zakat out of fear of Allah but, in spite of the prospect of divine punishment, there are Muslims who do not

pay. In this circumstance, the Islamic state must use its coercive power to make such people pay (Chapra, 1992). The situation is even worse today as zakat is not seriously enforced in most Muslim countries and as such, unwilling eligible zakat payers go unpunished. Even where government is willing to enforce, the diversity in economic activities that have led to the emergence of non physical assets, of high value, that are chargeable to zakat limits the ability to successfully track assets in this category. Obviously, in modern world, willingness of zakat payers rather than enforcement is important in the determination of true values of wealth of Muslims. Therefore, zakat is, in substance, a voluntary and personal affair in most of these countries.

Willing zakat payers have two options through which they can fulfil their religious duty. They either pay directly to the beneficiaries or to formal zakat organisations. In doubtful circumstances, zakat payers find ways to distribute their zakat directly to the beneficiaries. The implication of pursuing such an option is to deny Muslim countries the potential multiplier effect which formal zakat institutions have on the economy of Muslim countries and the ultimate impact which eventual higher economic output may have on the poor will be lost. Undoubtedly, the need to understand factors that will promote trust of zakat payers in organised zakat institutions is undeniable as it is done in the case of donor trust in respect of conventional charities (Sargent and Lee, 2002a).

2.2 Prior Studies on Behaviour of Zakat Payers

Studies on the behavioural aspects of zakat are, however, limited (Idris and Ayob, 2001). Most of them focused on factors that influence the behaviour of zakat payers and their attitudes of zakat payers toward zakat on employment income. For instance, Idris and Ayob (2001) conduct a study on the dimensions of attitude towards zakat on employment income and their implications on compliance behaviour. They identify the general acceptability, positive acceptability, uncertain acceptability, conditional acceptability and technical acceptability as the five dimensions of attitude towards zakat on employment. Of these, they discovered that only positive acceptability, uncertain acceptability, conditional acceptability are significantly related to compliance behaviour.

Idris, et al. (2003) investigate the impact of motivational factors such as perceived service quality, degree of knowledge of zakat, degree of exposure to promotional campaigns and level of religiosity on zakat compliant behaviour. He found that perceived service quality, degree of knowledge of zakat, degree of exposure to promotional campaign is significantly related to zakat payment behaviour while the level of religiosity has an inverse relationship with zakat payment behaviour. The unexpected relationship between the degree of religiosity and compliance might be linked to differences of opinion on the legality of the inclusion of employment income in zakatable wealth.

While the degree of religiosity is not a significant factor influencing the behaviour of zakat payers in the study by Idris, et al.2003, Nor et al. (2004) found that the level of religious belief and religious education as the two most significant factors influencing the payment of zakat on income. Variables like gender, number of dependants, level of education and knowledge of zakat on income were found to be related to the behaviour and compliance of zakat payers but of less significance. Zakat collection centres were not found to have any significant influence on payment of zakat on income.

Similarly, Nur Barizah and Hafiz (2010) also study underlying motives for paying zakat on income. They focus on nine factors, including, belief in obligatory nature of zakat, conviction on eligibility to pay, impact of incentives from government, belief in the right of the poor in the wealth of the payees, belief that zakat is a social obligation to the Ummah, belief in the need to pay zakat on income, impact of ease of payment, belief in the impact of zakat on the ummah and belief in the effectiveness of zakat as wealth redistribution mechanism. They find that respondents consider belief in the right of the poor in the wealth of the payees and belief that zakat is a social obligation to the Ummah as the two most important factors while they also regard other factors as important determinants.

Prior studies have also addressed the decision of zakat payers regarding their selection of channels for zakat distribution to reach the beneficiaries. Ahmad et al. (2006) examines factors that determine attitudes toward zakat institutions based on a sample of 753 respondents across six privatized zakat institutions. He found that zakat

distribution patterns and efficient management of zakat is related to payment of zakat to zakat institutions. Approximately 57 percent of the respondents reported that they were not satisfied with the existing distribution of zakat and that it significantly affected their choice of zakat distribution channels.

In a similar study, Muhammad investigates the perceptions of lecturers towards zakat administrations. In his classification of his respondents, only 12 percent paid zakat to beneficiaries in Selangor while 37.5 of respondents in Kelantan paid directly to the needy. High patronage of zakat institutions was attributed to privatization and the market type of approach to zakat collection activities. Feelings of personal satisfaction were cited as the major reason for paying to the needy. In Selangor approximately 58 percent of those who paid to the needy cited the same reason while approximately 70 percent of their counterparts in Kelantan also gave the same reason. Among the major findings of Muhammad (2008) include the significant relationship between favourable perceptions of zakat distribution and payment of zakat to zakat institutions and a significant relationship between perceptions of poor zakat distribution and increased probability to pay zakat directly to the recipients. Unlike Muhammad, Wahid et al. did not find any links between zakat distribution and a willingness to pay zakat nor did they find any significant effect of privatization on zakat payment.

There is no doubt that prior research on zakat payment behaviour will greatly contribute to zakat management especially in Malaysia where most of the studies were carried out. However, it is evident their findings are mixed and not integrated. Besides this, most findings are based on employment income in the public sector while private sector is left unexplored. Idris and Ayob (2001), therefore, called for studies of other sectors and states. A narrow scope of study will limit the general applicability of the findings.

Further analysis of the prior studies reveal Idris and Ayob (2001) studied zakat compliance attitude among systematically selected Malaysian sample. Similarly, factor such as religiosity, religious education are beyond the control of zakat institutions, hence their contribution to improvement of strategy formulation by zakat institutions is limited. Factors such as distribution pattern, personal satisfaction, efficiency of management, zakat collection centres exposure to promotional activities

will be very helpful to zakat management practices. Although, knowledge of influences of these factors is, in no doubt, useful, the factors are output of decisions made by decision making organ called board of directors or trustees. Besides, issues like organisational transparency or accountability have been found to influence organisational performance.

The impacts of board on the type and scope of decisions an organisation make are well documented in governance literature (Hillman and Dalziel,2003; Herman, and Renz,1999 ; Brown, 2007). The fact that Muhammed (1990) and Ghazali and Ibrahim (1990) identify trust of zakat payers as major factor that will influence their payment decision and none of these studies have specifically addressed this important determinant of choice of zakat institution, it represents a significant gap in zakat management literature. This paper reports the study that attempts to fill the gap.

3.0 METHODOLOGY

3.1 Item Generation

Based on the suggestion of Churchill (1979) and Green and Webb (1977), the study commenced with a literature review and experience survey (conducting exploratory interview with experts). Accordingly, the review and survey resulted in a number of factors posited to influence donor selection of a particular charity organisation and an extensive list of items used to measure these factors. Based on the review and in line with Green and Webb (1997), specific definitions for each construct of interest were developed. Using these definitions as the starting point, a pool of 44 items was generated to tap the underlying constructs measuring factors influencing payment of *zakat* to a specific *zakat* institution.

3.2 Content Validity

Two senior faculty members, three doctoral students, and a management staff in one of the Nigerian *zakat* institutions were constituted into a panel of judges. In line with the suggestion of deVellis (1991), the judges were to determine the relevance of each

item to the specific construct, comment on the fitness of individual items, evaluate each item's clarity and conciseness. Each judge was provided with working definitions of each construct and asked to categorise each item according to these definitions. Following the suggestion of deVellis (1991) and the approach of Sargeant and Lee (2002), the panel members were also required to evaluate each item for its appropriateness and clarity based on the rating scale from 1 – 5. A consensus in respect of categorisation, appropriateness and clarity ratings of minimum of 4 was used to admit items to the final pool. At the end of this process, 12 items were eliminated from the initial pool resulting in the retention of 32 items.

After the final 32 items were certified as good candidates for questionnaire by the panel of judges, they were randomly ordered and incorporated into a questionnaire. The purpose of the pilot study was to provide empirical evidence on the validity and reliability of the instrument. Two pilots were conducted. The first pilot study led to further reduction of items to 27 items. Reliability test on these items resulted into the elimination of an additional 4 items leaving 23 items for the second pilot test. The Cronbach Coefficient Alpha for all the constructs ranged from .74 to .90 which is above the acceptable benchmark of .7 (Nunnally, 1978). After unsuccessful attempts to get a reliable sampling frame in Nigeria, Muslim professionals who observe religious seclusion in the last ten days of the Islamic fasting month (*itqaf*) were considered as best alternative Muslims who will voluntarily pay zakat. Accordingly the participants were used for the second pilot. The decision resulted in delay till another fasting month in the following year before the final questionnaires could be administered. At the end of the analysis of the second pilot study, additional two items were eliminated leaving a total of 21 items. Based on practical significance, one item was added resulting in 22 items which were eventually incorporated into the final questionnaire.

3.3 Data Collection

As indicated above, Muslim professionals who observe religious seclusion in the last ten days of the Islamic fasting month (*itqaf*) were considered as best alternative Muslims who will voluntarily pay zakat. Twelve mosques were purposively selected. With the help of leaders of these worshippers in each of these selected mosques, a list

of professionals was prepared. From the list, 480 respondents were randomly selected. 390 usable questionnaires were obtained from the total of 415 questionnaires that were returned representing a response rate of about 86 per cent. The distribution of the respondents cut across Legal, Banking, Accounting, Engineering, Architectural, Medicine and allied professions.

4.0 ANALYSIS AND RESULTS

Factor analysis was run twice. The first yielded 5 factors but item PTN5 loaded on two factors leading to its elimination leaving two 21 items. The second analysis resulted into distinct loading of the 21 items across five factors as anticipated. These five factors have eigenvalues of 3.296, 3.141, 3.018, 2.816 and 2.260 while they collectively accounted for 69.19 per cent of the variance (see table 1). These five factors are: trust in zakat institution (5 items); perception of governmental model of zakat institution (4 items); perception of stakeholders' management (4 items); perception of board capita (5items); and perception of disclosure practices (3 items).

The emergences of distinct factors, in which each comprise of proposed items, provide evidence of discriminant validity for the dimensions (Hair, Black, Babin and Anderson, 2010). In addition the variance of each construct explained exceeds the advocated rule of thumb of $\geq .5$ (Fornell and Larcker, 1981).

Table 1

Construct	Items	Factor Loading	Variance Explained	Cumulative Variance	Eigen value
Trust in Zakat Institution	PTZ1	.642	15,696	15696	3.296
	PTZ2	.824			
	PTZ3	.800			
	PTZ4	.589			
	PTZ6	.736			
Perception of Governmental Model of Zakat Institution	PNZ1	.896	14.958	30654	3.141
	PNZ2	.854			
	PNZ3	.925			
	PNZ4	.855			
Perception of Stakeholders' Management	PSM1	.875	14.370	45024	3.018
	PSM2	.850			
	PSM3	.800			
	PSM4	.752			
Perception of Board Capital	PBC1	.798	13.408	58432	2.816
	PBC2	.712			
	PBC3	.742			
	PBC4	.693			
	PBC5	.666			
Perception of Disclosure Practices	PDP1	.858	10.763	69.195	2.260
	PDP2	.841			
	PDP3	.668			

Reliability analysis of each of the constructs, using Cronbach (1951) alpha is conducted to establish the internal consistency for each of the scales. The reliability of each of the scales exceeds an acceptable standard of .70 (Nunnally, 1978) (See table 2).

Table 2

Constructs	Cronbach's Alpha	No. Of Items
Trust in Zakat Institution PTZ	.832	5
Perception of Governmental Model of Zakat Institution. (PNZ)	.905	4
Perception of Governmental Model of Zakat Institution. (PNZ)	.874	4
Perception of Board Capital. (PBC)	.797	5
Perception of Disclosure Practices (PDP)	.849	3

5.0 CONCLUSION

This study, being exploratory in nature, provides the appropriate incentives for further work in this area. The findings offer insight into better understanding of behaviour of zakat payers with specific reference to how they develop trust in a particular zakat institution. Unlike findings from prior studies that focus on quality of service, it suggests that board capital, disclosure and stakeholder management practices as well as the model of zakat institutions are relevant to the development of zakat payers' trust.

In the meantime, the findings will assist zakat managers in the day to day running of their institutions. They will also provide guide to government in drawing up appropriate policies that will guide selection of members of zakat institutions regardless of the nature of ownership. Although, the study appears to be a departure from the traditional application of management accounting research to zakat issues by way of introduction of multidisciplinary perspectives into this study, the findings have provided wider avenues for future research. Subsequent enquiries may focus on governance or stakeholder perspectives or accountability or combination of all these in a more elaborate form in one study.

There is no doubt, validity and reliability of the scales developed in this study need to be further verified in future studies. Although, there is every reason to believe that the use of professional Muslims who performed religious seclusion in the month of Ramadan is appropriate for this study, varied sampling frames are needed to confirm this assumption. The use of confirmatory factor analysis based on structural equation modeling (SEM) will offer a more robust evidence of validity and reliability of the scales developed in the study. The use of structural equation model may be a response for the increase use of SEM in management accounting research (Smith and Langfield-Smith, 2004).

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THE ETHICS OF TAX EVASION: A SURVEY OF STUDENTS' PERCEPTIONS AT HADHRAMOUT UNIVERSITY

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Abstract

Most of the studies conducted in tax evasion issue focused on the economic and public finance perspectives rather than they did it from the philosophical and theoretical perspectives (McGee, 2005). This study examines the perceptions of the undergraduate students in College of Business at Hadhramout University for the academic year 2009/2010 as to the agreement of the ethics of tax evasion. A questionnaire has been designed using a seven point Likert scale and distributed out as an instrument for collecting data. The arguments are then ranked from strongest to weakest. In a like manner, 124 usable surveys were received. The results of the study show that tax evasion is ethical under some circumstances. The majority of the respondents were opposed to the view that tax evasion is always or almost always ethical. However, respondents commented the point of view that, as Muslims, it is unethical to evade tax.

Keywords: Ethics of tax evasion, students, Yemen

1.0 Introduction

Tax evasion is an intentionally paying less tax than what law requires (Elffers and Hessing, 1997). Kasipillai, Baldry, and Rao (2000) evidenced empirically that attitudes towards tax morality are influenced factors in the tax evasion issue. Similarly, Reckers, Sander, and Roark (1994) reported that persons who perceive tax evasion as an ethical issue are less likely to evade regardless the situation than persons who do not. In the same line, Chan and Mo (2000) evidenced that persons comply

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with tax because of perceived moral obligations to obey tax laws. Karlinsky, Burton, and Blanthorne (2004) indicated that perception of tax evasion as a non-serious crime has led to an environment where taxpayers may not be afraid of evading tax. Importantly, Most of the studies conducted about tax evasion focused on the economic and public finance perspectives rather than they did it from the philosophical and theoretical perspectives (McGee, 2005). This is probably because most economists are utilitarian and most lawyers are legalists (McGee and Christopher, 2005). To the best researcher's knowledge, no prior empirical study has been found to investigate the issue of ethics of tax evasion in the Middle East setting. Thus, this study examines the perception of the Master students from Middle East in College of Business at UUM as to the agreement of the ethics of tax evasion through a survey instrument that has been developed and used in a previous study conducted about accounting, business, and economics students in Hong Kong by McGee and Ho (2006). The survey included eighteen (18) statements that have been distributed to a total of 62 students that represent the all enrolled Master students from Middle East in College of Business at UUM for the academic year of 2008/2009. It is worth to highlight that COB students have been chosen as a sample for this study because, after graduation, some of them might work in leading fields of taxation such as tax administration, tax lecturers and so far.

This paper proceeds as follows. After introducing the topic, the next section (section 2) highlights the prior literature. The methodology; survey design and data collection process are outlined in section 3. The following section (section 4) covers the results and section 5 concludes and offers direction for further analysis.

2.0 Literature Review

2.1 Prior Related Research

At least two major studies have been done on the ethics of tax evasion. The earliest and most comprehensive twentieth century work was a doctoral thesis written by Martin Crowe (1944), titled The Moral Obligation of Paying Just Taxes. This thesis reviewed the theological and philosophical debate that had been going on, mostly within the Catholic Church, over the previous 500 years. Some of the debate took

place in the Latin language. A more recent doctoral dissertation on the topic was written by Torgler (2003), who discussed tax evasion from the perspective of public finance but also touched on some psychological and philosophical aspects of the issue. Inglehart et al. (2004) did a huge study that collected the views of more than 200,000 people from more than 80 countries on several hundred questions, one of which was tax evasion. McGee (1998) edited a book that contained more than 20 papers looking at tax evasion from various country and religious perspectives.

More recently, a number of authors have done empirical studies that examine tax evasion from the perspective of ethics. Those studies used a survey instrument that was based on the arguments Crowe (1944) discussed to justify tax evasion over the last 500 years. McGee and Cohn (2006) surveyed the views of Orthodox Jews. The views of international business academics (McGee, 2005a) and various groups in Romania (McGee, 2005b), Argentina (McGee & Rossi, 2006), Dominican Republic (McGee, Lopez & Polanco, 2007), Guatemala (McGee & Lingle, 2005), Puerto Rico (McGee & Lopez, 2007), Ecuador (McGee, Lopez & Jaramillo, 2007), Colombia (McGee, Lopez & Yepes, 2007), Bosnia (McGee, Basic & Tyler, 2006), Ukraine (Nasadyuk & McGee, 2006), Estonia (McGee, Alver & Alver, 2007), Australia (McGee & Bose, 2007), Armenia (McGee & Maranjyan, 2006), Germany (McGee, Nickerson & Fees, 2006), France (McGee & M'Zali, 2007), Thailand (McGee, 2006), Poland (McGee & Bernal, 2006), Hong Kong (McGee & Ho, 2006), Macau (McGee, Noronha & Tyler, 2006), Taiwan (McGee & Andres, 2007) and China (McGee & Noronha, 2007; McGee & An, 2006; McGee & Guo, 2006) have used survey instruments similar to the one used in this study. The present study replicates these studies using Yemen as a case study.

2.2. Islamic Perspective towards Tax Evasion

There is a lack of research about the influence of Islamic religious perspectives on tax evasion. Generally, few studies conducted about the tax system to be implemented as a national revenue collection system in Islamic countries focused on imposing Zakat instead of the tax. Peerzade (2005) proposed two conditions in the tax system to be considered as an Islamic tax system. The first condition is necessary in which the perceived approach of Zakat should form the core of the resource mobilization effort.

The second condition is that, in addition to the current secular rules and regulations regarding rates, exemption levels, administration, etc., the approach should also incorporate the Islamic prescriptions. Murtuza and Ghazanfer (1998) examined the religious literature and reported that Muslims have a duty to God to contribute to the poor. They have not indicated to the relationship between the individual and the government.

Raquibuz Zaman (1986) indicated that it is an ethical behavior for a Muslim to evade indirect taxes which include excise taxes, customs duties and perhaps corporate income taxes. Additionally, he clarified that Muslims do not have to pay tax, particularly the taxes which lead to the increase in the consumer prices. Furthermore, it is unjust when the Islamic perspective forbade the evasion of taxes, while Non-Muslim residents would evade the taxes, and enjoy all the tax benefits. Al-Awwal (2005) has reported that every taxpayer has a right to arrange its affair in a manner to minimize the tax incident within the ambit of the provisions of tax laws. If the arrangement is such that it is contrary to, the provisions of law, it amounts to evasion of tax, which is an offence. Under tax planning, what is required to be done is that the taxpayer should avail the benefit of all the deductions, exemptions properly to minimize the incidents of tax as provided in the statute. Consultancy on tax planning is an important business in many advanced countries. Further, In 1997 and 1998 there were other surveys conducted who found that the tax evasion may be justified if the tax will increase the prices or when the tax are imposed on the income.

Nevertheless, some Islamic thinkers believe that the Muslim has to pay tax, and justified their opinion by two reasons: firstly, that tax is paid for services provided and to facilitate many transactions related to taxpayer's life and trade. Secondly, that Muslims should pay what is required because evasion of taxes may lead to the evasion of Zakat (Islamic Economic Program, 2009).

There are three main perspectives towards paying taxes by Muslims. (1) The first group (The first Islamic perspective (: Collecting the tax by Governments is completely prohibited in all cases. We, as Muslims, have been already given a perfect

system, Zakat, to do so from Allah, the God, has been ruled in the Holy Quran and the Prophet Mohammad (Peace and blessing of Allah be upon him) has taught us how to implement this system. So it is forbidden to import non- Muslim, Western, tax system and replace it with the Islamic Zakat system. (2) The second group (the second Islamic perspective): This group agrees with the first group about the prohibition of collecting tax in Islamic countries generally except that there are some conditions the Government has the right to impose tax and, in this case, it is not considered a sin. These conditions are as follows:

i. There is a legitimacy public need of the money.

ii. Inadequate Islamic legitimacy resources: Kalzkah, Sayyid Qutb, abscess, Ushur.

iii. Eliminate wasteful expenditure before imposing tax.

iv. Consulting Islamic parliament before implementing tax.

v. The tax imposed should be amounts as needed.

vi. It should be imposed justly and according to legitimacy Islamic resources.

vii. The tax collected has to be spent in the interests of the nation for which it was collected.

(3) The third group (The third Islamic perspective): This group argues that Muslims under an Islamic government have to obey the rules and laws of the government (Verdict Encyclopedia, 2010).

3.0 Methodology

In this section, a survey instrument was used and data collection procedures are discussed. This survey is developed based on the 15 arguments favoring tax evasion that Martin Crowe (1944) discussed plus three more arguments dealing with human rights issues The questionnaire is divided into two sections (referred to as sections A and B). Section A consisted of eighteen (18) statements. Using a seven- point Likert scale, respondents were asked to indicate their agreement or disagreement with each statement (1 as strongly agree to 7 as strongly disagree). The survey was distributed in both English and Arabic languages.

Section B of the questionnaire is designed to obtain demographic characteristics of the respondents. Questions asked in this part relate to age, gender, marital status, level of stud, major of study and whether the tax subject has been undertaken.

Initially, the questionnaire was pre-tested on a total of 15 students, studying at Universti Utara Malaysia (UUM,) with a view to refine the questionnaire. Every step was taken to ensure that the final questionnaire was clearly and easily understood by the respondents.

All questionnaires were personally distributed to a group of 124 undergraduate students of accounting, business and finance at Hadhramout University enrolled for the academic year 2009/20010. 124 usable responses were received. A descriptive analysis is used to analyze the questionnaire.

4.0 Empirical Results

4.1 Respondents Profile

Table 1: Summary of the demographic makeup of the sample

Demographic	Frequency (n=124)	Percent %
Gender		
Male	122	98.4
Female	2	1.60
Age (years)		
19.00-21.00	18	15.0
22.00-24.00	85	69.0
25.00-above	21	17.0
Marital Status		
Single	110	88.7
Married	10	8.10
Other	4	3.20
Level of study		
Freshmen	8	6.50
Sophomore	21	19.6
Junior	57	46.0
Senior	38	30.6
Major of study		
Accounting	86	69.4
Business Administration	25	20.2
Finance and Banking	13	10.5
Studied Tax		
Yes	62	50.0
No	62	50.0

A total of 124 questionnaires were gathered from the survey. As shown in Table 1, the majority of the respondents (98.4%) were male, and (1.60%) were female. The largest group (69.0%), in terms of age, was those aged between 22 and 24. Specifically, (15.0%) were aged between 19 and 21, while (17.0%) were aged between 25 and above. In terms of marital status, the majority of the respondents (88.7%) were single, (8.10 %) were married, and 3.20% was others. Regarding the level of study, the largest group (46.0%) was a junior, (30.6 %) was a senior, (19.6%) was a sophomore, and (6.50%) was freshmen. In term of major of study, the majority of the respondents (69.4%) were accounting, (20.2%) were Business Administration, (10.5%) were Finance and Banking. With regard to whether the respondents have undertaken the tax subject, the majority of the respondents (50.0%) studied tax, and (50.0%) did not.

Table 2 lists the 18 statements and shows the mean scores for each statement. The mean score for all 18 statements was 4.015, which, on a scale of 1 to 7 indicates a rather weak feeling that tax evasion is generally unethical. However, as table 2 shows, some scores are higher than others, which indicate that some arguments to support tax evasion are stronger than others.

Table 2: Summary of Responses
Overall Scores: (1 = strongly agree; 7= strongly disagree)

S#	Statement	Score
1	Tax evasion is ethical if tax rates are too high	3.7258
2	Tax evasion is ethical even if tax rates are not too high	5.4113
3	Tax evasion is ethical if the tax system is unfair	2.8387
4	Tax evasion is ethical if a large portion of the money collected is wasted	3.4839
5	Tax evasion is ethical even if most of the money collected is spent wisely	5.0000
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of	2.8790
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects	4.9032
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	4.2742
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	4.3710
10	Tax evasion is ethical if everyone is doing it	4.7661
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends	3.0161
12	Tax evasion is ethical if the probability of getting caught is low	3.9758

13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust	3.4435
14	Tax evasion is ethical if I can't afford to pay	3.4516
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more	4.6290
16	Tax evasion is ethical for me as a Muslim	5.4274
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	2.9677
18	Tax evasion is ethical if the government imprisons people for their political opinions	3.7097

Table3: Summary of Responses
Overall Scores: (1 = strongly agree; 7= strongly disagree)

S#	Statement	Score
3	Tax evasion is ethical if the tax system is unfair	2.8387
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of	2.8790
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	2.9677
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends	3.0161
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust	3.4435
14	Tax evasion is ethical if I can't afford to pay	3.4516
4	Tax evasion is ethical if a large portion of the money collected is wasted	3.4839
18	Tax evasion is ethical if the government imprisons people for their political opinions	3.7097
1	Tax evasion is ethical if tax rates are too high	3.7258
12	Tax evasion is ethical if the probability of getting caught is low	3.9758
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	4.2742
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	4.3710
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more	4.6290
10	Tax evasion is ethical if everyone is doing it	4.7661
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects	4.9032
5	Tax evasion is ethical even if most of the money collected is spent wisely	5.0000
2	Tax evasion is ethical even if tax rates are not too high	5.4113
16	Tax evasion is ethical for me as a Muslim	5.4274

Table 3 ranks the arguments from strongest to weakest. The range is 2.8387 to 5.4274, which indicates that there is widespread support for the position that tax evasion is ethical in some circumstances. Table 3 ranks the scores for the 18 statements from the

point of views that tax evasion is ethical to that tax evasion is not ethical. The strongest agreement that tax evasion is always or almost always is ethical appears in the unfair tax system. Moreover, the agreement to point of view that tax evasion is sometimes ethical appears in the second rank as money is wasted in disapproved project. In the fourth rank comes a view related to the discrimination practices among people in terms of their religion, race and ethnic background. The fifth rank indicates to the support of unjust war. The sixth rank is giving to the unaffordable paying tax. In the seventh rank, the respondents indicate to fact of wasting a large proportion of the tax collected. The eighth rank is giving to the view that the government imprisons people for their political opinions. The ninth rank is pointed to the view of high tax rates. In the tenth rank comes a view of low probability of getting caught by the government. The eleventh rank refers to the spending of the tax collected on projects that do not benefit people. In the twelfth rank comes the view of spending money on projects that are morally disapproved of. The thirteenth rank is giving to the view of the unfair paying taxes. The fourteenth rank indicates to whether the practice of tax evasion is common among people. The fifteenth rank is giving to the view of spending a large portion of the money on worthy projects. The sixteenth rank is giving to the view of spending the money wisely. The seventeenth rank indicates to the view of low tax rates. The last rank is the view of the Islamic perspective.

Table 4: Comparison of Martial Statues
Scores: (1 = strongly agree; 7 = strongly disagree).

S#	Statement	Single	Married	Others	P value
1	Tax evasion is ethical if tax rates are too high	3.7545	3.7000	3.0000	-9.406**
2	Tax evasion is ethical even if tax rates are not too high	5.4182	5.3000	5.5000	-10.771**
3	Tax evasion is ethical if the tax system is unfair	2.8091	3.4000	2.2500	-8.445**
4	Tax evasion is ethical if a large portion of the money collected is wasted	3.5636	2.7000	3.2500	-8.868**
5	Tax evasion is ethical even if most of the money collected is spent wisely	4.9455	6.0000	4.0000	-9.961**
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of	2.9727	2.4000	1.5000	-6.656**
7	Tax evasion is ethical even if a	5.0636	4.4000	1.7500	-9.355**

	large portion of the money collected is spent on worthy projects				
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	4.2818	4.3000	4.0000	-10.120**
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	4.4818	3.7000	3.0000	-9.492**
10	Tax evasion is ethical if everyone is doing it	4.8182	4.7000	3.5000	-10.170**
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends	2.9727	3.6000	2.7500	-7.133**
12	Tax evasion is ethical if the probability of getting caught is low	3.9273	4.6000	3.7500	-10.061**
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust	3.4364	3.0000	4.7500	-8.935**
14	Tax evasion is ethical if I can't afford to pay	3.4818	2.9000	4.0000	-9.552**
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more	4.5818	5.2000	4.5000	-10.539**
16	Tax evasion is ethical for me as a Muslim	5.2909	6.5000	6.5000	-10.489**
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	2.9364	3.8000	1.7500	-7.778**
18	Tax evasion is ethical if the government imprisons people for their political opinions	3.5909	5.0000	3.7500	-9.500**
	Average	4.018178	4.177778	3.527778	

Table 4 shows the scores broken down by Martial Statues. The average score for Single was 4.018178. The average for married was 4.177778, and the score for others was 3.527778. A Wilcoxon test was performed comparing single to married and others to determine whether the differences in scores were significant. The results of that test are reported in Table 4. The differences were significant for the all 18 statements.

Table 5: Comparison of Level of Study
Scores: (1 = strongly agree; 7 = strongly disagree)

S#	Statement	Freshmen	Sophomore	Junior	Senior	P value
1	Tax evasion is ethical if tax rates are too high	3.3750	3.8095	3.6140	3.9211	-1.139
2	Tax evasion is ethical even if tax rates are not too high	5.6250	5.0000	5.1930	5.9211	-8.148**
3	Tax evasion is ethical if the tax system is unfair	2.6250	2.4762	2.7719	3.1842	-2.168**
4	Tax evasion is ethical if a large portion of the money collected is wasted	3.2500	3.9048	3.4912	3.2895	-.707
5	Tax evasion is ethical even if most of the money collected is spent wisely	5.8750	4.9524	5.0000	4.8421	-6.035**
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of	3.5000	3.3333	3.0877	2.1842	-3.146**
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects	6.0000	4.8571	4.6842	5.0263	-5.080**
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	3.6250	4.4762	4.2982	4.2632	-5.124**
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	5.5000	4.1905	4.2982	4.3421	-3.337**
10	Tax evasion is ethical if everyone is doing it	5.1250	4.7143	4.4561	5.1842	-6.238**
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt	2.6250	3.5238	2.9123	2.9737	-2.299**

	politicians or their families and friends					
12	Tax evasion is ethical if the probability of getting caught is low	4.3750	4.1429	3.4912	4.5263	-2.814**
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust	3.0000	3.6667	3.3684	3.5263	-.591
14	Tax evasion is ethical if I can't afford to pay	3.3750	3.6667	3.3684	3.4737	-1.079
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more	5.5000	4.8571	4.3860	4.6842	-5.731**
16	Tax evasion is ethical for me as a Muslim	5.8750	6.0476	5.0877	5.5000	-7.214**
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	2.0000	3.2857	2.8772	3.1316	-1.651
18	Tax evasion is ethical if the government imprisons people for their political opinions	2.6250	3.7143	3.6842	3.9737	-1.939
	Average	4.104167	4.145506	3.892772	4.108194	

Table 5 shows the scores broken down by level of study. The average score for freshmen was 4.104167. The average for Sophomore was 4.145506, the average score of Junior was 3.892772, and the average score for Senior was 4.108194. A Wilcoxon test was performed comparing freshmen, sophomore, Junior, and senior to determine whether the differences in scores were significant. The results of that test are reported in Table 5. There are significant differences in the view of ethics of tax evasion in statements 2, 3, 5, 6, 7, 8, 9, 10, 11, 12, 15 and 16.

Table 6: Comparison of Major of Study
Scores: (1 = strongly agree; 7 = strongly disagree)

S#	Statement	accounting	Business administration	Finance and banking	P value
1	Tax evasion is ethical if tax rates are too high	3.8023	3.3600	3.9231	-.185
2	Tax evasion is ethical even if tax rates are not too high	5.5930	5.0400	4.9231	-1.241
3	Tax evasion is ethical if the tax system is unfair	2.8023	2.9200	2.9231	-.223
4	Tax evasion is ethical if a large portion of the money collected is wasted	3.5581	3.4000	3.1538	-.425
5	Tax evasion is ethical even if most of the money collected is spent wisely	5.1163	4.8800	3.1538	-1.178
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of	2.6628	3.4000	3.3077	-1.374
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects	4.9302	5.0000	4.5385	-.579
8	Tax evasion is ethical if a large portion of the money collected is spent on projects that do not benefit me.	4.2209	4.2400	4.6923	-.760
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	4.1628	4.7200	5.0769	-1.349
10	Tax evasion is ethical if everyone is doing it	4.8256	4.7600	4.3846	-.892
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends	2.9651	2.9200	3.5385	-1.223
12	Tax evasion is ethical if the probability of getting caught is low	4.0814	4.1200	3.0000	-1.741
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust	3.5233	3.3600	3.0769	-.546
14	Tax evasion is ethical if I can’t afford to pay	3.4535	3.4400	3.4615	-.005

15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more	4.7326	4.0400	5.0769	-.706
16	Tax evasion is ethical for me as a Muslim	5.5000	5.8400	4.1538	-2.731
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	3.0000	2.9600	2.7692	-.202
18	Tax evasion is ethical if the government imprisons people for their political opinions	3.8953	3.0400	3.7692	-.202
	Average	4.045861111	3.968888889	3.82905	

Table 6 shows the scores broken down by major of study. The average score for accounting was 4.045861111. The average for business administration was 3.968888889, and the average score for finance and banking was 3.968888889. A Wilcoxon test was performed comparing accounting, business administration and finance and banking to determine whether the differences in scores were significant. The results of that test are reported in Table 6. The differences were not significant for any of the 18 statements.

Table 7: Comparison of Studied Taxation
Scores: (1 = strongly agree; 7 = strongly disagree)

S#	Statement	Undertaken	Not undertaken	P value
1	Tax evasion is ethical if tax rates are too high	3.5968	3.8548	-8.139**
2	Tax evasion is ethical even if tax rates are not too high	5.5484	5.2742	-10.170**
3	Tax evasion is ethical if the tax system is unfair	2.9677	2.7097	-5.789**
4	Tax evasion is ethical if a large portion of the money collected is wasted	3.4516	3.5161	-7.883**
5	Tax evasion is ethical even if most of the money collected is spent wisely	5.1129	4.8871	-8.977**
6	Tax evasion is ethical if a large portion of the money collected is spent on projects that I morally disapprove of	2.5968	3.1613	-4.556**
7	Tax evasion is ethical even if a large portion of the money collected is spent on worthy projects	4.8710	4.9355	-8.783**
8	Tax evasion is ethical if a large portion of the money collected is spent on projects	3.9839	4.5645	-9.911**

	that do not benefit me.			
9	Tax evasion is ethical even if a large portion of the money collected is spent on projects that do benefit me	4.2258	4.5161	-8.923**
10	Tax evasion is ethical if everyone is doing it	5.1129	4.4194	-9.821**
11	Tax evasion is ethical if a significant portion of the money collected winds up in the pockets of corrupt politicians or their families and friends	2.6935	3.3387	-4.416**
12	Tax evasion is ethical if the probability of getting caught is low	4.2258	3.7258	-8.788**
13	Tax evasion is ethical if some of the proceeds go to support a war that I consider to be unjust	3.5000	3.3871	-6.970**
14	Tax evasion is ethical if I can't afford to pay	3.2742	3.6290	-8.139**
15	Tax evasion is ethical even if it means that if I pay less, others will have to pay more	4.5968	4.6613	-9.733**
16	Tax evasion is ethical for me as a Muslim	5.4355	5.4194	-9.563**
17	Tax evasion is ethical if the government discriminates against me because of my religion, race or ethnic background	2.8387	3.0968	-5.241**
18	Tax evasion is ethical if the government imprisons people for their political opinions	3.6935	3.7258	-7.686**
	Average	3.984767	4.0457	

Table 7 shows the scores broken down by whether the tax subject is undertaken by the respondent. The average score for students who have undertaken the tax subject was 3.984767. The average score for students who have not undertaken the tax subject was 4.0457. A Wilcoxon test was performed comparing both groups to determine whether the differences in scores were significant. The results of that test are reported in Table 6. The differences were significant for the 18 statements of ethics of tax evasion.

5.0 Conclusion

This study has been conducted to survey 124 degree students from Yemen enrolled for the academic year 2009/2010 in College of Business at Hadhramout university in an effort to examine their perceptions as to the agreement of the ethics of tax evasion. In a like manner, 124 usable surveys were received. The results of the study show that tax evasion is ethical under some circumstances. The majority of the respondents

were opposed to the view that tax evasion is always or almost always ethical. As a general rule, students might justify tax evasion by giving stronger support in some circumstance than others. In this study, students consider tax evasion as an ethical practice if the tax system is unfair, the government is corrupt, wasteful, or if the government engages in human rights abuses. The weakest arguments were in cases when the tax evasion is viewed from the Islamic perspective. As a Muslim, tax evasion is not justifiable. This indicates that almost all of the students are with the third view of Islamic perspective towards tax evasion which is obeying the Muslim ruler and pay the tax since it is regulated by him. Furthermore, students are opposed to tax evasion when tax rates are not high, or when the money collected are spent wisely and on worthy project. The findings of this study are in the same vein with some other studies that have been conducted using a similar survey instrument. This include the findings of studies of Argentina (McGee & Rossi, 2006), the Dominican

Republic (McGee, Lopez & Polanco, 2007), Ecuador (McGee, Lopez & Jaramillo, 2007), China (McGee& Noronha, 2007; McGee & An, 2006), Hong Kong (McGee & Ho, 2006), Macau (McGee, Noronha &Tyler, 2006), Poland (McGee & Bernal, 2006), Ukraine (Nasadyuk & McGee, 2006) and Australia (McGee & Bose, 2007), Guatemala (McGee & Lingle, 2005), PuertoRico (McGee & Lopez, 2007), Colombia (McGee, Lopez & Yepes, 2007), Thailand (McGee, 2006), China (McGee & Guo, 2006), Taiwan (McGee & Andres, 2007), Romania (McGee, 2005b), Estonia (McGee, Alver & Alver, 2007), Orthodox Jews (McGee & Cohn, 2006) and international business professors (McGee, 2005a). More research is needed to determine the issues of tax evasion among other countries in the Middle East. These findings have policy implications if governments want to collect a higher percentage of taxes. This way, government must change the perceptions of their taxpaying citizenry. They must spend funds wisely. They must not be corrupt and the tax system must be perceived as fair.

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FACTORS INFLUENCING ZAKAT PAYERS TRUST: AN EXPLORATORY STUDY

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Abstract

Zakat is an obligatory welfare mechanism divinely designed to address imbalances in wealth distribution so that Muslims who cannot earn enough to meet their basic needs may enjoy decent and respectable living. As a result of historical circumstances, this important compulsory duty has reduced to mere voluntary activity in most Muslims countries. Recent media propaganda on possible abuse in the use of zakat collection by international zakat organisation has also resulted in confidence-gap among zakat payers. Although the scourge of poverty continues to exist within Muslims, limited studies on zakat management have addressed trust of zakat payers. Accordingly, this paper reports the result of a qualitative study to gain additional insight into factors influencing trust of zakat payers in a particular zakat institution. Such knowledge will help zakat managers across Muslims countries to influence zakat payers' trust and patronage. Six factors including, economic situation, familiarity, Attributes of trustees, disclosure practices, stakeholder management and nature of model of zakat institution were identified as antecedents of trust. The implications for zakat institutions in building trust of zakat payers are discussed. The findings provide fresh insight into our understanding of zakat payers.

Keywords: Attributes of Trustees, Disclosure Practices, Stakeholder management

1.0 INTRODUCTION

Zakat institutions, like charitable organisations in developed economies, play a remarkable role is the socio-economic welfare not only in any typical Muslim country but also in a given Muslim community around the globe. Ideally, zakat is expected to be managed by organized agency run by an ideal Muslim government or nongovernmental organisations in Muslim communities across non- Islamic societies of the west. Whereas the major source of revenue for zakat institutions is the obligatory religious levy payable by eligible Muslims, charitable institutions depend on voluntary donations. As a result of the publicised financial scandals and allegations

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of diversion of zakat to finance activities not prescribed by Shariah, public trust in both charities and zakat institutions has waned drastically.

Lost of trust portends a serious threat to ability of these institutions to continuing justifying their existence through provision of services in line with their missions. A number of research efforts have gone into how donors build trust in charities but empirical studies on zakat payers' trust are scarce. Managers of zakat institutions need to understand how their major patrons develop trust in zakat institutions to safe the social entity from total collapse. In the following section, prior studies on discussed. Section three considers the data collection method employed in this study whereas data analysis was chronicled in section four. The empirical results analysed in term of five themes were discussed in chapter five. Discussion and conclusion were presented in Section six.

2.0 PRIOR LITERATURE

Notwithstanding the sparse level of enquiry on trust among accounting scholars, emerging evidence suggests an increasing interest of accounting researchers on accounting issues relating to trust (See for example; Neu, 1991a and b; Seal and Vincent-Jones, 1997; Tomkins, 2001; Langfield-Smith,2008; Baldvinsdottir, et al., 2003, 2011). These further suggest the interest among accounting scholars to explore interrelationship between accounting information, governance and trust. For instance, in the study by Baldvinsdottir, Hagberg, Johansson, Johansson and Marton (2003) it has been found that the trust people have in accounting figures is connected with the trust which the accountants have succeeded in winning from other people in the organisation. Similarly, formal accounting and contracting processes have also been found to engender trust and cooperative long–term relation (Seal and Vincent-Jones, 1997). In the like manner, trust and control mechanisms have been suggested as sources of confidence in strategic alliance (Das, 1998).

While there are studies reporting positive link between accounting information and trust, negative relationship between these two was also highlighted in the literature. A stream of research finds that trust is a primary determinant of collaboration success while some scholars suggest that control systems reduce trust among collaborators

(Zaheer and Venkatraman1995;Coletti, Sedatole and Towry, 2005). Furthermore, apart from the fact that most of the prior research relate to inter-firm relations, almost all the studies were carried out within commercial contexts. Wholesale adoption of findings to research in nonprofit organisations is not helpful, since charitable activities are not governed by the same calculus as that of commercial relationships.(Sargeant and Lee, 2002a). Studies on trust in charity literature, therefore, provide a better alternative.

A number of studies on giving have been conducted in charity literature but research specifically addressing the factors determining trust in a particular charitable institution is sparse (Handy, 2000; Sargeant and Lee, 2002b; Sargeant, Ford and West, 2006; Torres-Moraga, Vasquez-Parraga and Barra 2010). Handy (2000) proposes specific types of signals that charities can use to establish their trustworthiness to raise funds from the public and also uses data obtained from charities to verify the proposal. Among others, disclosure of information audited by a credible independent auditing firm, legal backing by way of enabling law or governmental approval, backing by board of trustees made up of reputable members, affiliation with reputable organisation, disclosure of visible past and current achievements, testimony from recipients or other donors, are highlighted as possible signals that can help build public trust in charities. These signals form the basis of most studies on trust in charities.

For instance, Sargeant and Lee (2002a) examine the factors that may lead to the improvement of trust in the voluntary sector. They find that judgement, attitude to beneficiaries, attitude to philanthropy, service quality and role competence are good predictors of the level of trust that a given individual will place in the voluntary sector. Although these factors relate to the sector, individual organisations seeking donor trust can achieve it by improving on all these five factors. Sergeant and Lee (2002b) provide a refinement to the findings from the study by Sergeant and Lee (2002a). As opposed to the five factors found in the earlier study, only four antecedents of trust were identified. The four factors include attitude to philanthropy, perceived organisational judgement, role competence and service quality.

In addition, Sergeant and Lee (2004) explore the link between trust, relationship

commitment and giving behaviour. More specifically, it extends the earlier studies by the authors by only testing the ability of trust in voluntary institutions to lead to giving behaviour and also to investigate the possibility of any mediating factor between trust and giving behaviour using trust behaviour; relationship investment, mutual influence, communication acceptance, and forbearance from opportunism. On the one hand, they find that an increase in trust tends to lead to enhancement in commitment, while on the other, their findings further suggest the existence of the mediating role of commitment in the relationship between trust and giving behaviour. Sergeant, West and Ford (2004) use the structural equation technique to investigate the perceptual factors that influence giving behaviour. Although the study is not specifically on trust, it is considered relevant because of the model of giving behaviour developed. Five factors – demonstrable utility, familiar utility, charity effectiveness, professionalism and service quality – are used to predict giving in the model. Except for professionalism, which produces a negative relationship, the results support hypothesized positive relationships between the variables and giving behaviour. As indicated earlier, familiarity, service quality, perception of charity, used in this study, have been used as antecedents of trust in other studies. Impliedly, the finding suggests a possible link between trust in particular charity and donating into such institution

In a similar vein, Sergeant, Ford and West (2006) explore the factors of giving behaviour and the mediating roles of trust and commitment. The findings from this study reveal a number of interesting areas in donor behaviour. They find that emotional utility, familial utility and trust are positively related to relationship commitment while organisational performance and communication are positively related to trust. In addition, trust is found to be a strong predictor of commitment, while, in turn, it mediates the relationship between trust and of average gift giving. Indeed, commitment is found to have a strong relationship with giving behaviour.

In a departure from previous studies on trust that are based on data from developed countries, Torres-Moraga et al.(2010) use data from an emerging charity sector in a developing economy – Chile – to develop a model of donor trust to explain how donor trust is generated. They find a direct relationship between organisational reputation, donor's familiarity, perception of the organisation's opportunism and donor trust, while the relationship between the perception of the organisation's

communication effectiveness and trust is indirect. Two things are common to all the studies. First, they focus on charitable institutions in a non-Islamic environment and it is unclear if the findings can be used to understand the behaviour of contributors to the Islamic charity – *zakat* institution. Second, majority of them are based on survey data which often suffer from in-depth insight into phenomenon of interest. The authors have reported results of few quantitative studies on zakat payers' trust but empirical qualitative studies designed to understand how zakat payers develop trust in zakat institution are rarer. Obviously, this represents a gap in the literature and it is this void that this paper aims to bridge by reporting the qualitative phase that was used to complement quantitative findings of a bigger study on model of *zakat* payers' trust.

3.0 RESEARCH METHOD

Given the purpose as well as resource limitation, semi-structured interview was used for this study. Typically, this type of interview allows the researcher to have control over the process of the interview and also provides opportunity for the interviewer to probe when need arises. Since the interview is structured by a list of questions, it offers the advantage of comparing responses from interviewees.

The study used non-probability sampling to produce samples for participation in semi-structured interviews. Non-probability sampling is generally used when sampling frames are unavailable or the population is widely dispersed (De Vaus, 2002). Interviewees were selected from survey respondents who paid their zakat within a year before the date of the interview. In addition, to ensure a reasonable degree of representativeness, their professional backgrounds and their region of birth were also taken into account in the selection of the sample. The study employed 6 semi-structured interviews to elicit factors that influenced interviewees in the choice of the particular zakat institution through which they paid their zakat. Sixteen Nigerian working class men drawn from both private and public sectors were interviewed between September 2010 and October 2010. All interviews conducted were face-to-face, lasted between twenty to thirty minutes and were audio-recorded. The profiles of companies interviewed are presented in Table 1.

Great efforts were made to ensure a broad representation of the survey respondent out of which the interview participants was drawn. Desired result could not be achieved due to paucity of reliable data base that can guide the selection of sample for the study. Eventually, the population for the study was working class Muslims who took part in the spiritual retreat in the last ten days of the fasting month of the Muslims. First contact with the interview participants was at the time of questionnaire administration. During the pre-questionnaire administration talk, the attention of the participants was drawn to the invitation to take part in the follow up interview. Interested people were advised to inform the principal researcher through the telephone number provided at the back of individual questionnaire or to indicate their contact number in the space provided.

Table 1.Profile of Interview Participants

Description of Characteristics	**Number of Participants**	**Percentage of Total Participants**
Age		
20-30yrs 31-40yrs 41-50yrs Above50yrs Total	1 6 7 2 16	6.25% 37.5% 43.75% 12.5% 100
Zakat Status		
Actual Zakat Payers Total	16 16	100% 100%
Educational Level		
HND or Degree Master and Above Total	7 9 16	43.75% 56.25% 100%
Sector		
Public Sector Private Sector Total	7 9 16	43.75% 56.25% 100%

Each interview started with a few minutes' discussion about the objectives of the study which was followed by some general information. Despite the initial reservation that participants might not want to discuss their religious affair, which is

often viewed as relationship between the God and His servant, most respondents were very helpful and willing to take the time to answer all the questions.

4.0 DATA ANALYSIS

Although Yin (2003) and Creswell (2008) state that there is no universally accepted approach to analyzing qualitative studies, however, methodologists have given guide on approach which individual research may adopt after due consideration has been given to the peculiarity of the study. Accordingly, an adaptation of general inductive approach, which is a composite data analytical approach derived from combination of general inductive approach suggested by Creswell (2008) and Moustakas's (1994) modified Van Kaam's (1959, 1966) approach, was adopted for this study. The major benefits of the composite approach are the ease of usage and the possibility of comparison of results from different participants' samples by quantifying the qualitative data.

5.0 INTERVIEW FINDINGS

Six themes that emerged from the follow up interviews with zakat payers included economic situation, familiarity, disclosure practices, zakat stakeholder management, attributes of members of board of trustees and nature of model of zakat institution. They were derived from clustering or categorizing of invariant constituents drawn from the responses of each participant. Verbatim quotations from participants were used to support the detailed discussions of each of the theme.

5.1 Economic situation

A significant number of research participants (43.75%) indicated that close association with people was a factor that influenced their choice of zakat distribution channel. Participant 2 stated:

> The prevailing situation of the poor within my immediate environment is number one consideration. How do you expect people in my mosque

> to feel towards me if majority finds it difficult to eat three square meal a day while I ride a very good car, my wife rides a good car, my kids have a driver attached to them for their school run and I take my zakat to one organisation that will not remember them to distribute for me..

Similarly, Participant 10 asserted

> I take advantage Existence of opportunity to pay Zakat in my locality. I believe it should be enjoyed by the poor in my locality. What I mean by opportunity is the presence of poor people in the place I live or the place I grew up. My parents live in our family house; the people take good care of them when I am not there. If there are poor Muslims among these people, it is only fair to first remember them when I am thinking of how to distribute my zakat

5.2 Familiarity

A good percentage of research participants (43.75%) affirmed that relationship with organization and family and Imam influenced the media they used in distributing their zakat. More specifically, 31.25% of the research participants identified the individual constituent of relationship with an Islamic organization as major consideration in the choice of their zakat distribution channel.

Participant 3 mentioned:

> My membership of the Zakat organization was the major consideration. Our organisation consists of students and workers. Majority of these students are from poor homes, some of us are not always comfortable leaving programs without extend gifts to one or two of them. The poverty situation forced the executive to form a zakat managing institution and I know few brothers, who are better placed, give monthly stipends to some of these students. You can imagine, if I have to pay zakat, where my mind will go.

5.3 Disclosure Practices

A reasonable proportion of the research participants (37.5%) confirmed that information on zakat collected and the way it was distributed was important to their decision on choice of zakat distribution channel. Participant 7 agreed that it is good to disclose but he expressed reservation for information disclosed. He stressed:

> People are behind financial statements. The statement cannot be more reliable than those who prepared it. It may not influence my decision. But it is good that Zakat institutions prepare it. You know, giving

> money to Zakat institution requires confidence in the institution. One way to build such confidence is through provision of reliable and relevant information. Amount of Zakat collected and distributed should be included in the financial statement. Evidence of number of poor who benefited should be included as well.

Also Participant 8 indicated:

> I have indirectly mentioned them, but since you demand for specific items, I will say total amount of Zakat collected should be disclosed, total amount distributed should be disclosed, break down of total distribution should be disclosed, salary of top earners in the organization should be disclosed, the achievements recorded should equally be disclosed.

5.4 Zakat Stakeholder management

Three subthemes, indicators of impact on the poor, indicators of assistance given to the poor and indicators of attention given to the zakat payers emerged. 25% of the research participants indicated that indicators of impact on the poor are important factors to be considered in their decisions on choice of zakat distribution medium.

Participants 2 stated:

> Attention that a Zakat institution gives to stakeholders will affect the success of such institution. For instance, when a Zakat institution organizes Zakat workshop for eligible Zakat payers to educate them on how to determine their Zakat liabilities, the Zakat payers will take the institution more seriously compared to other institutions that do not conduct workshops. Again Zakat distribution ceremony, where people can see happiness and sense of honour on the faces of Zakat recipients will be better appreciated than others that do not care about the welfare and feeling of the poor.

A significant percentage (62.5%) of research participants agreed that indicators of assistance given to the poor are critical factors to be considered in their decision on choice of zakat distribution channel. Participant 13 commented:

> If I say the treatment is not important to my decision, then I can as well throw my Zakat into the river. I will not pay to an institution that I am told pools Zakat funds from others with the impression to use it for the benefit of the poor but instead uses collected fund to modernize its

> office and pay fat salaries to staff while the poor people are just given meagre amount.

A good percentage (62.5%) of research participants identified indicators of attention given to the zakat payers as important determinants of zakat distribution channel. Participant 12 commented:

> The organization should sensitize its stakeholders, should maintain link with Zakat payers, should arrange to collate data on Zakat beneficiaries as well as Zakat payers, it should share information among its stakeholders by way of handbills, media adverts and even Juma'at services announcement, and on top of all should take good care of the poor.

5.5 Attribute of Members of Board of Trustees

Four sub-themes, including indicators of board reputation, indicators of inclination towards board dominated by Shari'ah experts, indicators of inclination toward board with members from diverse background and indicators of inclination towards board dominated by members with high integrity.

18.75% of the research participants identified reputation of board as important factor. Participant 3 stated:

> Yaaaa, you remember I mentioned credibility of the organization is important. Members of board form the core of the credibility .For instance, the chairman of our Zakat institution that I pay my Zakat to is a well known and highly influential person in the community. His name is enough to draw a lot of rich people into the organization.

A significant percentage of research participants (50%) of the participants regarded the presence of Shari'ah experts on the board of zakat institution as important influencing factor. Participant 2 stated:

> Sure, if you have a Board of Zakat institution without an Islamic scholar, you can be sure that the institution will not take compliance with Shari'ah very seriously. Although, I do not belong to the traditional school that may feel only Shari'ah experts should be on the board, but, first and foremost, Islamic scholars must be the priority on such board if you want compliance with Islamic rules guiding zakat.

50% of the research participants identified these indicators as important factor in their decision to select the medium through which to pay their zakat. Similarly, participant 9 commented:

> Hmm, world of today is too dynamic and as such requires approaches that are not static. I want to envision a board comprising of seasoned administrators, managers, academician to oversee the affairs of the Zakat board. You see, the academician should by default be an expert in Shari‘ah or Islamic law. The combination of both knowledge and the experience will fuse together to produce a very dynamic board which a Zakat institution of my dream.

A very significant percentage (68.75%) of the research participants identified indicators of integrity of board members as important factor in their decision on choice of zakat distribution channel. Participant 7 categorically stated:

> You know, if you talked about confidence, credible members of the board of Zakat institution is very important. I say credible members, because the presence of one dishonest member will prevent me from associating with such Zakat institution.

5.6 Nature of Model of zakat institution

43.75% of the participants identified indicators of preference for governmental model of zakat institution as important factor in their decision on zakat distribution channel. Participant 15 Stated:

> Government funded Zakat institution will be better than the nongovernmental. The reason is simple. Government has the wherewithal, authority and the like to organize things because we have people, who are working for government; who will not be paid out of Zakat fund. May be they may be paid allowance. A lot of wealthy people actually made their money through government patronages, so it is difficult for them to hide the extent of their wealth to government (income assessment power) where as they can hide their wealth for religious organizations.

A significant percentage (68.75%) of the participants regarded indicators of preference for nongovernmental model as important factor in their choice of zakat distribution channel. Participant 11 declared:

> I must say I go for Ngo run institution. In the south, where I live in this part of the country, there are no Shari‘ah laws in practice, so it is not

> feasible where you have government that does not respect Islamic values; that does not tolerate Islam and that is so discriminatory in favour of Christianity, to manage Zakat.

Also participant 14 stated:

> Well, since Nigeria is not an Islamic country, it is totally difficult for me to rely on government for Zakat management. Even in States that have declared Shari'ah, the leadership of the state is very important. If the leadership is unwilling, as we have seen in limited instances, management of Zakat fund by government will be difficult. "Even if state government floats an NGO as in the case of Jimjak State (pseudonym), it is still government institution which cannot be totally free from weakness in government ministries and departments".

6.0 DISCUSSION AND CONCLUSION

This study explores factors that influence how zakat trust a particular zakat institution they consider fit to act as their agent to discharge their religious duty of zakat payment. The six findings arising from the study has a far reaching effect on the zakat management landscape in general and Nigerian zakat management subsector in particular. Specifically, the study revealed that economic situation, familiarity, perception of disclosure practices, perception of zakat stakeholder management, perception of attributes of attributes of members of trustee and perception of model of zakat institution. Except for the economic situation and nature of model institution, the other four factors support in prior studies on trust in charity and for profit organsation (Sargeant and Lee, 2002; Sargeant and Lee, 2004; Sargeant, Ford and West, 2006; Mayer et al. 1995; Torres-Moraga et al., 2010).

Consideration for economic situation may be of greater significance in environment where poverty is widely spread and level of social trust is low. This may impact negatively on the development of functional zakat institution unless there is governmental enforcement. Enforcement is unlikely in multi-religious countries like Nigeria or where Muslims are in minority. Even, in Muslim countries, the degree of success of any enforcement will be influenced by the degree of monitisation of such economy. Where a lot of activities are carried out in the informal market, enforcement may not produce the anticipated result.

It appears participants are not particular influence by the nature of model of zakat institution as a factor. Findings on the relative efficiency of governmental and nongovernmental organisations are mixed. However, it appears peculiarity of Nigeria, has encouraged a moderate shift in favour of nongovernmental zakat institution as seen in the result. Impliedly, a national zakat institution may be difficult to implement in such environment. However, a survey should be able to shed more light on the preference of zakat payers.

Although there are mixed empirical findings on donors' perception of importance of adoption of broad disclosure practices for not for profit organisations (Hyndman, 1991; Parsons, 2007), finding in respect of broad disclosure practices for zakat institutions in the current study is in line with recommended good practice in normative literature. Similarly, the support for intrinsic model of stakeholder management by the study appears to complement the inclination towards broad disclosure practices.

Findings in respect of attributes of trustees of zakat institutions is in line with the view of Leblanc (2004) that effectiveness of an organisation is dependent upon, among others, specific competencies and the behaviour of individual directors. It also provides a theoretical support for the integrative model of organisational trust developed by Mayer et al. (1995). The result has implication on process of recruitment into the board of zakat institutions. Zakat board cannot be an avenue for compensation of political loyalists if such institution is to be trusted by the public.

Given the uniqueness of the qualitative approach used in the development of model of zakat payers trust, this study constitutes a significant contribution to the body of knowledge in both trust and zakat management literature. The fact that trust of zakat payers is critical to the sustainability of zakat sector as a whole, the model developed in this study should go a long way in enhancing the ability of zakat managers to efficiently attract zakat payers. Since zakat institutions are mechanisms for maintenance of welfare of the people, the findings will be helpful in formulating poverty alleviating policies. The findings should help in conducting survey research the can also add to the generalisabilty of the findings.

Notwithstanding the contribution of this study, the use of only Muslim men who go extra miles in their religious devotion may introduce bias into the findings. The use of sample comprising of very religious and moderate Muslims of different sexes in future study should help refine the results obtained in the current study. Fukuyama (1995) argues that differences economic progress of nations is related to the social trust. Therefore, the fact that the findings were based on data from a country that has been classified as poor nation, it is not unlikely that the different propensity to trust may not bias the current results. Replication of this study in relatively affluent Muslim country should refine the study.

Based on the findings, it is evident that there is a need for standards for disclosure practices as well as stakeholder management practices by zakat institutions and an effective oversight agency to monitor compliance in individual geographical jurisdiction. It is even more important if the idea of international zakat organisation being sponsored by Malaysia will be widely accepted across countries. The revelation on the attributes of competence and integrity for trustees points to the need to pay special attention on who leads zakat management institutions if we expect the institutions to be trusted.

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POTENSI APLIKASI ALAT-ALAT PROMOSI KOMUNIKASI PEMASARAN DALAM MENGGALAKKAN KUTIPAN ZAKAT DARIPADA PENDAPATAN PENGGAJIAN

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Abstrak

Secara berperingkat, akhirnya semua negeri di Malaysia telah membuat keputusan mewajibkan zakat ke atas pendapatan penggajian kepada semua umat Islam yang layak sebagaimana yang telah diputuskan oleh dengan keputusan Muzakarah Jawatankuasa Fatwa Majlis Kebangsaan Bagi Hal Ehwal Ugama Islam Malaysia pada 22 Jun 1997. Namun, kajian lepas mendapati bilangan dan kutipan masih lagi rendah berbanding dengan bilangan sebenar pembayar yang layak membayar. Justeru itu, kertas kerja ini bertujuan untuk melihat secara lebih dekat peranan dan alat-alat komunikasi pemasaran untuk membantu pihak pungutan zakat negeri dalam usaha meningkatkan bilangan pembayar dan jumlah kutipan terhadap zakat jenis ini. Terdapat beberapa alat komunikasi pemasaran yang sebenarnya telahpun diaplikasi oleh beberapa pusat zakat negeri namun masih terdapat lagi alat komunikasi pemasaran yang berpotensi untuk diaplikasi pada masa hadapan. Kertas kerja konsep ini diharap dapat memberi input kepada pihak pengurusan pusat zakat di setiap negeri dalam merangka strategi komunikasi pemasaran untuk meningkatkan kutipan zakat daripada pendapatan penggajian.

Katakunci :Zakat, pendapatan penggajian, kutipan, pemasaran, komunikasi pemasaran, promosi.

1.0 PENGENALAN

Cabaran dalam melaksanakan zakat ke atas pendapatan penggajian adalah kerana hukumnya tidak dinyatakan secara jelas di dalam ayat Quran sebagaimana zakat lain seperti emas dan perak, hasil ternakan dan hasil pertanian. Zakat ke atas pendapatan penggajian atau juga di istilah sebagai zakat *al-mal al-mustafad* adalah zakat moden

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yang dilaksanakan berdasarkan *Qiyas*[2] dan *Al-Nama Binafsih*[3]. Justeru itu, keputusan untuk mewajibkan zakat ini keatas semua Islam antara negara di dunia belum mencapai keseragaman.

Di peringkat kebangsaan, pada 22 Jun 1997, Muzakarah Jawatankuasa Fatwa Majlis Kebangsaan Bagi Hal Ehwal Ugama Islam Malaysia telah mengeluarkan fatwa bahawa zakat ke atas pendapatan adalah wajib. Keputusan ini diwartakan pada pada 29 April 1999 (Jakim, 2010). Walau bagaimanapun pengurusan pentadbiran zakat berbeza mengikut dasar yang diamalkan oleh Majlis Agama Islam setiap negeri. Setelah lebih sedekad, akhirnya semua negeri di Malaysia secara beransur-ansur, di mana Perak adalah negeri terakhir telahpun membuat keputusan mewajibkan zakat jenis ini kepada semua umat Islam yang layak. Walaubagaimanapun, hanya sebilangan sahaja yang telah mewartakan keputusan ini.

Berdasarkan beberapa kajian sebelum ini, kutipan zakat ke atas pendapatan penggajian masih lagi ditahap kurang memuaskan. Hairunnizam et al. (2006) dalam kajiannya mendapati daripada 2,500 orang responden dibeberapa negeri di Malaysia, hanya 742 orang (28.7%) yang membayar zakat, manakala selebihnya (1846 orang tidak membayar zakat). Ia juga turut di sokong oleh penemuan oleh Nur Barizah & Hafiz (2010) yang mana bilangan sebenar pembayar zakat jenis ini masih lagi rendah berbanding dengan bilangan yang layak membayar. Tambahan lagi, jika dibandingkan kutipan oleh Lembaga Hasil Dalam Negeri Malaysia dengan kutipan zakat untuk pendapatan penggajian, hasil kutipan zakat jenis ini jauh lebih rendah (Raedah et. al, 2011). Perkara ini perlu diberi perhatian kerana Hairunnizam et al. (2006) menyatakan kutipan zakat daripada pendapatan penggajian menjadi penyumbang tertinggi kepada kutipan zakat di Malaysia disamping tanggungjawab menyedarkan umat Islam tentang kewajipan zakat ke atas pendapatan penggajian.

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[2] *Qiyas adalah kaedah yang akan digunakan oleh ahli ulama Islam dalam menentukan amalan shariah jika sesuatu perkara itu tidak dinyatakan di dalam Al Quran, Hadith atau Ijma'*

[3] *Al-Nama Binafsih kaedah menetukan zakat kakayaan berdasarkan konsep "harta yang berkembang"*

Antara usaha yang boleh dilakukan oleh pihak pungutan zakat negeri adalah melalui aplikasi alat-alat komunikasi pemasaran dalam meningkatkan kesedaran umat Islam terhadap kewajipan menunaikan zakat dan sekaligus meningkatkan bilangan pembayar serta kutipan zakat ke atas pendapatan samada dari segi bilangan pembayar dan juga amaun. Sehubungan dengan itu, kertas kerja ini disediakan untuk melihat alat-alat komunikasi pemasaran yang berpotensi untuk digunakan dalam membantu pihak pungutan zakat negeri untuk mencapai sasaran ini. Tinjauan terhadap laman web khususnya Pusat Zakat Negeri Sembilan (PZNS), Lembaga Zakat Selangor (LZS) dan Pusat Pungutan Zakat Majlis Agama Islam Wilayah Persekutuan (PPZ) dilakukan untuk melihat aktiviti komunikasi pemasaran yang dijalankan.

2.0 KAJIAN LITERATUR

2.1 Pemasaran

Pemasaran adalah satu proses mencipta, berkomunikasi dan menyampaikan sesuatu nilai kepada pelanggan atau pasaran dan berusaha menjaga perhubungan dengan mereka supaya faedah dapat dirasai bersama di antara organisasai dan pihak-pihak yang berkepentingan (Kurtz & Boone, 2012). Pemasaran sentiasa menjadi tunjang kepada sesebuah organisasi dalam menjana pendapatan dan keuntungan sesebuah syarikat. Pemasaran kadang-kala disalah erti kepada perkara yang hanya menjurus kepada penjualan dan pengiklanan sedangkan ianya merangkumi pelbagai aspek perniagaan dari mengenalpasti pasaran sehingga kepada pulangan keuntungan. Konsep pemasaran yang lebih moden, menekankan kepada mencipta nilai pelangan dan memastikan mereka menemui kepuasan yang diharapkan bersesuaian dengan nilai atau harga pembelian yang dibuat (Kotler & Armstrong, 2010). Kaedah pemasaran sesuai diaplikasikan bukan sahaja kepada organisasi yang berorentasikan keuntungan malahan turut kepada organisasi yang bukan berorentasikan keuntungan (Kurtz & Boone, 2012; Kotler & Armstrong, 2010).

Namun begitu, organisasi perlu mempunyai strategi pemasaran yang baik dan berkesan dalam menarik perhatian dan pembelian pelanggan dan sekaligus dapat mempertahankan kelangsungan sesebuah perniagaan dan operasi. Dalam era globilisasi ini, kelangsungan sesebuah organisasi adalah sesuatu cabaran yang perlu

digalas oleh para pemasar melalui strategi-strategi pemasaran yang berkesan. Di antaranya, umum mengetahui tentang elemen-elemen traditional yang berkaitan dengan pemasaran iaitu strategi produk, harga (*price*), perletakkan (*place*) dan promosi (*promotion*) atau 4P (Kotler & Armstrong, 2010). Kini, setelah perkhidmatan turut mendapat tempat di pasaran sama seperti produk, maka elemen-elemen ini berkembang kepada orang (*people*), proses (*process*) dan bukti fisikal (*physical evidence*) yang menjadikan ianya sebagai 7P (Clarity Marketing Ltd, 2005). Dalam memastikan kelangsungan sesebuah organisasi samaada yang berorentasikan keuntungan atau tidak, pemasar perlu dahulu menyalur dan menyampaikan maklumat melalui kaedah yang berkesan kepada pasaran. Maka, elemen promosi memainkan peranan yang penting sebagai strategi komunikasi pemasaran yang menghubungkan pemasar dan pasaran melalui alat dan kaedah komunikasi seperti jualan peribadi (*personal selling*), pengiklanan, promosi jualan, perhubungan awam (Mc Daniel et al., 2011) dan pemasaran langsung (*direct marketing*) (Kotler & Armstrong, 2010).

2.2 Komunikasi Pemasaran

Komunikasi yang diterangkan oleh Duncan dan Moriarty (1998), adalah aktiviti dan perhubungan kemanusiaan secara bersama yang melibatkan semua bidang termasuk politik, ekonomi dan lain-lain dalam membentuk, menyusun dan menyalurkan maklumat (Duncan & Moriarty,1998). Manakala, Clow dan Baack (2007) menambah, ianya melibatkan satu proses menghantar, menerima dan memproses maklumat disamping menyalurkan idea atau pesanan dari penghantar kepada penerima maklumat. Terdapat pelbagai model yang boleh digunakan bagi memperjelaskan teori komunikasi dengan lebih lanjut seperti *'the extended hierarchy of effects models'*. Model-model ini menerangkan proses komunikasi bermula dengan tahap mengenalpasti maklumat kepada perasaan keinginan untuk mencuba atau memiliki dan akhirnya mewujudkan motivasi dan tindak balas perlakuan yang positif atau negativ (Egan, 2007). Komunikasi pemasaran yang berkesan melibatkan pelbagai aplikasi alat komunikasi dan juga keberkesanan kaedah yang digunakan. Aplikasi alat dan kaedah ini pula perlu diintegrasikan agar ianya diterima dan difahami oleh semua sasaran pelanggan.

2.3 Komunikasi Pemasaran Dari Perspektif Islam

Dalam konteks sesebuah organisasi dan syarikat berteraskan Islam, keperluan kepada pemasaran dan jualan perseorangan juga tidak kurang penting. Walaubagaimanapun, kaedah pemasaran perlulah mengikut kaedah yang ditetapkan oleh Islam. Kaedah pemasaran yang dibuat semata-mata untuk meningkatkan keuntungan tanpa memikirkan keperluan utama pengguna sudah tentunya akan menyumbang kepada keruntuhan moral dalam pemasaran (Ishak & Abdullah, 2012). Dalam hal ini, seseorang jurujual perlulah mempunyai etika yang baik, pengetahuan berasaskan Islam dan rasa tanggungjawab dalam menjalankan tugas mereka. Mereka perlulah melaksanakan tugas diberi tanpa menganiayai pelanggan kerana mereka akan dipersoalkan atas amanah yang diberikan kelak.

> *Dan (ingatlah) Kami akan mengadakan neraca timbangan yang adil untuk (menimbang amal makhluk-makhluk pada) hari kiamat; maka tidak ada diri sesiapa akan teraniaya sedikitpun; dan jika (amalnya) itu seberat biji sawi (sekalipun), nescaya Kami akan mendatangkannya (untuk ditimbang dan dihitung); dan cukuplah Kami sebagai Penghitung (al-Quran: 21:47)*

Abul Hassan dan Abdul Latiff (2008) di dalam tinjauan literatur mereka berkaitan perkhidmatan perbankan Islam merumuskan bahawa pemasaran beretika Islam boleh menghasilkan peningkatan dari segi: (i) tahap kepuasan pengguna terhadap produk utama bank, (ii) tahap kepuasan pengguna terhadap institusi bank, (iii) tahap kepercayaan kepada bank dan (iv) peningkatan tahap kesetiaan kepada bank.

Tidak terkecuali, pusat zakat negeri juga didapati turut mengaplikasikan alat komunikasi pemasaran tertentu (yang bersesuaian dan berlandaskan shariah) seperti pemasaran langsung, jualan langsung, pengiklanan, publisiti dan promosi jualan dalam meningkatkan kesedaran umat Islam berkaitan zakat dan meningkatkan kutipan zakat khususnya zakat ke atas pendapatan penggajian.

Pemasaran Langsung

Definisi untuk pemasaran langsung sering berubah-ubah mengikut masa. Bird (1989) pada asalnya, mendefinasikan pemasaran langsung sebagai sebarang aktiviti yang

mecetuskan dan mengeksploitasi hubungan langsung antara organisasi dengan pelanggan mereka secara individu. Kemudiannya, US Direct Marketing Association (DMA) mendefinisikan pemasaran langsung sebagai sistem pemasaran yang interaktif yang menggunakan satu atau lebih media pengiklanan untuk memberi kesan maklumbalas boleh ukur dan/atau urusniaga pada mana-mana lokasi (Tapp, 2000).

Pemasaran langsung juga disebut sebagai pemasaran sasaran, pemasaran hubungan, pemasaran pangkalan data, pemasaran satu-kepada-satu dan pemasaran integrasi (Stone & Jacobs, 2008) diperkenalkan untuk merapatkan hubungan dengan pelanggan (Clow & Baack, 2002). Pemasaran langsung merupakan pendekatan pasaran berdasarkan rekod pelanggan di dalam pangkalan data yang menjadi asas kepada analisis,perancangan, pelaksanaan dan kawalan ke atas semua aktiviti pemasaran ini (Tapp, 2000). Objektif utama pemasaran langsung adalah untuk mewujudkan hubungan jangka panjang dengan pelanggan (Stone & Jacobs, 2008, Kotler et al.,2009), disamping mendapatkan kesetiaan pelanggan (Stone & Jacobs, 2008), dan untuk mempertahankan pelanggan sedia ada dan pelanggan baru (Tapp,2000 & Clow & Baack,2001).

Kelebihan utama pemasaran langsung kepada pihak organisasi perniagaan adalah menjadi alat dalam membina hubungan dengan pelanggan dan mendapat maklumbalas segera. Oleh kerana kaedah ini melibatkan komunikasi secara personal, hubungan antara organisasi dengan pelanggan adalah lebih interaktif. Disamping itu, pemasaran langsung yang biasanya menggunakan internet dapat mengurangkan kos, meningkatkan kelajuan dan kecekapan, lebih fleksibel serta lebih global (Kotler & Armstrong, 2010)

Terdapat pelbagai kaedah dalam pemasaran langsung termasuk jualan peribadi, mel samaada surat pos atau melalui Internet, katalog, maklumbalas langsung televisyen (media massa), gerai dan atas talian (Kotler et al., 2009 & Clow & Baack, 2002). Kebanyakan bentuk pemasaran jenis ini telah lama diaplikasi dalam dunia perniagaan, kecuali pemasaran atas talian.

Perkembangan pemasaran langsung di Amerika Syarikat (US) adalah memberangsangkan. Antara fakta jangkaan menarik yang dimuatkan di dalam buku

laporan *"The Power of Direct Marketing :ROI, Sales, Expenditures, and Employment in the US, 2011 -2012 Edition*" Edisi ke 14 yang dikeluarkan oleh Direct Marketing Association's (2011) adalah:

- Hasil jualan daripada pemasaran langsung di US dijangkakan meningkat sebanyak 7.1 peratus daripada $1.83 trillion pada tahun 2010 kepada $1.96 trillion pada tahun 2011. Angka ini dijangka akan terus meningkat kepada $2.05 trillion (4.7 peratus) pada tahun 2012, walaupun jumlah hasil jualan US dijangka kekal pada 6.2 peratus.
- Pemasaran langsung berasakan internet dijangkakan mengalami pertumbuhan dua digit pada tahun 2011 dan 2012.
- Kebanyakan pemasaran langsung tradisional termasuk majalah dan surat khabar dijangka menurun kecuali radio dan television.

DM Percentage of Total Advertising Spend by Media, 2006–2011

(Billions of dollars)

	2006		2011		2006-2011 CHANGE	
	TOTAL AD SPEND	DM PERCENT	TOTAL AD SPEND	DM PERCENT	TOTAL AD SPEND	DM PERCENT
DIRECT MAIL (NON-CATALOG & CATALOG)	$58.6	90.6%	$54.2	92.4%	-$4.5	1.8%
TELEPHONE	91.1	49.1	74.6	49.1	-16.5	0.0
NEWSPAPER	46.6	34.6	20.8	37.4	-25.8	2.8
TELEVISION	71.9	30.6	76.0	29.0	4.1	-1.6
MAGAZINE	23.4	36.1	19.6	35.6	-3.8	-0.5
RADIO	19.6	24.9	14.9	26.1	-4.7	1.2
ONLINE MEDIA	16.9	98.8	31.9	98.0	15.0	-0.8
OTHER	28.3	16.6	20.9	20.4	-7.4	3.9
TOTAL	$356.6	47.9%	$313.0	52.1%	-$43.6	4.2%

Source: The Power of Direct Marketing 2011-12, DMA.

Sumber: Direct Marketing Association

Beberapa bentuk komunikasi pemasaran langsung, samada tradisional ataupun moden telahpun diaplikasi oleh beberapa pusat zakat negeri dalam usaha meningkatkan kutipan zakat. Contohnya, PZNS melalui strategi Pameran Zakat membuka gerai pameran dilokasi-lokasi seperti pusat membeli belah, exspo, hari terbuka dan lain-lain tempat yang menjadi tumpuan orang ramai dengan menempatkan pegawainya untuk berkomunikasi secara bersemuka dengan pelanggan serta mengedarkan risalah. LZS pula membuka kaunter setiap hari di lokasi yang tetap dan PPZ membuka kaunter info

berdasarkan jemputan daripada pihak luar. Kaedah bertemu muka lain dengan pelanggan adalah program taklimat yang dijalankan oleh PZNS yang dijalankan di premis kerajaan dan swasta.

Selain itu, masih dibawah kaedah komunikasi pemasaran langsung secara tradisional, PZNS menghantar mail peringatan yang mengandungi penyata pembayaran zakat serta borang jawapan berkaitan zakat pendapatan kepada pelanggan mereka pada awal tahun.

Manakala komunikasi pemasaran moden pula melibatkan khidmat pesanan ringkas (sms), *twitter*, *facebook* dan *blog*. PZNS dan PPZ menghantar sms kepada pelanggan mereka lebih kepada untuk mengekalkan hubungan sedia ada, seperti ucapan selamat hari raya, selamat berpuasa dan sebagainya. Disamping itu, PPZ dan LZS mewujudkan *twitter*, *facebook* dan *blog* untuk organisasi masing-masing dalam mendekati umat Islam dan meningkatkan kesedaran terhadap kewajipan berzakat.

Jualan Peribadi

Jualan peribadi merujuk kepada jualan secara individu, meliputi proses penerangan oleh jurujual terhadap produk/perkhidmatan dan perkhidmatan selepas jualan. Jualan peribadi merupakan kaedah promosi paling paling tradisional, melibatkan jualan secara bersemuka di antara seorang penjual dengan pelanggan. Kotler et al. (2009) mendefinisikan jualan peribadi sebagai pembentangan secara personal oleh ahli pasukan jualan sesebuah syarikat bertujuan untuk mempertingkatkan jualan dan membina perhubungan dengan pelanggan.

Terdapat pelbagai teknik jualan peribadi pada hari ini selaras dengan perubahan yang berlaku dari semasa ke semasa. Kaedah tradisional yang melibatkan pasukan jurujual melakukan jualan di pelbagai lokasi luar syarikat (seperti mengikut geografi berbeza) turut berubah hasil perubahan teknologi seperti sistem telekomunikasi dan teknologi komunikasi maklumat (ICT). Teknologi ini telah mewujudkan pasukan dalaman jualan peribadi seperti '*telemarketer*' yang bertugas di dalam persekitaran syarikat. Disamping itu, perubahan pada pelanggan juga menyebabkan tugas jurujual bukan lagi hanya tertakluk menjual barangan yag dikeluarkan oleh syarikat, bahkan menyampaikan kehendak pelanggan kepada syarikat (Kotler et al., 2009).

Jones et al. (2005) menyatakan bahawa kejayaan sesebuah pasukan jurujual peribadi dan pihak syarikat adalah dipengaruhi oleh beberapa faktor. Faktor-faktor ini perlu diambil kira dalam melakukan penambaikan mengikut perubahan semasa. Secara umum, perubahan ini boleh dibahagikan kepada dua bahagian iaitu faktor dalam dan luaran. Faktor dalaman merujuk kepada pelanggan dan persaingan manakala faktor luaran merujuk kepada perundangan dan teknologi.

Dalam konteks sesebuah Pusat Kutipan Zakat, sudah tentunya penambaikan dalam teknik jualan peribadi adalah amat penting dalam meningkatkan jumlah kutipan zakat. Para amil dan staf Pusat Kutipan Zakat yang lain mempunyai tanggungjawab besar untuk menyampaikan maklumat secara terus, telus, tepat dan diyakini supaya dapat menarik bakal pembayar zakat menunaikan tanggungjawab mereka dengan berkesan. Ini kerana, terdapat pembayar zakat enggan membayar zakat atau membayar zakat secara persendirian (menyebabkan kebocoran pembayaran zakat) disebabkan ketidakfahaman mereka mengenai harta yang dikenakan zakat (lebih-lebih jika ia melibatkan khilaf) dan ketidakyakinan terhadap kaedah pengagihan zakat (Hairunnizam, Mohd Ali & Sanep 2005)

Pengiklanan

Pengiklanan adalah suatu alat komunikasi yang digunakan oleh penaja dalam memperkenalkan, mempromosi dan meningkatkan penjualan sesuatu produk, perkhidmatan atau idea yang berbentuk bukan peribadi tetapi berbayar (Kurtz & Boone, 2012; Kotler & Armstrong, 2010; Mc Daniel et al., 2011). Ia dilihat sebagai salah satu alat komunikasi pemasaran yang mencecah kos dan perbelanjaan yang tinggi. Berdasarkan kajian oleh Marketing Charts (2012) dan perangkaan yang disediakan Magna Global, hasil pendapatan pengiklanan di Amerika Syarikat telah meningkat kepada 3.1 peratus pada tahun 2011 dan mencecah sebanyak AS $171.7 billion. Ini menunjukkan pengiklanan tetap menjadi pilihan organisasi dalam mempromosikan dan menyampaikan maklumat tentang produk atau jenama mereka sungguh pun pengiklanan menelan perbelanjaan yang tinggi. Menurut analisis yang dikeluarkan oleh **G**lobal Media and Information Company Nielsen, perbelanjaan pengiklanan di rantau Asia Tenggara telah mencatatkan pertumbuhan melebihi AS 5 bilion pada suku ketiga 2011 (CASBAA, 2002-2012).

Salah satu daripada ciri-ciri pengiklanan ialah bersifat bukan peribadi yang mana ianya lebih terarah kepada kumpulan-kumpulan pengguna dan bukannya individu (Egan, 2007) sebagai sasaran penonton. Rangkaian media massa seperti televisyen, radio, suratkhabar, majalah (Belch & Belch 2012), dan papan iklan (Kotler & Armstrong, 2010) adalah antara media-media pilihan popular untuk melaksanakan strategi pengiklanan. Ada sesetengah penulis berpendapat Internet juga merupakan salah satu media popular pengiklanan di era globalisasi ini.

Berdasarkan Laporan Tahunan Lembaga Zakat Selangor 2010, media massa diakui dapat memainkan peranan penting dalam memberi pendedahan dan informasi tentang LZS kepada masyarakat. Penyebaran meluas berkenaan aktiviti-aktiviti dan program-program dakwah serta pengagihan Zakat telah memperlihatkan kerjasama yang erat antara LZS dan pihak media massa. Sebanyak 907 iklan, 49 buah papan iklan, 600 iklan di LCD bas dan teksi serta 1300 kain rentang dan bunting telah dihasilkan LZS sepanjang tahun untuk memberi kesedaran dan maklumat kepada masyarakat tentang zakat.

Sementara itu, di Negeri Sembilan, umpamanya PZNS bekerjasama dengan Radio Malaysia Negeri Sembilan (RMNS) dengan mengadakan Slot Info Zakat. Antara rancangannya adalah Kuiz Infozakat dan *Jinggles* zakat yang bertujuan melihat sejauh mana maklumat zakat diperolehi dan diketahui masyarakat serta hebahan maklumat kewajipan berzakat kepada pendengar radio yang bukan sahaja kepada pendengar di Negeri Sembilan tetapi turut dapat didengar oleh pendengar di Melaka, Johor dan Selangor. Slot ini telah mendapat maklum balas menerusi panggilan dari pendengar-pendengar yang memerlukan maklumat lanjut tentang zakat. Selain itu, pengedaran risalah zakat, "Operasi Sampai" atau "Ops Sampai" di kawasan taman-taman perumahan dan kawasan kampung oleh pegawai zakat turut dilakukan bagi memberi panduan ringkas tentang zakat, skim potongan berjadual dan sebagainya.

Selain itu, terdapat juga aktiviti pengedaran risalah zakat di kompleks kerajaan dan kawasan tumpuan umum seperti di pejabat pos dan tenaga nasional yang mana risalah diletakkan di *wiper-wiper* kenderaan. Turut dilakukan adalah "Operasi Akhbar" atau "Ops Akhbar" iaitu pengedaran risalah zakat yang diselitkan ke dalam akhbar yang menjadi tumpuan para pembaca akhbar seperti akhbar mingguan.

Publisiti / Perhubungan Awam

Ianya adalah medium promosi yang bukan peribadi dan digunakan penaja untuk memberi imej dan berita yang mengalakan dan positif mengenai organisasi, produk, perkhidmatan, idea mahupun aktiviti-aktiviti dan program- program yang dikendalikan organisasi melalui siaran dan sidang akhbar; rencana dan artikel; gambar, filem, video (Belch & Belch, 2012) dan lain-lain. Program-program yang dianjurkan organisasi ini bertujuan untuk menaikkan imej korporat seperti majlis makan malam tahunan, derma kebajikan, siri ceramah dan penajaan.

Taklimat adalah aktiviti pulisiti dan perhubungan awam yang sering dilakukan oleh pusat zakat negeri. Melalui taklimat, khidmat pegawai-pegawai zakat bukan sahaja memberikan penerangan malah memberi respon secara langsung kepada masyarakat terhadap permasalahan atau maklumat yang diperlukan seperti pengiraan zakat oleh pembayar zakat. Taklimat ini dikendalikan dengan kerjasama badan-badan kerajaan, berkanun dan juga swasta bagi menyalurkan maklumat tepat kepada pekerja mereka. Manakala, di masjid atau di surau-surau taman perumahan telah diwujudkan "kuliah zakat" yang biasanya dilakukan selepas solat maghrib.

Inisiatif lain yang turut dibuat adalah mewujudkan video klip jejak asnaf di dalam laman sesawang PZNS yang bertujuan bagi masyarakat melihat pengagihan zakat mereka diagihkan kepada asnaf. Pemberian zakat kepada asnaf turut disebarkan di dalam berita televisyen, radio, suratkhabtar, dan majalah sebagai maklumat dan pendedahan berguna kepada pembayar zakat dan masyarakat Islam di Malaysia khasnya. LZS umpamanya, telah melakukan sebanyak 262 wawancara atau tazkirah zakat dan menghasilkan 536 bahan berita atau artikel berkenaan zakat (LZS,2010).

Namun begitu, pusat zakat perlu memastikan kandungan maklumat berita dan artikel adalah berkesan dalam memberi kesedaran dan kefahaman yang menyeluruh. Program-program yang lebih dinamik dan bercorak interaktif perlu diwujudkan untuk menarik golongan belia.

Promosi Jualan

Promosi jualan didefinasikan sebagai insentif jangka pendek untuk menggalakkan pembelian atau jualan sesuatu produk atau perkhidmatan (Kotler & Armstrong, 2008).

Ianya juga adalah aktiviti komunikasi pemasaran yang digunakan untuk menggalakkan perdagangan dan/atau menggalakkan pengguna akhir untuk membeli atau mengambil langkah yang relevan dengan mempengaruhi "*perceived value*" produk yang sedang dipromosikan atau dengan cara lain memotivasikan agar tindakan diambil (Pickton & Broderick, 2005). Promosi jualan menawarkan sebab atau alasan untuk membeli produk atau perkhidmatan pada masa kini, dalam kadar yang segera berbanding pengiklanan yang menawarkan sebab mengapa pembelian sesuatu produk atau perkhidmatan perlu dilakukan .

Promosi jualan dijalankan berdasarkan objektif yang ingin dicapai. Sebagai contoh, promosi kepada pengguna menekankan pembelian jangka pendek kepada pelanggan atau untuk meningkatkan hubungan jangka panjang dengan pelanggan (Kotler & Armstrong, 2008). Promosi jualan juga kebiasaanya digunakan bersama-sama alat promosi yang lain seperti pengiklanan dan jualan peribadi.

Alat promosi utama kepada pengguna adalah sampel, kupon, pulangan / rebat tunai, harga pek, premium, pengiklanan kepakaran, naungan ganjaran (*patronage rewards*), "*point-of-purchase*" yang dipaparkan atau didemonstrasikan, pertandingan, loteri dan permainan (Kotler & Armstrong, 2008). Namun begitu, tidak semua alat promosi yang disenaraikan di atas sesuai diaplikasikan di pusat pungutan zakat.

Pembayaran zakat pendapatan penggajian boleh dilakukan melalui potongan gaji bulanan atau juga dengan cara pembayar zakat membuat pembayaran secara atas talian (*on-line*) atau hadir sendiri ke cawangan pejabat-pejabat zakat yang ada. Bagi pembayar yang hadir sendiri ke cawangan pejabat pembayaran zakat atau kaunter pungutan zakat, pemberian hadiah-hadiah kecil seperti jam dinding, kit kecantikan , buku nota, pen, kalendar, beg dan lain-lain barangan cenderahati disediakan. Ini merupakan satu galakan supaya pembayar tersebut meneruskan niat murni mereka untuk membayar zakat pendapatan penggajian dan juga zakat-zakat yang lain. Pemberian hadiah-hadiah kecil ini dilaksanakan olah PZNS dan juga pusat-pusat zakat di negeri lain. Bagi PPZ, dinyatakan di laman sesawang mereka bahawa antara 6 sebab mengapa perlu berzakat di PPZ ialah cenderahati menanti anda (http://www.zakat.com.my/). Cenderahati istimewa menanti setiap pembayar zakat yang membayar zakat di mana-mana kaunter zakat mereka.

Selain daripada itu, pembayaran zakat pendapatan penggajian membolehkan pembayar zakat menerima rebat cukai, iaitu rebat ke atas cukai pendapatan yang dikenakan oleh pihak Lembaga Hasil Dalam Negeri. Setakat ini, tiada had jumlah pembayaran zakat pendapatan penggajian yang dikenakan bagi menerima rebat cukai ini.

3.0 CADANGAN

Sehingga kini, tidak dinafikan kebanyakan pusat zakat negeri-negeri telah mengaplikasi pelbagai bentuk alat komunikasi pemasaran samada melibatakan pemasaran langsung, jualan peribadi, pengiklanan, publisiti/perhubungan awam dan promosi jualan. Namun, masih terdapat lagi beberapa aktiviti komunikasi pemasaran yang berpotensi diaplikasi oleh pusat zakat negeri-negeri dalam meningkatkan kesedaran terhadap kewajipan membayar zakat ke atas pendapatan penggajian sekalugus meningkatkan bilangan pembayar dan jumlah kutipan zakat jenis ini.

Berdasarkan kajian literatur di atas, terdapat beberapa cadangan dan penambaikan yang boleh dilakukan oleh pusat zakat negeri-negeri dalam memperkasakan aktiviti pemasaran sedia. Dari aspek staf atau pegawai pusat zakat itu sendiri, selain mempunyai keterampilan dan akhlak yang baik yang boleh menyakinkan pelanggan tentang kemampuan organisasi mereka dalam melakukan yang terbaik atas amanah (harta) yang diberikan, mereka juga perlu dilengkapkan dengan pengetahuan yang menyeluruh tentang harta yang diwajibkan zakat, perkara khilaf mengenai harta zakat dan perundangan berbeza mengikut semua negeri (tidak hanya tertakluk pada negeri yang berkaitan sahaja). Adalah bonus jika mereka memahami tentang kelakuan pelanggan yang berbeza dan cara menarik minat pelanggan yang terdiri daripada pelbagai lapisan- latar belakang pendidikan, pendapatan, umur dan sebagainya.

Seiring dengan kecanggihan teknologi, pusat zakat juga wajib menyediakan kelengkapan teknologi dan ICT yang lengkap membolehkan staf berhubung terus dengan pelanggan dan sebaliknya.Disamping itu, adalah penting bagi pusat zakat untuk membangunkan pangkalan data yang lengkap mengenai para pembayar zakat

yang sedia ada dan baru bagi mebolehkan staf mengenal pasti pembayar zakat berpotensi dan menghubungi mereka secara terus.

Manakala aktiviti komunikasi pemasaran yang boleh ditambahbaik dan berpotensi dilaksanakan termasuklah mengiklankan talian segera untuk dihubungi, alamat laman sesawang atau tarikh-tarikh promosi yang akan dilakukan di seluruh negara dengan memilih saluran yang tepat (sebagai contoh tv3 bagi televisyen) bagi setiap medium pengiklanan yang menjadi tumpuan penonton,pendengar dan pembaca serta menentukan waktu yang sesuai bagi setiap saluran yang akan dikeudarakan atau dicetak.

Pusat zakat juga perlu memastikan mesej yang disampaikan adalah menarik dan dapat menarik perhatian masyarakat dengan mengintegrasikan pelbagai bentuk medium komunikasi supaya ianya efisyen dan tidak membazirkan kos promosi. Ini sangat penting kerana mesej dapat menyampaikan maksud yang berkesan dan mempengaruhi minda dan perasaan penonton sehingga boleh menghasilkan sesuatu tindakan. Mereka boleh menggunakan kaedah tradisi seperti penggunaan papan iklan di tempat-tempat dan kenderaan-kenderaan yang sesuai serta kaedah digital seperti menggunakan iklan-iklan Internet seperti “pop-up” untuk peringatan kepada pembayar zakat.

Di samping itu juga, pusat pungutan zakat boleh menganjurkan pertandingan bagi menggalakkan lagi minat pembayar zakat untuk meneruskan usaha murni mereka ini. Pertandingan boleh dilihat dari segi pembayar zakat yang membayar jumlah zakat tertinggi, pengetahuan am tentang zakat dan juga lain-lain. Hadiah-hadiah yang ditawarkan hendaklah menarik seperti pakej menunaikan umrah, pakej pelancongan dan sebagainya, supaya lebih ramai penyertaan diterima daripada pembayar zakat.

Selain daripada pemberian hadiah-hadiah kecil yang kebiasaannya mempunyai logo pusat pungutan zakat, pusat pungutan zakat juga boleh bekerjasama dengan syarikat-syarikat lain yang bersesuaian untuk menawarkan kupon produk atau perkhidmatan kepada pembayar zakat. Sebagai contoh, dengan membayar zakat, pembayar zakat menerima kupon potongan harga barangan makanan keluaran syarikat Muslim atau

potongan harga pembelian barangan atau pakaian untuk menunaikan fardu haji dan umrah.

Bagi memastikan pembayaran zakat pendapatan penggajian secara berterusan, kempen-kempen untuk membangkitkan kesedaran pembayar zakat mengenai kewajipan membayar zakat pendapatan penggajian adalah diperlukan. Majikan boleh turut memainkan peranan sebagai penggalak kepada usaha ini dengan menjadi urusetia pembayaran zakat melalui skim potongan gaji.

4.0 PENUTUP

Kertas kerja konseptual ini melihat kepada aktiviti komunikasi pemasaran yang diaplikasi oleh pusat zakat negeri dalam usaha memberi kesedaran kepada umat Islam terhadap kewajipan menunaikan zakat ke atas pendapatan penggajian dan seterusnya membantu mereka meningkatkan bilangan pembayar dan jumlah kutipan terhadap zakat jenis ini. Hasil tinjauan ke atas laman web bagi tiga pusat zakat, iaitu PZNS, LZS dan PPZ membuktikan bahawa terdapat pelbagai aktiviti pemasaran yang telah diaplikasikan pada masa sekarang, namun masih ada ruang untuk penambahbaikan disamping beberapa alat pemasaran yang berpotensi untuk diperkenalkan. Selain alat komunikasi pemasaran, pusat zakat juga perlu melakukan penambahbaikan pada aset sedia ada seperti staf dan kemudahan teknologi dalam meperkasakan aktiviti kutipan zakat. Dicadangkan supaya pada masa hadapan, kajian secara empirikal dilaksanakan untuk melihat kesan atau pengaruh alat komunikasi pemasaran dalam memberi kesedaran.

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GOVERNING *BAITUL MAL* TOWARDS 2020, ISSUES AND CHALLENGES: INDONESIA EXPERIENCES

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Abstract

Baitul-Mal is normally known as one of financial institution in Islam. This point is true because presently Baitul-Mal role is more prominent in terms of providing assistance and contributions to reduce the poverty in the country. The rapid global economic changes towards 2020 clearly impact to the Baitul as a socioeconomic institution, politically and economically. This paper tries to explore and examine some basic issues and challenges in the development of *Baitul Mal* facing economic transformation 2020 in the Indonesian context.

Keywords: *Baitul Mal, Issues, Challenges, Indonesia*

1. Introduction

Baitul Mal has existed since in the era of Rasulullah SAW even though had not well established. Baitul Mal institutions independently formed as an economic institution in the era of Khalifah Umar bin Khattab suggested by Walid bin Hisyam, an expert in Fiqh. Since then, Baitul Mal had become a vital institution in Islamic countries. Farther, Baitul Mal has handled a variety of matters ranging from withdrawal zakat (also tax), *ghanimah*, infaq, sadaqah to construct public facilities such as roads, bridges, hire armies and as well as social or other public interests. Compare with today, Baitul Mal can be said functioning as the Ministry of Finance, Directorate General of Taxes, Ministry of Social Affairs, Ministry of Public Works and so on.

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The term “Baitul Mal" means House of Money and “Baitul Tamwil” means House of Expense or Islamic Bank. Of the historical roots above, it appears that the function of Baitul Mal waat Tamwil truly in the conception of Islam as an alternative Shari'ah financial institutions that have a social dimension and productive in national and even global scale, and pulse of economy Ummah that will foster other Islamic economic institutions.

In a further development in Indonesia, driven by a sense of deep concern over the number of poor (most of them are Muslims) are trapped by money lenders and also in order to provide an alternative for those who wish to develop business but cannot deal directly with Islamic banking (both BMI and BPRS) due to its relatively small and micro enterprises, then in 1992 was born a small financial institutions that operate and use the combined between the concept of Baitul Mal and Bait at Tamwil aiming in the micro business sector. The "encouraged self" agency named *Baitul Mal wa at-Tamwil* abbreviated as BMT.

Baitul Mal; Concept and Legitimacy

The role of the state can only be well functioning, if there is an organization that will be given a trust and mandatory to perform the task. In recognizing the importance of this organization, *Baitul-Mal* or public treasury, according to some viewers,[3] was founded by the Prophet of Islam himself when he established Islamic state at Al-Madinah. But this view is not supported by the majority of the scholars of Islamic history for the reason that in the reign of the Prophet the income of the state was meager which never exceeded its expenses and hence the need of *Baitul-Mal* was never felt. According to more current and dominant view,[4] *Baitul-Mal* was first established during the reign of Abu Bakr who succeeded in the year 632, A.D. as First caliph of the Islamic state. With the conquests of Iraq, Syria and other countries there was considerable increase in the revenues of the Islamic state which necessitated the establishment of public treasury.

[3] Such as Abdul Qadir Zallum, 'al-Amwal Fi ad Dawlah al Khilafah', p.15

[4] Nicolos P. Aghnides: Muhammad and Theories of Finance, Lahore: United printing Press, 1961

In the early days of Islam, *Baitul-Mal* is not so prominent and important. Because the economic development at that time was limited and there was not much revenue for the state, hence there is no difficulty to manage it. Problem of surplus also does not arise, because the earned income equals to the amount spent. In short, the *Baitul-Mal* during the early days of Islam, and also during the prophet time can be summarized as no specific place to saving the property; limited sources; ad-hoc funds are existing; and simple allocation and distribution procedure, there is no necessary to store it. However, *Baitul-Mal* took its real shape on a permanent footing during the rule of Umar *al Farooq*, the second caliph of Islam. It is during his time that the treasures of the countries conquered from former Iranian and Roman empires started pouring into Muslim capital which made the institution of *Baitul-Mal* a powerful and very important department of the state.

It is better to explain the concept of *Baitul-Mal*, as envisaged by early muslims who founded it, before we proceed to expand upon sources of its income and heads of its expenses. "Every property which belongs to muslims in general and not to any muslim in particular constitutes a part of the assets of the public treasury (*Baitul-Mal*). It is not necessary that the property should be actually in the vaults (*Hirz*) of the treasury for it to be considered an asset of the treasury, because the conception of *Baitul-Mal* refers to the destination of the property, not to its actual location. Therefore, every expenditure which must be incurred in the interests of the muslims in general is a liability of *Baitul-Mal* and when it is made, it is considered to have been made by it, whether or not it has actually been paid out of the vaults of *Baitul-Mal*; this is for the reason that a revenue which has gone into the hands of the public collectors or has been directly spent with them is really a part of the income and expenditure of the *Baitul-Mal* itself, and therefore, subject to the regulations governing the same.[5]

Dictionary of Islam defined *Baitul-Mal* as National treasury who received the money collected by the state from various sources such as Zakat, Waqf, etc.[6] Zallum(1983) in his book, *'al-Amwal FiDawlah al Khilafah'* defines *Baitul-Mal* as the competent authority in

[5] Nicolos P. Aghnides: Muhammadan Theories of Finance, Lahore: United printing Press, 1961
[6] *Patrick Thomas Huges, 1964, Dictionary of Islam, Lahore Premier Book House, Lahore, p. 35*

charge of all the State's revenues and all the expenditures for which the muslims are eligible. This definition conforms *Baitul-Mal* as the treasury of the state. So every property, such land, buildings, minerals, money, or merchandise for which the muslims are entitled, according to the divine rules, but the person entitled to its ownership has not been designated though the area upon which it is spent is determined; such property would be a rightful property of muslim's treasury, regardless of whether it is already in the sanctuary of the treasury or not. Likewise, every property due to be spent upon its beneficiaries and rightful owners, or in the interests of the muslims and their affairs, or in carrying the Islamic *Daw'ah,* all such funds are a duty upon the treasury, regardless of whether the funds are spent or not. Therefore, the *Baitul-Mal* in this context is the competent authority.

Imam Al-Sarakhsi, the well-known Hanafi Jurist, says in his work "*Al-Mabsut*": "The *Baitul-Mal* has some rights and obligations which may possibly be undetermined." At another place the same author says: "If the head of an Islamic state needs money to give salaries to his army, but he finds no money in the Kharaj department of the *Baitul-Mal* (where from the salaries are generally given) he can give salaries from the Shadaqah (Zakah) department, but the amount so taken from the Shadaqah department shall be deemed to be a debt on Kharaj department."

The revenues which accrue to the *Baitul-Mal* of state have been placed by the classical jurists of Islam under three categories. They are: (i) The 'Zakat' and 'Shadaqah' revenues; (ii) the 'Ghanimah' revenue or spoils of war; (iii) the 'Fai' revenues such as Jizyah and Kharaj. These revenues have already been discussed in detail by Abu Ubaid in his book *al Amwal*. Since the revenues falling under the second and third category are no longer available to a modern Islamic state, the same would be substituted by the modern taxes.

The above mentioned classes of revenue are maintained distinctly under separate heads or titles by the *Baitul-Mal* as the items of expenditure to which they can be allocated are different in Shariah. The zakat and Shadaqah revenues can be applied to the heads of

expenditure as prescribed by the Qur'an[7] which relate mainly to the welfare of the poor; whereas other revenues are spend by the Islamic state at its discretion to fulfill its multifarious responsibilities such as establishment of law and justice, defense, civil administration, transport and communication, economic development, education and health and social action program.

A full-fledged proper organization of *Baitul-Mal* existed during the muslim rule right from the time of Umar Farooq, the second caliph of Islam. Central *Baitul-Mal* existed in the capital of the empire under the direct control of the caliph, where as at the provincial level the *Baitul-Mal* was controlled by the governor of the province. There were no commercial banks or central bank during those times. It appears that all the requirements and needs of the government and the society used to be met by *Baitul-Mal* which supervised public revenues and public expenditure, helped the poor and performed almost similar functions which the ministry of finance performs today. In addition to that, it also performed the functions of a central bank except in: issuing the currency, and controlling credit and utilizing interest rates as policy tools.

Conceptually BMT is an institution which contain two main activities (Muhamad, 2000:106) :

a. Collecting funds from varian of sources, such as: zakat, infaq, shodaqah, etc. And those will be distributed to an authorized parties in terms of poverty alleviation.
b. Productive activities with a purpose to create or gain additional income for the poor and fostering economic growth.

BMT or *Baitul Mal wa at Tamwil* also is a unique Islamic microfinance institution. BMT are not banks, although most of them operate exactly like banks. Some BMTs are registered with the Ministry of Cooperation and Small Enterprise as Shariah saving and loan cooperatives. Some BMTs operate as parts of Islamic cooperatives or as the business

[7] QS.9:60

units of Islamic charity organizations. Most operate informally with minimum regulation and supervision.

According to the two points above, can be concluded that BMT converged 2 different activities, profit and non-profit oriented. BMT as a micro Shariah financial institution, besides collecting funds from the society also functioning as a funding institution, which lending money for consumptive or product usage. Here, consumptive means not only murabahah (margin mark-up) for consumptive goods but also means managing funds for infaq, zakat and sadaqah and distribute in forms of educational scholarship, public facilities, and others. While productive means lending capital to the small and medium enterprises. All of operational activities from BMT supervise by the Dewan Pengawas Syariah (Shariah Supervisory Board) and main function of DPS are giving suggestions and supervise any activities on Syariah matters (Ridwan, 2004). Thus, any kinds of product and services from BMT must be approved from the DPS at first.

2. *Baitul Mal* Indonesia; Historical Development and Legal Aspect

Since the issuance of Law No. 10 of 1998 to Legal Change No. 7/1992 on Banking and issue and fatwa prohibition of the Bank interest by the Indonesia Ulama Committe (MUI) in 2003, the Shariah Finance Institution (LKS) such as Shariah Banking, Shariah Pawn Shop (pegadaian Syariah), Takaful (Insurance Shariah), *Baitul Mal wa at-Tamwil* or commonly called a BMT or Shariah Koperasi become a trend among the middle and upper levels of society and even below. In Indonesia, BMT developed starting in 1984 at Masjid Salman Institut Teknologi Bandung (ITB) by the students that try to set up a board based on the Shari'ah financing for small businesses. Then BMT empowered by ICMI set as a movement in the operations follow up by the Small Business Incubation Centre (PINBUK). Then, Baitul Mal Wat Tamwil (BMT) which was first recognized in Indonesia as Bina Insan Kamil BMT in 1992 in Jakarta.

Indonesia has been developing its system of microfinance since 1970s. It is important for Indonesia to have a strong microfinance system as SMEs constitute the backbone of the economy. It is estimated that 89% of Indonesian people are employed in small enterprises (including household and cottage enterprises) and account for 41% of Indonesian gross domestic product (Rice, 2000). However, the sustainability of BMT is not without obstacles. Based on Law No. 7 of 1992 mentions that all forms of fund raising activities in the community in the form of savings and loans must be channeled in the form of the Bank (Article 26). This was a problem for BMT at the time, however, to overcome this problem then comes the number LPSM (Lembaga Pengembangan Swadaya Masyarakat/NGO) is an umbrella for KSM BMT. LPSM include: P3UK as early initiators, PINBUK, and FES "Dompet Dhuafa" Republika.

Economic activity based on people is the philosophy of BMT, from members by members for members and based on Law No. 25 of 1992 is entitled to use the cooperative corporation, where in lies the difference with the cooperative conventional (non-Islamic) lies only in the course of technical operations, Sharia forbids interest and carrying moral ethics by the rules of *halal* and *haram* in business.

So that in 1994 established a communication forum (FORKOM) consisting BMT in Jakarta, Bogor, Tangerang and Bekasi (JABOTABEK). These BMT Communications Forum JABOTABEK since 1995 meeting in every month, attempt to initiate a legal umbrella for its members, then BMT established with the idea of a cooperative corporation although the subject is still limited to using this type of legal entity Employees Cooperative Foundation.

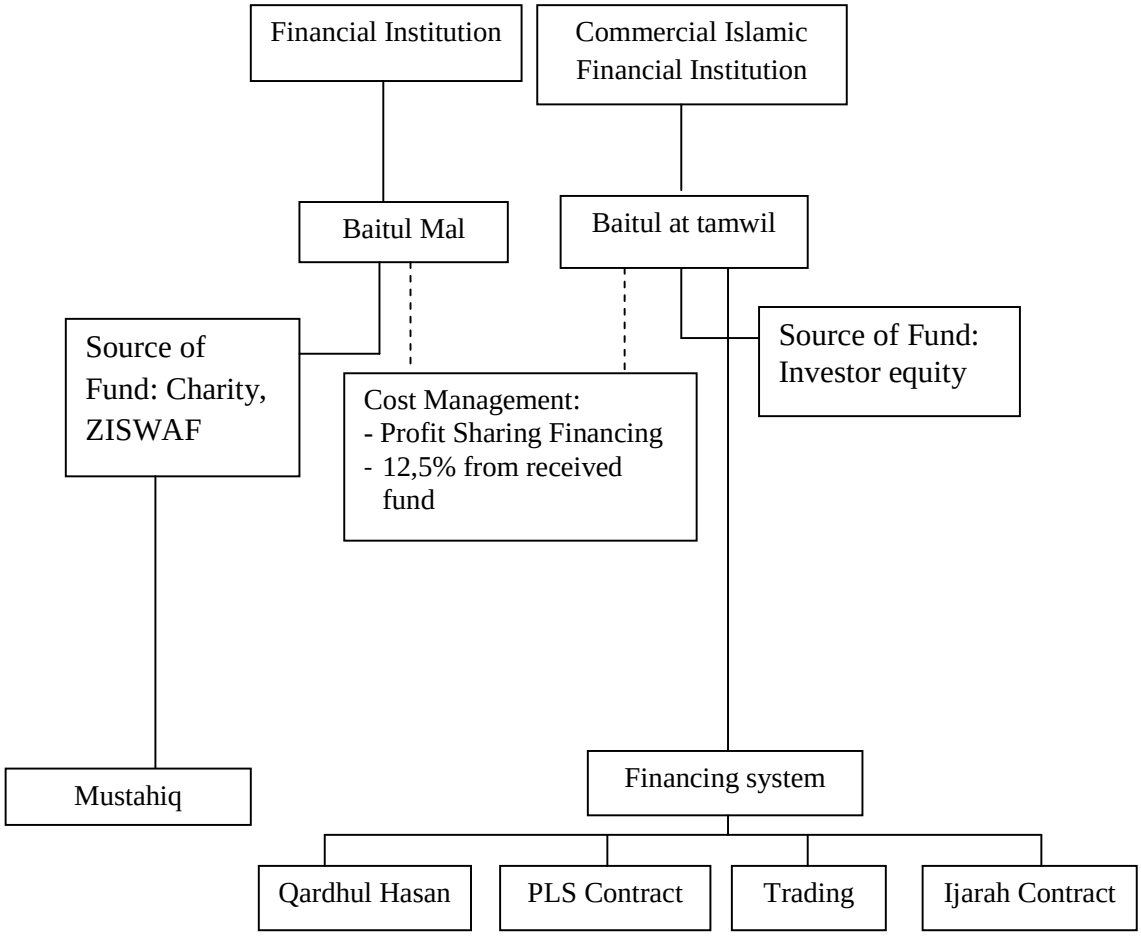
In 1998 from the results of several meetings with members Forkom BMT has been an incorporated cooperative agreement for the establishment of a secondary cooperative namely Cooperative Indonesia Sharia (KOSINDO) in 1998, a secondary co-operative with a decision of the Minister of Cooperatives and Small and Medium Enterprises of the Republic of Indonesia Number. 028/BH/M.I/XI/1998 chaired by DR, H. Ahmad Hatta, MA. Besides KOSINDO standing as well as other secondary cooperatives INKOPSYAH

(Parent Cooperative Sharia) initiated by PINBUK (Small Business Incubation Center). ICMI, and KOFESMID (Cooperative Islamic Economic Forum Partner Wallet Dhuafa) established by Dhuafa Wallet. Republika.

Most of BMT in Indonesia has 2 types background of an establishment such as a micro financial and Syariah financial institutions. Such identification has been shown by several pioneering BMT which operates in the late 1980's and early 1990's. Even their existence was not known widely, but they still serve the community groups that are relatively homogenous. Notwithstanding with a very limited geographical coverage, the economic impact of its activities was still very minimal. However, the characteristic and background has been identified quite clear.

Rapid expansion begun in 1995 and met the big momentum in crisis 1997/1998. The number of BMT has risen from 300 at the end of 1995 to 1501 at the end of 1997, and 2470 in 1998 (Timberg, 1999). Nowadays, can be said that the wider community aware about the existence of BMT. There are approximately 3900 BMT operates in Indonesia at the end of 2010, some of them have operating offices in different areas includes in rural and urban areas, in and outside Java.

Concept and Mechanism BMT in Indonesia



Source: Author

Currently, BMT is developing a process established by gradual law legality, first to start a KSM (Kelompok Swadaya Masyarakat), and if it has reached the value of certain assets and then prepare to convert to the cooperative corporation. If the board reach the situation where the members and managers are well prepared to manage the cooperatives, the BMT is possible to develop as a legal cooperative corporation. This policy has performed because the legal business in Indonesia recognized only three: Limited Company (PT), State Owned Enterprises (SOEs) and the Cooperative. Thus, the most logical for BMT legality is cooperative not financial institutions, either foundations nor KSM or others.

Thus guidelines work, health assessment, internal rules for BMT refer to the provisions of the Ministry of Cooperatives and not others

2.1 Assessing cooperative corporation for BMT.

Judging from the conformity principle of cooperation and legal permissibility cooperative in Islam, hence the cooperative is an institution that can be applied to BMT. The ability is also based on the relevance concept of cooperative and BMT both can be seen from their initial, background and history of these institutions are equally defend the interests of the poor as a reaction to the economic system. Cooperative was born as a means and a protest against the oppressive capitalist economic system and cause suffering to the people in order to improve their welfare. Likewise BMT born because of the presence of BMI and BPR (S) which has not been able to reach the lower economic groups. It is caused due to various constraints, such as laws and regulations, long process of licensing and complicated, and difficult in funds mobilization. BMT was born as an alternative to overcome this situation. *Secondly*, refer to the definition contained in both of them can be concluded that these two institutions contain two elements. The elements are economic and social which are closely-related. Prove that the two institutions are not only engaged in the business but the social aspects as well. *Third*, the relevance is also seen through the basic principles contained by these two concepts. Essentially found that the values contained are not contradictory. Principally, both organizations strive for the welfare of members in particular and society in general through the management laden with ethical values and moral high ground. That will also distinguish these two institutions with other forms of business economy. *Fourth*, there is common purpose in the two institutions. Equally strive for the welfare of members in particular and society in general, especially for small community groups in order to alleviate poverty for the improvement of the people's economy. Fifth, based on the function and role of cooperatives and BMT appear that both have two functions. The function are social and economic functions which interrelated.

3. Indonesian Economic: An Overview

According to the EIU's Indonesia country report filed in December 2010, Indonesia's economy was affected less severely by the global recession than other neighboring Asian countries. This was mostly due to the fact that exports make up a relatively small portion of the country's economy. Due to less need to recover from the global economic downturn, the EIU forecasters reported that Indonesia's real GDP accelerated to 5.9% in the first three quarters of 2010 and believed the whole year figure would also come in at 5.9%. Beyond, 2010 EIU forecasted real GDP growth to be around 6% in 2011, 6.4% in 2012; and an estimated 63% from 2013 to 2015. After an increased demand of various commodities by China in 2010, Indonesia exports were expected to slow in 2011, but should expand by an annual rate of 8% from 2012-2015.

EIU researchers reported the following downside risks to their forecast including the possibility of fiscal austerity programs leading to a sharper slowdown in global growth than expected and loose monetary policy stance of Western central banks like the U.S. Federal Reserve which has led to heavy flows of capital into Asian countries. These heavy flows led to wide fears that asset price bubbles could develop in the Asian countries because such bubbles create risks particularly if assets are used to back higher levels of borrowing. According to the EIU report, Indonesia was one of the recipients of strong flows of foreign finance in 2010 and will probably continue to attract funds in 2011. However, Indonesian companies and households are not highly leveraged and so the price asset bubble may be less of a factor and a period of mild borrowing could work to further stimulate the economy in the near future. This would be particularly helpful if the funds were spent on infrastructure improvements.

3.1 Indonesia Economic Strategy Towards 2020

Indonesia as a developing country, the multidimensional crisis in the last three years, many economists and political economists questioning the ability to compete in free trade. In this connection, the fundamental question that arises is: "Does Indonesia really ready and able to get benefit from free trade?" Or conversely, Indonesia would likely be an easy target for other countries to control the Indonesia economy through free trade .

ASEAN in its own environment, there is a vision in 2020 that was prepared in an informal meeting of Heads of State of ASEAN in Kuala Lumpur on December 15, 1997 which was then followed by a meeting in Hanoi that produce Hanoi Plan of Action (HPA). Some of the agenda of activities to be implemented to realize the Vision 2020 is to improve the quality of human resources, economic, environmental, social, technological, intellectual property rights, security and peace, and tourism through a series of joint action in the form of relations of good cooperation and mutual benefit (win and win solution or a non zero-sum game).

Departing from the 2020 vision and to reach out, the Indonesian government should realize that the direction of national economic development has focused on lower level thereby creating a strong foundation to face the challenges of the next 20-30 years through economic policies pro-people, development of quality education and health .

One of economic development strategy that has been proven is through BMT which can optimize the small and medium enterprise business thus increase income and welfare of the poor. In Indonesia there are more or less 52 million units of Small and Medium Enterprises (in 2011) and contributed to GDP by 60%, approximately 97% of employment. However, these SMEs access to financial institutions only 2% of the total new units, which means about 13 million SMEs. This clearly illustrates that this sector has not been maximized.

Indonesia develops the vision of becoming one economic power in a world. Strategic steps already made. One of the planned expansion Indonesia Master Plan Economic Development Acceleration (MP3EI) which was launched in 2011. MP3EI program has a target in 2014 Indonesia had become a world economic power with 16 people with a per capita income of U.S. dollars 5000 and PDB on a trillion U.S. dollars. And in 2025, the average income per capita population of Indonesia is 16,000 U.S. dollars to PDB above 4 trillion U.S. dollars

	2009	2010	2011	2012F
Real GDP (%yoy)	4.6%	6.1%	6.5%	6.3%
Exports (%yoy, US$)	-14.3%	32.1%	27.5%	10.0%
Imports (%yoy, US$)	-24.0%	43.7%	30.3%	17.5%
Trade balance (US$ Bio)	30.1	31.1	35.3	27.7
Current Account (% of GDP)	2.0%	0.8%	0.24%	-0.2%
International Reserves (US$ Bio)	66.1	96.2	110.1	120.9
Import & Debt cover (months)	6.5	7.1	6.3	6.7
IDR / USD (end of period)	9,403	8,991	9,068	8,950
CPI Inflation (%yoy, year-end)	2.8%	7.0%	3.8%	7.8%
BI rate (%p.a, year-end.)	6.50%	6.50%	6.00%	6.25%
Fiscal Deficit (% of GDP)	1.6%	0.6%	1.3%	1.8%

Source: Indonesia Statistic Departement

4. Issues And Challenge Of Baitul Mal Towards 2020

BMT's rapid development over the past two decades is still not optimal when compared to the much greater potential. There are still many obstacles and challenges in its operation and its position in the dynamics of the national economy. The challenges and obstacles can be categorized and referred to external and internal, as below:

4.1 External Challenges

- Dynamics of Indonesia’s Macroeconomics

  It is not easy to calculate Indonesian economy in the next ten years. The government does not have the long-term economic outlook. The most dominant variable in the most economic analysis for the next few years it related to external economic conditions of Indonesia. Including the dynamics of world trade, international market prices of certain commodities, the economy of developed countries, and bilateral economic countries with Indonesia, and the flow of global capital and money market. This is obviously very influential in the growth of BMT in the future.

- Banking Sector Dynamics

  Technically, the major challenges facing to the banks today are the big of excess liquidity. In the conditions excess liquidity, capital inflows surge can also cause an increase in excess liquidity. The challenge is how to liquidity can be channeled to productive economic sector through the development of Microcredit. As for the position of micro-credit by the end of 2010 about to Rp. 967.60 billion which is a bank loan about Rp.1.813, 32 trillion. Mikro, Kecil, and Menengah (MKM) credit consists of: i) Microcredit, the amount of loans up to 50 million ii) Credit plafon, more than Rp. 50 million up to RP 500 million. iii) Intermediate credit, Rp. 500 million to Rp. 5 billion. However, in general banking industry still facing credit constraints for small and micro enterprises. The constraints, are: not all banks have a network that spread to all regions; the bank doesn't have knowledge of the character and condition of small and micro businesses; Problems of supervision and management of the micro business.

- Legality and Regulation

  Legality is the one of the most fundamental issues of BMT in Indonesia. This because BMT in Indonesia until now don’t have yet specific legality shading institution legality of BMT. BMT institution still considering as Koperasi Syariah. This, of course will cause many new problems, because after all BMT and Cooperatives differ both concept and management of work. Judging from conformity cooperative principles in Islam and Islamic law in the permissibility of cooperatives, the cooperative is an institution that can be applied to BMT. The ability is also based on the relevance of the concept of the cooperative and BMT can be seen from; *Firstly*, the background and history of the birth of both organizations are equally in order to fight for the interests of the group as a reaction to the economic system prevailing at that time. The cooperative was born as a means and a protest against the oppressive capitalist economic system and cause suffering to the people in order to improve their welfare. Likewise BMT born because of the presence of BMI and BPR (S) which has not been able to reach the lower economic groups. It is caused due to various constraints, such as regulatory legislation, permitting complex and long, and the

mobilization of funds difficult. BMT was born as an alternative to overcome this situation. *Secondly,* with reference to the definition contained both can be concluded that these two institutions both contain two elements. The elements are the elements of economic and social elements are interrelated. This is evidence that the two institutions are not only engaged in the business but the social aspects are not forgotten. *Third*, the relevance is also seen through the basic principles contained the two concepts. In the basic principles of both found that the values contained therein are not contradictory. In essence, both organizations strive for the welfare of members in particular and society in general through the management laden with ethical values and moral high ground. That will also distinguish these two institutions with other forms of business economy. *Fourth*, there is unity of purpose in the two institutions. Objectives contained is equally strive for the welfare of members in particular and society in general, especially for small community groups in order to alleviate poverty for the community. Fifth, economic recovery, based on the function and role of cooperatives and BMT appear that both have two functions. The function of social and economic is interrelated. While the role of these two institutions is the driving force of the economy by developing productive and real economic.

4.2 Internal Challenges

- Shariah Compliance

  Dynamics and rapid development of BMT, especially in terms of operational Tamwil, marked also by the complexity of the financial transactions in a modern and global economy. Sometimes still can be offset less by the Islamic authorities in determining of relevant rules, as well as the weak aspects of monitoring the implementation of the regulations. Some BMT very creative in developing products, but are not careful in keeping the sharia compliance to remain sharia consistency.

- Maintaining The Idealism

  BMT is also characterized by the development of many new activists of BMT, which is more concerned with the business aspects or commercial advantage rather than merely social and struggle to enforce Islamic finance. Required painstaking efforts in

clarifying various aspects of the BMT, such as management, the type of product, type of contract, cooperation networks, and so on. The most basic is an attempt to reinforce the identity, ie what and how BMT itself, by not turning off the creativity of each BMT to exist in their environment.

- Institutional Strengthening

  Among the issues developed in the middle of the BMT movement is increasing professionalism and management as well as high levels of achievement in BMT health. This discourse is in line with the development of the banking sector. for example, there is a determination to implement the principles of good corporate governance. BMT is possible to apply the five principles of good corporate governance in the management, with some necessary adjustments required. For example with regard to accountability BMT who refers to the mechanisms of cooperative arrangements, while still providing input to policy makers that are made of a supportive regulatory developments, rather than discourage it. Keep in mind is that the non-financial aspects which inherent in BMT institution also need the strong institutional capacity as supporting power in its operation.

- Development of Human Resources

  One of the biggest challenges of BMT in the future is the availability of human resources. History of success in the past two decades BMT movement can be said to rely on sincerity and tenacity of his activits. Then if observed all over the external and internal challenges requires the presence of high-quality human resources to deal with it anyway. In providing human resources, public education institutions and specialized organizations that are not directly related to BMT, its role can be maximized. However, in terms of improving the quality of human resources, internal parties seem BMT more potential to develop their own resources.

5. Baitul Mal Strategy Towards Global Economic 2020

In this framework, the Indonesian PBMT (BMT Association) felt the need to organize a blueprint for the development of the BMT in the coming years. And decided to set the year 2020 as a fundamental reference in formulating a number of key targets to be achieved. The document referred to as "BMT Direction 2020". Direction is basically a term that has a similar meaning such as: blueprints, landscape, guidance, or architecture.

BMT Direction 2020 is designed as policy recommendations (policy direction) that must be taken by BMTs and PBMT Indonesia within the next ten years. Identified the expected major challenges, along with preparations for possible major changes in the wider environment.

BMT Direction 2020 contains an explanation of the identity of BMT, a kind of identity and self-image that underlies the operation and inspire the actors as well. It will also explain the vision, mission and goals for the development of BMT. Also set out general policies on some key aspects related to the operation of BMT such as: organizational, structural, control, regulation and other supporting agencies. This direction not only as a guide, but it also includes the stages and steps of activities or an action plan which initiate the concrete implementation. The action plan will have any repairs or improvements where necessary in each year implementation.

With this Direction, it is hoped the warriors of BMT together with other stakeholders will know how to form and exist BMT over the next ten years. They will all be much easier to do their own planning and mutual support to each other. Strategic initiatives of Direction are expected to inspire and guide the stakeholders for the business development activities BMT. For example, for each BMT will have their ownguidance tosynchronize their activities.

The Direction is designed also as one of the essential infrastructure for the overall financial system stability, and a strong fundamental for economic growth and

sustainability. It is closely related to the need to share the role between the Banking and Financial Institutions (MFIs) in maintaining financial system stability. Past experience shows that the collapse of the banking industry not only adversely impact the banking system itself, but also affects the stability of the financial sector as a whole, which in turn will directly affect the continuity of the real sector. In addition to revamping the banking system, it is necessary the existence and the greater role of MFIs (including BMT in it) so that more stability is determined by forces within the country and involve more parties.
Experience of financial crises in many countries over the past decade indicates that even the fundamentals of the banking industry strong enough but still could be unstablein a short time. Capital Markets industry as its main partner too, showed symptoms of increasing instability as well. Acceleration spread of the bad things between the industry took place more quickly. One reason is because the major players in both industries are the same.

In this context must be understood the importance of the need to increase the portion of MFIs in the national financial system. Thus, an argument for the need to develop and strengthen of MFI is not a philanthropist, but a necessity forthe Indonesian economy. Countries that rely only on the financial system of banking, money market and capital markets more easily to unstable and attached by the financial crisis, even though in the developed countries. The Direction is expected to have an important role as:

- Guidelines for BMT in an attempt to develop community economic empowerment movement and improve microfinance services;
- Main arguments considered in developing and strengthening the industry BMT are supportedby the Government, Parliament and Bank Indonesia;
- Reference to the BMT stakeholders in the development of movement and other Islamic financial institutions;
- As Explanation to the public in general, and academic circles in particular on the existence and development plans of BMT;
- Guidelines for other institutions to get both benefits, economically (microfinance services and meal) and non-economical by the existence of BMT which studies

Islamic microfinance in Indonesia, etc.), Thus expected to capture clear information about the continuity and consistency in BMT movement programs.[8]

Data Islamic Bank and Koperasi Syariah (BMT) in Indonesia

	2005	2006	2007	2008	2009	2010	2011	2012
BUS	3	3	3	5	6	11	11	11
UUS	19	20	25	27	25	23	23	24
BPRS	95	105	114	131	139	150	153	155
ASSET		7,5T	15T	20T	28T	36T	49T	66T
BMT/KS	3.200					4.000		
ASSET	2T					7T		
ANGT	3JT					5JT		

Also based on the several challenges as mentioned above we can propose some directions to BMT which hopefully may strengthen the development of BMT in the future, as follow:

- The establishment of a high level adherence to the principles of Sharia.
- GCG-creation and management professionalism in order to strengthen the internal condition of the BMT.
- Establishment of a healthy BMT business structure, so able to become a keeper of the national financial system stability.
- Availability of complete infrastructure for the industry BMT and BMT movement.
- Operating-system of regulation and supervision to effective and efficient BMT.
- BMT-creation of a robust integrated business with economic community, so that they can be one pillar of the national economy.
- Reaching effort to empower the poor to become more prosperous.

[8] Source: Direction BMT 2020 Indonesia BMT association, submitted in 2011 in Cibubur BMT Summit, November 2011.

6. Summary

Efforts to achieve economic self-sufficiency of the Ummah, is a big mission and duty. *First*, build the entrepreneurship, ethos, of ummah and equip them with skills superior and competitive. *Second*, conduct trainings and workshop skills. This is important, because the quality of the human race is still low. In addition it is necessary to improve the quality of education and educational strata of people through formal education, *Third*, if the small business is producen, then they should be assisted in market products. *Fourth*, improve the quality of products to meet the standard. *Fifth*, provide capital support through government programs, micro finance institutions and Islamic banking. *Sixth*, motivate encourage people to be productive in agriculture, mining, plantations, etc., So that they become economically independent. *Seventh*, help small businesses in accessing micro and banking institutions, both in making the proposal, financial reporting and implementation of modern financial management. *Eighth*, optimizing the role of government policy and regulation. Government policy should be really pro-ummah. We have to design the system economic pro-ummah follow the rules that focus on equity and well-being in order to produce justice. This is the vital role of Islamic finance. Economic policies both at central and regional levels should be aimed at empowering ummah to independence. Islamic-economy necessitates the establishment of good governance principles are accessibility, transparency and accountability in all aspects, including (renegotiate) contract. We must go back to the teachings taught independence of Umar ibn Khattab,. "*be the Master of economy and be the productive one, if not, I am afraid you will depend on them*". All this is intended to achieve an independent life of fairy, free, freedom (liberty), fairness (equality, justice), and welfare (prosperity).

BMT is an Islamic micro-finance institution with the legal entity is a cooperative financial institution that is able to touch the bottom of the economic development community. The existence of BMT will help economic growth for people who are not able to be touched by other financial institutions. Hopefully the role of BMT as a micro - finance institution may cover all the missions of enforcement economic development of the Ummah with its all mechanism throughout good governance and management.

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A WWW CYBERGUIDE RATING APPROACH TO CONTENT AND DESIGN ANALYSIS FOR ISLAMIC BANKS WEBSITES IN MALAYSIA

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Abstract

Over the past decades, Islamic banking has gained a worldwide recognition. Started among Muslim countries in order to cater for the Shariah compliance banking needs of Muslims, it has now become widespread throughout the world. In Malaysia, the players in the Islamic banking industries are the local Islamic banks and recently a few foreign Islamic banks have shown interests and started their operation in this country. Internet has become a very powerful tool to disseminate information and this phenomenon has been fully utilized by Islamic banks in order to send their message to their current and potential customers. This exploratory study aims to evaluate the design and content of Islamic banks websites in Malaysia and also to compare the cumulative strengths and weaknesses in terms of website design and content between local and foreign Islamic banks in Malaysia. Suggestions for future research directions conclude the report.

Keywords: *WWW Cyberguide Rating, Website Content Analysis, Islamic Banks Websites*

1. Evolution of Islamic Banking System

The inconsistency scenarios on the global financial market has not only shed doubts on the appropriate functioning of conventional "Western" banking, but has also shifted the attention on Islamic banking. Although the idea and implementation of Islamic banking system is relatively new, it is nevertheless attracted the attention of group of Muslim and non-Muslim investors around the globe. The appearance of modern Islamic banking system in recent years is one of the most vital movements in the economic sector, and with the estimated 2.1 billion Muslims worldwide population, its ripe the growth potential of this business.

There has always been a demand among Muslims and non-Muslims for financial products and services that conform to Shariah (Islamic Law) where all the financial

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activities and transactions without indulging in 'riba' (Tarek & M., 2001). This phenomenon may explain by the increasing numbers of Islamic banks for fulfill the customer needs. The development of viable alternatives to conventional finance increasingly enables Muslims to participate in the financial world without violating their Islamic principles (Silva, 2006). The majority view today however reflects a broad interpretation of the Qur'anic in Surah Al-Baqara verse 275-279:

> *"Those who swallow usury cannot rise up save as he ariseth whom the devil hath prostrated by (his) touch. That is because they say: Trade is just like usury; whereas Allah permitteth trading and forbiddeth usury. He unto whom an admonition from his Lord cometh, and (he) refraineth (in obedience thereto), he shall keep (the profits of) that which is past, and his affair (henceforth) is with Allah. As for him who returneth (to usury) - Such are rightful owners of the Fire. They will abide therein. Allah hath blighted usury and made almsgiving fruitful. Allah loveth not the impious and guilty. Lo! those who believe and do good works and establish worship and pay the poor-due, their reward is with their Lord and there shall no fear come upon them neither shall they grieve. O ye who believe! Observe your duty to Allah, and give up what remaineth (due to you) from usury, if ye are (in truth) believers. And if ye do not, then be warned of war (against you) from Allah and His messenger. And if ye repent, then ye have your principal (without interest). Wrong not, and ye shall not be wronged"*.

That majority believes that interest, or *riba*, as it is known in Arabic, is forbidden in Islamic jurisprudence (Abdur Rajman I. Doi, 2008). The fundamental reason for the prohibition of interest in Islam is that the depositor should not profit unduly from the hard work and risk bearing of others. On the other hand, the underlying principles that govern Islamic banking are mutual risk and profit sharing between parties, the assurance of fairness for all and that transactions are based on underlying business activity or asset.

Historically, the modern Islamic banking has taken a while to develop. It is clearly understood that, the macroeconomic concept of Qur'anic, that is, of social justice,

spawned the so-called *ribawi* free Islamic banking at a micro-economic level. For example, Malaysia has an experienced in developing the small-scale ribawi free banking systems in the mid-1940s, however they did not survive long. According to Ariff (1988), Malaysia initiated somewhat of a tradition of Islamic banking institutions commencing in the early 1960's. The first Islamic financial institution created in Malaysia was the Muslim Pilgrims Savings Corporation, founded in 1963 to help Muslims to save money so that they would be able to make the pilgrimage known as Hajj.

Islamic Banks in Malaysia

Meanwhile, the Islamic banking system gained its popularity throughout the Islamic countries when the intergovernmental Islamic bank called the Islamic Development Bank (IDB) was created in 1974 by the members of the Organization of Islamic Conference (OIC). The IDB is a Multilateral Development Bank, established to foster the economic development and social progress of its 57 self-declared Islamic member countries and Muslim communities in non-member countries in accordance with the principles of Shari'ah. As a consequent, the Asia Pacific region found the concept attractive and Malaysia especially applied the Islamic banking market in a sizeable way in 1983 when the establishment of Bank Islam Malaysia, which is now recognized as the chief commercial Islamic bank in Malaysia.

Today, Islamic banking in Malaysia is a dynamic industry that is extensively regarded as a competitive alternative to conventional banking systems. The scenario on Islamic banking in Malaysia is now diverse local and foreign participations, showcasing their dynamism with a wide array of innovative financial products and services are offered. Islamic bank industry in Malaysia has grown tremendously since the enactment of the Islamic Banking Act 1983 and with the liberalization of the Islamic banking system, more Islamic banks have been established. As today, there were 18 Islamic banks with nearly 2,500 branches are doing their operation in Malaysia which consists of 11 local ownership and 7 foreign ownership.

Websites and Internet Banking

Changes in technology have a great impact on the development of the global economy. The global progression of electronic commerce shows that people are

becoming dependent on the Internet for communications and services (Winnie & John, 2002). Many industries, including banking industry was not spared. Thus, the existence of alternative channels through electronic banking services such as bank Automated Teller Machines (ATMs), phone-banking, PC banking and Internet banking act as tools to facilitate and ease the transactions of the clients. In other words, customers do not need to go to banks for financial transactions but it is sufficient to access the internet at home. Leading banks in our nation have developed their working system by introducing computer system into their operation for speedy operation, and elimination of documentation and document expenses (Leelapongprasut, Praneetpolgrang, & Paopun, 2005). Banks can no longer depend on their physical presence but also have to introduce website Internet banking has been reported as the most important innovation for banking services deployment of the last years (Diniz, Porto, & Adaci, 2005). It is also believed that the Web will lead to a revolution in consumer banking (Lee & Mohammad, 2003). According to Chai Lee (2010), web site performance and analysis is a crucial factor in determining today's online business's success. Many elements of design and graphic art can be used to convey the content of the web (Lee G. C., 2010).

2. Objectives

The purpose of this research is to evaluate the Malaysian local and foreign Islamic banks websites. The specific objectives of the study are as stated follows:

a) To evaluate the design and content of Islamic banks website in Malaysia
b) To compare the cumulative strengths and weaknesses in terms of website design and content between local and foreign Islamic banks websites in Malaysia

3. Method

In order to evaluate these websites, there are several fundamental assumptions that should be made clear. They are (EETAP Resource Library, 1999):

a) Evaluation will involve personal judgment
b) Not all information are created equal
c) There is good information on bad sites, and bad information on good sites
d) Information on the Web should be viewed as no more or less than information from other sources

e) An individual who evaluates the website will have certain degrees of biasness in viewing the information
f) Authorship on the Web does not mean 'authority'
g) Evaluation of a website is a process and not the ultimate goal
h) There are two types of website evaluation; content and design

To minimize the effect of personal judgment and also biasness, these websites are analyzed by both authors and during this evaluation period, both authors have consulted each other in order to eliminate any confusion arising from this exercise.

According To Bank Negara (2011), there are sixteen full-fledged licensed Islamic banks in Malaysia. For the purpose of this research, these banks can be summed up in Table 1.

Table 1: List of Licensed Islamic Financial Institutions in Malaysia

No.	Name	Ownership
1	Affin Islamic Bank Berhad	Local
2	Al Rajhi Banking & Investment Corporation (Malaysia) Berhad	Foreign
3	Alliance Islamic Bank Berhad	Local
4	AmIslamic Bank Berhad	Local
5	Asian Finance Bank (M) Berhad	Foreign
6	Bank Islam Malaysia Berhad	Local
7	Bank Muamalat Malaysia Berhad	Local
8	CIMB Islamic Bank Berhad	Local
9	Hong Leong Islamic Banking Berhad	Local
10	HSBC Amanah Malaysia Berhad	Foreign
11	Kuwait Finance House (Malaysia) Berhad	Foreign
12	Maybank Islamic Berhad	Local
13	OCBC Al-Amin Bank Berhad	Foreign
14	Public Islamic Bank Berhad	Local
15	RHB Islamic Bank Berhad	Local
16	Standard Chartered Saadiq Berhad	Foreign

These sixteen licensed Islamic financial institutions can be divided into two distinct categories which are local and foreign origins. According to Ongus et. al (2006, p. 63), a website evaluation is necessary in order to enable planners and developers to keep up with the increasingly diverse nature of site that are posted on the internet. For the purpose of this paper, the authors have decided to adopt WWW Cyberguide Ratings for Website Design and Content (Joseph, 2008). This web evaluation method

was introduced by Karen McLachlan in 1996 and further refined to keep abreast with the changes in technology in 2002 (Whitten, Smith, Munday, & LaPlante, 2006). She developed the evaluation tools as means of introducing the World Wide Web to novice users in 1996 (NA, 2009). The tools have been widely used by researchers to evaluate content and graphic design of home pages (Yei-sook, NA; NA, 1997). In the case of Malaysian websites evaluation, the tools have been used to gauge the best practices used by Malaysian environmental websites and also used to evaluate e-banking websites (Aida, Hanipah, Hazmilah, Kalthom, & Aziz, 2010; Lee G. C., 2010; Aida , Kalthom , & Noraini, 2009; Goi, 2005). The evaluation components are categorized as follows:

a) Content

   i. First look

      In this section, the authors analyzed the content based on the first impression assumption. In other words, based on the first glance, the web site should be able to tell the audience the basic content and the intended audience of the site.

   ii. Information providers

      This section provides the author with the basic idea on the availability of the author of the site, information of the site's author and whether the author is qualified to present the information on the topic presented on the site.

   iii. Information currency

      This section provides the authors with information on whether the information provided on the set is up to date.

   iv. Information quality

      In this section, the authors analyzed whether the content has achieved its purpose. Apart from that, items that were also analyzed ranges from the organization of the site, interactivity issues, content accuracy up until the issues on the grammar and spelling correctness and appropriateness of the site.

   v. Further information

      This section provides information on the availability of further information provided by the sites to fulfill the audience needs.

b) Design

i. Speed

This section evaluates the efficiency of homepage downloading time

ii. Home page

This section provides information on the attractiveness of the homepage, the clarity of the homepage content, and also whether the copyright date is clearly established.

iii. Ease of navigation

The section provides information on the clarity of the direction given in order to navigate the website.

iv. Use of multimedia

The section discusses the use of multimedia in the website.

v. Browser compatibility

The section examines the compatibility of the website with different available browsers in the market.

vi. Content presentation

The section provides information on the format used in the website, the sufficiency of information, and also the roles played by the links provided by the website.

vii. Currency

This section explores the currency of the information provided in the website.

viii. Availability of further information

This section provide information on whether link for other useful websites are provided and also a working link is provided to contact a person or address for further information.

4. Analysis and Discussion

Ongus et. al (2006) provided with a solution to evaluate the website using McLachlan's method (2008) by assigning the respond 'Yes' with 1 mark and 'No' with 0 mark. Based on this exercise, they rated the websites' design attribute according to the following schema:

(16-24 marks) - Very well designed website, easy to use

(11-15 marks) – Website design need to be improved but site is usable

(0-10 marks) – Poorly designed website, difficult to use

On the other side of the coin, they rated the websites' content attributes according to the following schema:
(16-24 marks) – Very useful website for users' information needs
(11-15 marks) – Website worth bookmarking for future references
(0-10 marks) – Website not worth coming back to

Table 2: Design Evaluation Attributes and Scores

BANK/ QUESTIONS	1.Speed	2.Home page	3.Ease of navigation	4.Use of multimedia	5.Browser compatibility	6.Content Presentation	7.Currency	8.Availability of further information	Total Mark
AFFIN	1	4	2	1	1	5	-	2	16
OCBC	1	4	5	2	-	5	-	2	19
CIMB	1	4	5	-	1	4	-	2	17
MUAMALAT	1	3	4	1	-	5	-	2	16
B.ISLAM	1	4	4	2	1	5	-	2	19
ASIAN FINANCE	1	4	4	2	1	5	-	2	19
STANDARD CHARTERED	1	6	3	2	1	4	-	2	19
RHB BANK	1	6	3	2	-	5	-	2	19
PUBLIC ISLAMIC	1	6	2	2	-	5	-	2	18
MAYBANK ISLAM	1	6	2	2	1	5	-	2	19
KUWAIT FINANCE	1	6	3	2	-	5	-	2	19
HSBC AMANAH	1	5	3	2	1	5	-	2	19
HONG LEONG	1	6	3	2	-	5	-	2	19
AM BANK	1	2	2	-	1	3	-	2	11
ALLIANCE ISLAMIC	1	4	3	-	1	5	-	2	16
AL-RAJHI BANK	1	6	3	2	-	5	-	2	19

Based on Table 2 above, all of the Islamic banks websites being studied can be download efficiently. In other words, the time taken for the sites to download is fast. In terms of attractiveness, copyright, and the formatting of the websites, all of the sites except for AMBank Islamic scored high marks for that particular attribute. One alarming trend that the authors quickly identified is that all Islamic banks website in this research did not provide the date of last revision and also did not indicate whether

out-dated materials have been removed from the sites. These actions are crucial because one of the intentions of users to browse through the banks' websites is to get information on new promotions on loans or investments. The users might end up frustrated when they realized that the promotions have ended.

Based on the Ongus et. al (2006) schema, only one bank's website is classified under the 11-15 marks category. In other word, the website design needs to be improved but the site is still usable by the users. According to Elias M. Awad (2003), there are three most important criteria for successful website; conciseness, scanability and objectivity. Rayport and Jaworski (2003) suggested seven design elements for the customer interface. These elements are:

a) Context
b) Commerce
c) Connection
d) Communication
e) Content
f) Community
g) Customization

The authors have identified several problems for the bank which is classified under the 11-15 marks category. Firstly, the bank does not have a dedicated website for its Islamic banking arm. In other words, the website is an extension of its group's website and this has caused confusion to the intended users. The design is very similar to its group's website thus users cannot differentiate between the groups' website and its Islamic banking arm. Its links to other pages were not helpful thus creating further confusion. Furthermore, the information provided did not make the site worth visiting thus users were left wanting for more information. Apart from that, the last revision date was not clearly labeled and there is no indication whether out-dated materials were removed.

The average score for foreign Islamic banks in Malaysia is 19 compared to the average score for local Islamic banks which is 17. In aggregate, both foreign and local Islamic banks in Malaysia fall under the 16-24 marks category in which they are categorized as being very well designed and easy to use. The entire foreign Islamic

banks website in Malaysia scored full marks for the usage of multimedia in their sites compared to only fifty percent for the local Islamic banks. Another interesting fact is that three of the local banks scored no mark for the usage of multimedia in the sites. The reasons were either the multimedia features that they were using did not serve a clear purpose or these features did not make a significant contribution to the sites.

Table 3: Content Evaluation Attributes and Scores

No	BANK/ QUESTIONS	1.First Look	2.Information Providers	3.Information Currency	4.Information Quality	5.Further Information	Total Mark
1	AFFIN	2	2	1	11	2	18
2	OCBC	2	2	1	11	2	18
3	CIMB	2	2	1	8	2	15
4	MUAMALAT	2	2	1	11	2	18
5	B.ISLAM	2	2	1	11	2	18
6	ASIAN FINANCE	2	2	1	10	2	17
7	STANDARD CHARTERED	2	2	1	11	2	18
8	RHB BANK	2	2	1	11	2	18
9	PUBLIC ISLAMIC	2	3	1	11	2	19
10	MAYBANK ISLAM	2	2	1	11	2	18
11	KUWAIT FINANCE	2	2	1	11	2	18
12	HSBC AMANAH	2	2	1	11	2	18
13	HONG LEONG	2	4	1	11	2	20
14	AM BANK	1	2	1	6	2	12
15	ALLIANCE ISLAMIC	2	2	1	11	2	18
16	AL-RAJHI BANK	2	2	1	11	2	18

Based on Table 3 above, all of the sites being studied can be categorized under the 16-24 marks category except AMBank Islamic and CIMB Islamic which were categorized under the 11-15 marks category for obtaining 12 marks and 15 marks respectively. Again, all sites scored poorly on the information currency section. In fact, they only scored 1 mark out of maximum 4 marks allocated for that section. The reason was there is no indication on whether the information is frequently updated.

All of the sites scored full mark for the 'Further Information' section in which link to other sites were related to fulfill the users' needs or purposes. Apart from that, the content of the linked sites was considered to be worthwhile and appropriate to the users' needs or purposes.

The average score for foreign Islamic banks in Malaysia is 17.83 compared to the average score for local Islamic banks which is 17.4. In aggregate, both foreign and local Islamic banks in Malaysia fall under the 16-24 marks category in which they are categorized as being very useful websites for users' information needs. The variance between the aggregate score in term of website content is not far apart.

5. Conclusion

Based on the research, it can be concluded that foreign Islamic banks in Malaysia have a competitive advantage in terms of proficiency in their website design and content development. This advantage can be contributed by their experience doing business globally. Even though the advantage is on the foreign Islamic banks side, the local Islamic banks in not that far behind and with abundance talents available locally, the local Islamic banks can tap into that pool to find human capitals who can contribute in order to narrow this gap. One important issue that should be tackled by both local and foreign Islamic banks in Malaysia is the capability in ensuring that the information provided in their website is current. The authors would like to suggest to future researchers in this field to venture into the end users' side of the story. In other words, by tapping into the mind of the customers, the banks can come up with better sides that can cater the needs of the customers.

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ROLE OF ACCOUNTING INFORMATION IN INVESTORS' DECISIONS IN LIBYAN STOCK MARKET

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Abstract

The main purpose is to investigate role of accounting information in investors' decisions in Libyan stock market. Specifically, this study aims to determine the accounting variables that effect stock price which aid the investors in making proper investment decision. The researcher will focus on the price of share because it is an important indicator investors look for when they invest their money in stock market. Okafor et al. (2011) suggested the volatility in the stock price is a significant criterion that can greatly help existing and potential investors to define and refine their investment behaviour .In this case, the dependent variable of the study is share price and independent variables are accounting factors such as earning per share (EPS), book value per share (BVPS), Dividend per share(DPS), Return of equity (ROE) , Return on assets (ROA), in addition to the current ratio (CR) which measure the liquidity of the companies. The data analysis will be extracted from accounting information published in the financial statement of all companies listed in Libyan stock market from different sectors. It covers the period of 2007-2010. This study will employ quantitative method based on annual reports and survey questionnaire to collect data. The accounting variables will be extracted from annual report to see which variables might affect the stock price. In addition; a well- designed questionnaire will be distributed to selected sample of investors in Libyan stock market to know to what extent they consider the accounting variables in their investment decisions. The data will be analysed by employing regression analysis. It is expected that some variables might have some influence on the stock price and investing behaviour of investors in Libya**.** It is hoped that the result of the study may increase the awareness of investors in Libyan stock market to the importance of accounting information in their investment decision. In addition, the empirical evidence may provide the investors more confidence to increase their motivation to invest in Libyan stock market. This study will provide some recommendations that may be useful in improving the efficiency of Libyan stock market LSM which in turn effect in Libyan economy.

Keywords: Accounting Information, share price, investors, Libyan stock market

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1. Introduction

Stock market is a place for interested parties such as investors whether local or foreign investors to invest their money. The increasing level of investment in stock market leads to enhance the economic development in the country. For investors, stock price is important because it carries information on the potential growth of the company, the dividend yields that the investors could get from the investment and the most important factor whether the stock price has the potential to increase over time or not. This is important because the reason why investors invest in the company is to get the return in term of dividend and capital gain.

The stock price is one of the significant variable for evaluation the securities, and the managers look for the information which help them in predicating stock price and enable them to develop the informed decision whether to invest or not (Abdi et al. 2012). The investment in equity share and the return from the equity investment subject to many internal and external factors. The effect of internal factors such as earnings, dividends, book value, etc on share price assist investors to make wise investment decision (Nirmala et al. (2011). The result is consistent with the findings from (Allahawaiah & Al Amro, 2012).They found that internal factor such as dividend policy could be considered as an factor that effect on stock market price, which indicate that the firm is profitable and could provide return to investors. Many empirical studies have been done to investigate how accounting information play a crucial role in stock market, and the result of most of them found that accounting information have a significant effect on share price. Accounting information plays a major role as a guideline for investors and help them in their investment decision-making .For example, the study by (Ball & Brown 1968) in the USA found that annual company income number effect share price and annual accounting reports are one of many sources available to investors. Also, according to Oyerinde**, (**2009), investors cannot invest adequacy in stock market without the confidence in accounting information.

The current study focus on Libyan stock market, which is considered to be one of the emerging markets, which was established in2006. Our study will extend the literature review by studying the effect of accounting information to investors' decisions in one

of the emerging market in Arabic country such as Libya to know if there any effect of accounting information in Libyan stock market on investors' decisions or no.

Problem Statement

Taking investment decision in stock market is a major concern for investors, regulators and other groups who wants to invest their money. The investment process is important in raising the level of economic development in any country in the world because of its role in allocating the resources and enhancing the society .Therefore, the investment decision is the most important and difficult decision and should be based on financial or non financial information to stimulate the investors to invest in stock market. From here, emerge the role of accounting in raising the efficiency of the financial market as a financial system that serves several parties, including creditors and investors.

Chen et al. 2001 provided evidence that accounting information is value relevance in stock market and investors based their decisions to invest by carefully looking at the accounting information on that particular firm. In addition, Norman, 2012 has confirmed that the importance of the financial information together with economic information do contribute to the rationalization securities pricing.In addition, investing in stock market require the proper understanding about the performance indicators including firms financial information. However ,most empirical studies have been done in the developed and less developed countries whit a little attention has been given to Arabic countries specially Libya .despite the growing interest of the Arabic countries to establish and develop the financial market as an appropriate way to collect saving and utilize them in the channels of investment .

The main problem of this study is that there is the lack of research which investigate the role of accounting information in stock market in Arabic country such as Libya, therefore; the researcher will try to fell this gap by investigate role of accounting information to investors' decision in a new emerging market in Libyan.

Objectives of the Study

According to research problem the main goal of this study is to examine if accounting information content in financial statement particularly (income statement and balance sheet statement) is useful to investors in making investment in Libyan stock market.
To archive the main goal the following sub-objectives will be examined:

1- Determine the accounting variables published in financial statement which effect on investors' decision in Libyan Stock market.
2- Identify whether the investors in Libyan stock market perceive the importance of accounting information published in financial statement in their investment decisions.
3- Identify whether the accounting information published in annual reports adequacy to investors to take their investment decisions.
4- Identify to what extent the investors in Libyan stock market relied on accounting information in their investment decisions.
5- Identify if there any obstacles face the investors and avoid them of using accounting information in their investment decisions in Libyan stock market.

Research Question:

The main question in this study is what is the role of accounting information contained in financial statement to investors 'decision in stock market . The following sub questions have been formulated in order to answer the main question:

1- Is there any statistical relationship between the accounting information published in financial report and share price traded in Libyan stock market?
2- Do investors perceive the importance of accounting information in their investment decision?
3- Does accounting information published in financial statement adequacy to take investment decisions?
4- Do investors adopt on accounting information to invest in stock market ,and which variable given the priority by investors in their investment decision ?
5- Is there any obstacles face the investors and avoid them of using accounting information in investment decision making in stock market?

Hypotheses of Study:

To reach the purpose of this study, the researcher suggests the following hypotheses.

1- There is relationship between accounting variable such as EPS, BVPS, DVPS, ROE, ROA, CR and securities price in Libyan stock Market.
2- Investors in Libyan stock market perceive the importance of accounting information in investment decision –making in Libyan stock market.
3- Accounting information published in financial statement is adequacy to take investment decision.
4- Investors in Libyan stock market don't adopt on accounting information in their investment decision.
5- There are some obstacles face investors and avoid them of using the accounting information in the investment decision in Libyan stock market.

Significance of Study:

The importance of study will be it multiple benefits for stockholders who potentially benefit from the result of the study.

1-This study is important because it throw the light on stock exchange and its significant contribution in the growth of economy in developing country.

2- The lack of studies concerned with the Libyan financial market, which refers to the need for such these studies in order to raise the level of effectiveness of this market and to achieve full transparency in the information which raise the cultural level of the investors of the importance of accounting information in the process of investing in Libyan stock market.

3-This study will provide some useful information to investment practitioners (individual and institution investors),financial analysts, policy market, academicians and other researches in future.

4-This study will present some recommendations on the importance of accounting information in investment decision to increasing the trade activity of stock market, which on turn contribute to accelerate effective development in Libyan Stock Market.

Scope of Study:

The scope of this study is to examine role of accounting information to investor' decisions in Libyan stock market by analysing data extracted from financial statement of the companies from different sectors include manufacturing ,banking ,insurance, service and investment factors which listed in Libyan stock market(LSM).it covered the period from 2006-2010.

2. Literature Review

The studies on the role of accounting information in stock markets has received a great attention from the researchers in developed and less developed countries .The review of the relevant studies led us to identify the gaps to be addressed in this study. In general, the studies have examined role of accounting information in stock market has been found since 1960, starting from Ball and Brown (1968).They were the first to highlight the effect of accounting income numbers on the share price in New York Stock Exchange (NYSE) .They explored that the earning figure content information is reflected to stock price, and annual income report is one of the sources that investors require.

Sharma, (2011) empirically studied the determinant of stock price in India by looking into dividend per share ,earning per share ,book value per share ,price –earnings ratio, dividend yield ,dividend payout ,and the size of firms. By employing the correlation and a liner multiple regression models to measure the effect of independent variables on the dependent variable ,the overall results pointed out that dividend per share ,earning per share, and book value per share have a significant impact on share price ,however; dividend per share and earning per share have being the strongest determinant on share price. So the investors pay their attention to those variables before invest in stock market.

Norman, (2011) intended to examined whether people investing in stock exchange (SE) do consider financial statement analysis .Specifically ,the author undertook his study to realizing the usefulness of financial statements analysis when deciding to

invest in stock exchange by looking into four months from July to October 2006. He adopted a survey questionnaire distributed on the sample of study incorporated all six registered brokers and their clients in Tanzania located in Dar Es Salam Stock Exchange .the results indicated that most of individual investors in Tanzania don't depend on financial statement analysis of firms when investing mainly because most investors have not acquired knowledge on the importance of financial statements in making investment decision, however ;big investor such as financial institution invest with taking into account the important of financial analysis information.

In Palestine, Shaheen, (2010) focused on the view of external users of annual corporate reports in terms the availability, adequacy, relevance, and usefulness of information disclosed in financial statement of companies listed in Palestine Securities Exchange (PSE).A survey questionnaire distributed in the sample of users comprise of (Individual and Institutional Investors, Stock Brokers, Academicians, and bank creditor) over the period of 1-8-2008 to 1-11-2008.An approach of statistical analysis was utilized to test the hypotheses of study. The results regarding the most important report by users are similar to those of (Al-Razeem& Karbhari ,2004)which found the income statement , balance sheet and cash flow statement are significant reports likely to be used by the most Palestine users group. However, the information published by companies listed in PSE is insufficient to assess the risk and estimated the performance of the companies ,which indicated that available information is neither adequate nor relevant to investment decision because of the lack of disclosure required on the financial statements.

Theoretical Frame work

This study will be anchored on the following theoretical foundation.

Efficient Market Hypothesis

The idea of efficient market hypothesis goes back to the work of Eugene Fama in the mid-1960 .He provided this idea of an efficient capital market as one of the dominant themes in the financial economic literature. Fama in his famous work stated that the EMH's concept built on "that the intense competition in capital market leads to fair

pricing of debt and equity securities" (Chandra, (2008) p.276). Therefore, investors in efficient market are able to buy and sell share at fair price and they can raise funds at cost that reflect the risk of the investment they aim to make (Ogilvie, 2009). In other words, the market efficiency refers to that market price of securities is unbiased estimate of its intrinsic value (Chandra, 2008). Based on stated above "a perfectly efficient market is in continuous equilibrium ,so the intrinsic values of securities vibrate randomly and market price always equal underlying intrinsic values at every instant time"(Belkaoui, 2004 p.409).Nevertheless, according to the suggestion of Eugene Fama , the EMH aims to describe the efficiency of market through three different levels as following :(Chng et al. 2009):

- **Weak form .**This assume refers to that all price of securities fully reflect historical and current stock market information which indicates to that there is no relationship between past price changes and future price change.
- **Semi strong form .**The market is efficient in the semi strong form when the price of securities reflect all public information whether market or non market information such as economic ,political news ,earning and any other fundamental corporate information .
- **Strong form .**This assume encompasses both the weak and semi strong form in terms it refers to that stock price reflect all public and private information .In other words, the market to be perfect in all information must be able to all interested parties at the same time.

3. Research Design

Data source

The data will be used in this study can be obtained from the primary and secondary data. The primary date (questionnaire survey) will be handed to the participants in the study through visiting them in Libyan stock market ,and sometimes the researcher need to send a hard copies of questionnaire to investors whether by email or mail boxes where they existence ,while secondary data will be gathered from various sources .The time span for each variable is annually data cover the period from 2006-2010 depending on data availability will be extracted from accounting information AI

published in the financial statement of all companies listed in Libyan stock market .Data for share price will be collected from Libyan stock market websites .In addition to ,the(LSM) data will be collected from publication ,periodicals issued by Libyan stock market.

Conceptual of Variables

Since the main goal of this study based on identifying the importance of accounting information to investors 'decision in stock market, it will investigate the correlation between accounting information as independent variables and market information as dependent variable. Therefore the variables of study will be shown as the following.

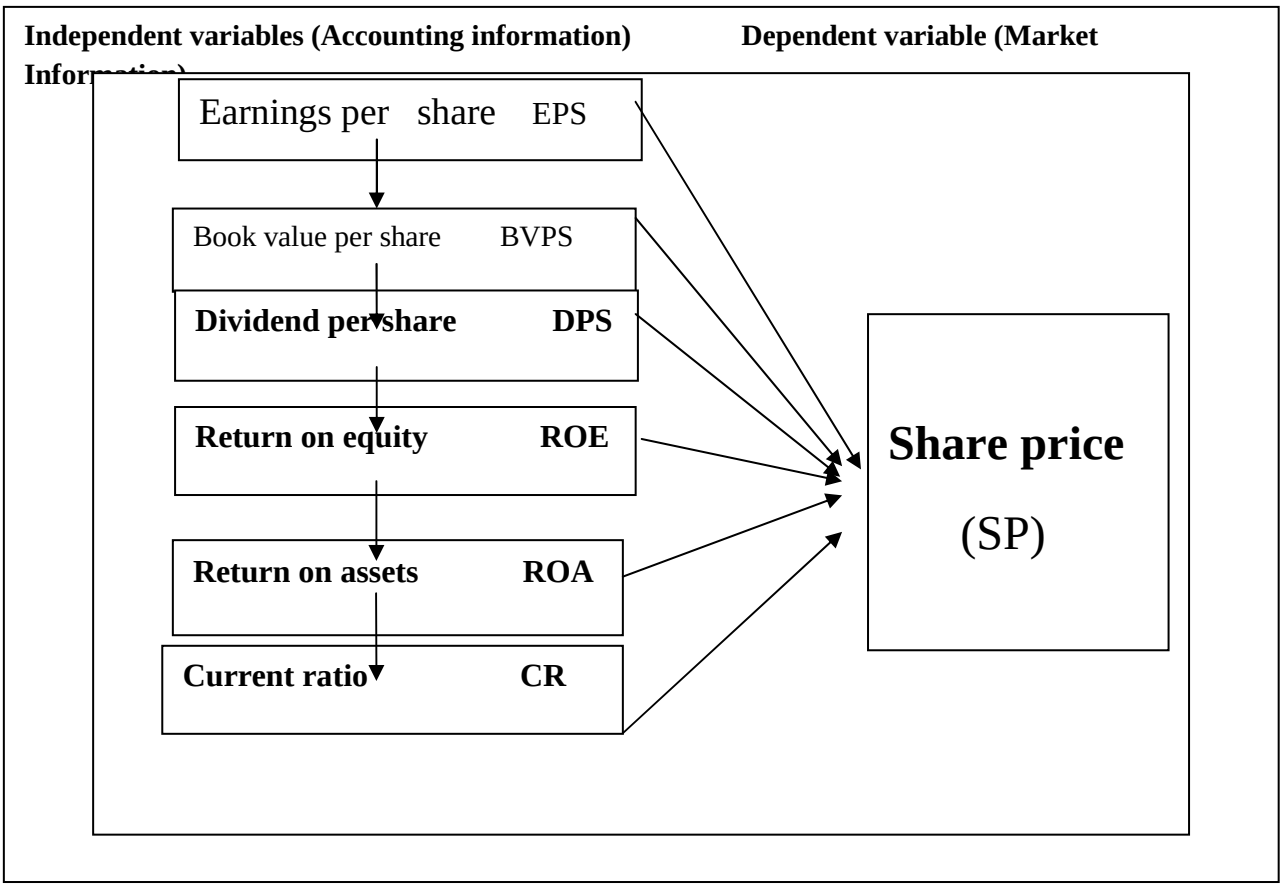
Independent variables (Accounting information)

Earnings per share EPS
Book value per share BVPS
Dividend per share DVPS
Return on equity ROE
Return on Assets ROA
Current ratio CR

Dependent variable (Market information)

Share price SP

Model of Study



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IMPLEMENTING MANAGEMENT INFORMATION SYSTEMS (MIS) IN LIBYAN ISLAMIC BANK

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Abstract

Management Information System (MIS) is a management system that is used by many banks in modern and developed countries nowadays. In Libya, the Islamic banks are still using the traditional way in doing their banking activities which affect the decision making process and the intention to invest by Libyan investors. Implementing Management Information Systems in Libyan Islamic Banks is very important in order to develop the economy of Libya and achieve client's satisfaction of Islamic banks. This study is the first study to conduct a research on this subject in Libya, and the importance of this study comes from its objective to replace the traditional and old way in doing Islamic banking activities with new and modern Management Information Systems. The study will explore the current level of banking service provided by Islamic banks in Libya and find the best approach to implement Management Information System in Islamic banks in Libya. This research will use qualitative methodology, which aims to have an in-depth understanding of the behaviour of banks' clients in Libya with accordance to the current information services provided by Libyan banks in general. The expected outcome of this study will help the Islamic bankers in Libya to fully implement Management Information System in their banks.

1. Introduction

Applying Management Information Systems in Islamic Banks in Libya is quite important to develop the economy of Libya through providing effective banking system that attract investors from inside and outside Libya who wish to invest in Libyan banks and follow the Islamic way with full confidence and satisfaction and invest their money in efficient Islamic banking systems.

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The Islamic Bank is a financial bank that is committed to apply the provisions of Islamic Shariah in all its financial transactions and investment banking, the Islamic banking system in its internal work is nearly identical to the non-Islamic banks with a fundamental difference in mechanism of calculating the profits and investment rates according to Islamic method and curriculum. The Islamic banks is standing by the application of Islamic Shariah on all its transactions and banking products to clients.[3]

The financial banks in Libya in general are facing huge challenges because of the absence of clear strategy for providing reliable financial management information systems that provides modern and effective banking information service and support decision-makers.

For decades the banking systems in Libya was suffering from bad banking service and inefficient information service which produce high reluctance by investors inside Libya, many of money capitals immigrated outside Libya due to ineffective banking service, and another reason is the absence of Islamic banks that provide efficient banking service with high security and follow the regulations of Islam in monetary policies and banking transactions.

The banking system plays a vital role in improving the national economy. The banking system represents the backbone of any national economy, according to that this research tries to find the best approach to implement the management information systems in Islamic banks and the remove the obstacles that prevent the implementation of management of information systems (MIS) inside Libyan Islamic banks.

Nowadays the management information systems represent core of most of banks in developed and developing countries and are considered as one of the main resources of the banks at the present time, Management Information systems support banks to face the rapid change and the strong competition between different financial institutions and global banks as well. Management information systems become a part

[3] Afifi, Ahmed Kamal al-Din and Yousef, Wael Mohammed, the Arab city in the e-government, e-government seminar. Reality and Challenges, Muscat, Sultanate of Oman, May 2003, p 156

of banking management systems not only at the local level, but also at the international level.

Islamic banks in Libya like traditional and conventional banks need to develop the entire management inclusive of all department using the management information systems that effectively contribute to the strategic decision-making process and help the banks to attract more investors through providing high quality banking service and information characterized with transparency and accuracy, such efficiency provided by management information systems will help the top management in Libyan Islamic banks to eliminate all obstacles and avoid conventional long routine and save time and efforts.

The Islamic banks do the same banking operations like deposit investment, investment instruments, and savings accounts. The Islamic banks meet the needs of clients by providing various types of funds, partnerships, and Islamic loans, also offers all types of usual banking services and bonds and letter of credits as well as credit card. It should be noted that in most Islamic banks there are legitimate body of Shariah scholars who have the responsibility to reference the legal aspects of banking transactions by Islamic Banks.

Management information systems become the main system for development in many banks. Banks needs for correct decision making and high accuracy in order to achieve success and attract new clients and investors.

The study will investigate the current level of banking service provided by Islamic banks in Libya and conclude the best implementation plan that suite the financial environment in Libya according to market demands and the rapid development in the global economy and the high competitions imposed by foreign non-Islamic banks.

2. The significance of the research

The importance of this research is from being focusing on the major characteristics associated with Management Information systems that can be utilized by Libyan Islamic Banks in order to develop strategic decisions and effective internal

management functions in order to attract Libyan investors to invest inside Libya rather than searching for banks outside Libya to put their money and grant security from non-Islamic banks

This paper will help top management in Islamic banks in Libya who never used or attempted to implement Management Information Systems, and encourage them implement such systems in order to develop the service quality provided by their banks to investors and encourage them to deposit their money in Libyan Islamic banks without fears from financial risk and accept reasonable profit coming from low risk investment.

The study will investigate the current level of banking service provided by Islamic banks in Libya and conclude the best implementation plan that suite the financial environment in Libya according to market demands and the rapid development in the global economy and the high competitions imposed by foreign non-Islamic banks.

3. The Purpose of the Study

The purpose of this paper is to identify the main characteristics of Management Information systems that enable top management to get the maximum benefits from management Information systems and also encourage Islamic banks in Libya who was never implemented Management Information systems to setup and install these systems in order to get high benefits and improve their banking service, in addition to that providing high quality information service.

The study explains the main principles of Islamic banking and the importance of Management Information System to develop Islamic banks in Libya in Particular because the management systems in all banks in Libya are old and most of Islamic banks in Libya are using traditional ways to process banking operations with few banks apply electronic systems and computers to process financial transaction and other customer services.

The study will analyze the current status of electronic management systems used by Islamic banks and to identify the main obstacles that prevent these banks from implementing or get the maximum advantages from electronic management systems.

This study will demonstrate the most important feature of Management information systems that how to develop the entire management functions using Management Information Systems.

The study will attempt to help the Islamic banks in Libyan to face the increasing challenges and completion from international banks through adopting the latest technologies in providing the banking services. The study emphasize that Libyan Islamic banks must protect its investors and shareholders by providing all information they need in their investments without delay and effectively though efficient Management Information system that support decision-making process and the type of information and service provided for bank's clients

4. Research Methodology

This research is qualitative researchers aim to gather an in-depth understanding of the behaviour of banks' clients in Libya with accordance to the current information services provided by Libyan banks in general. The qualitative methodology used in this research will investigates the why these banks can't adopt financial Management Information Systems and how these banks can deploy new information systems and how can this impact the investors for making the investment decision, and when these banks can start to implement the new management information systems.

5. Introducing Management Information System in Libya

The banking system in Libya was suffering for decades from using traditional methods to fulfil the daily banking activities and provide non-efficient banking service to the clients. The quality of service provided by all banks in Libya (private and public) was not efficient and depends on old ways. This situation led to reduce the

intention to invest in these banks by Libyan investors and let them send their deposits to other banks outside Libya which affect the Libyan Economy. Islamic Banks are new in Libya and yet these banks are facing the same problems associated with inefficient management and bad information service quality, and even there are many clients in Libya wish to deposit their money in Islamic banks due to religious reasons, but these banks are not qualified to provide modern management and information service to their clients.

According to the abovementioned, the study selects Libya as a good example of a country that need for immediate development in the banking service to cope with the current political and economic transformation in Libya. The study affirm that Management Information Systems MISs is the best solutions to the enormous management problems facing the Islamic banks in Libya.

6. Management Information System (MIS)

There are several literatures defined the concept of Management Information system (MIS) with different expressions, actually there is no explicit agreement among scholars and experts in the field of management science on one comprehensive definition of management information system

In general a Management Information System (MIS) is a type of information technology and computer application which combines information technology and management theories. The main goal behind building management system technology is to help various banks to do its work accurately and many jobs in the same time. The electronic management system composed of all the activities that help the banks in decision-making process. [4]

According to (Al-Maghrabi & Hamid, 2002) MIS is a set of sub-systems that react to information queries and cover the different requirements of management activities. (Kurdy, Manal, Alabd & Jalal, 2002) indicated that MIS represent a set of organized

[4] Serafi, Mohamed Abdel Fattah, Management Information Systems, King Faisal Center for Research and Studies, Riyadh, 2003, p 124.

functions that provide the managers in the bank the essential information to help them do their decisions accurately with minor errors. (Sultan, 2004) believes that MIS is a set of organized tools that provide information on the present, past and predict the future according to the activities and operations. MIS also provides a platform to learn what is happening in its external environment and guides and supports the performance of all departments, MIS improves the performance of the bank by providing information in time for decision-making process.

Haider and Fahmy (2002) defined Management Information Systems (MIS), is an organized way to display information relating to past and present which is related to internal process and external effects. MIS supports information systems planning, management and project activities within the bank, so as to provide appropriate information in the scheduled time to achieve effective decision-making[5]

The role of MIS in financial institutes is very important and the primary objective of the management information systems is providing information services, the current huge technical development in the world of information technology have changed a lot of the basic concepts of management, nowadays the information system played a significant role through the set of rules and procedures that ensure the flow of the right information to the investor to take the right decision or act better at a certain time.

(Bocij, Chaffy, Greasley, & Hiickie, 2003) said that the MIS is a set of interrelated parts work together in collaborated manner to transfer the data into information could be used to assist the managerial jobs like (planning, monitoring, making decisions and coordination and operational activities within the economical units.

We defined management information systems (MIS) is a computer applications that utilize information technology for the management department periodically to support them in making the right decision. MIS is a set of software applications that combine information technology together with computer systems and modern management in

[5] Afifi, Ahmed Kamal al-Din and Yousef, Wael Mohamed, "the Arab city in the e-government", Symposium on E-Government Reality and Challenges, Muscat, Sultanate of Oman, May 2003, p. 150

one integrated management system to help the employees in the banks in doing their jobs effectively and precisely, MIS save time and efforts.

7. The principles of Islamic Banking

Islamic banking which is also called participant banking represent the banking service or activity that is following the principles and regulations of Sharia law in Islam. Islamic Sharia prohibits the principle of fixed or floating payment on lending money, the principle of Sharia does not acceptance any kind of specific interest or payments, which is known in Islam Riba, or usury in other words for loans of money.
The Islamic bank does the same banking operations like deposit investment, investment instruments, and savings accounts; it is committed to apply the regulations of Islamic Sharia in its financial transactions, the main difference with conventional banks is offering low profit at low financial risk and mutual profit and loss sharing between the banks and the investor.

Islamic banks consider investing in businesses that provide goods or services that is opposing the basic principles of financial deals in Islam is considered prohibited and called "Haraam".[6] In the late 20th century, there were a number of Islamic banks established on these principles and formed in private or semi-private commercial institutions within the Muslim countries[7]

Islamic banks follow the Islamic approach and the Islamic financial regulations in calculating profits for investors. Islamic banks have created a new way of banking service which includes a low financial risk and a low level of profit, this combination is not exist in the conventional non-Islamic banks.[8]

[6] Saeed, A. (1996). "Islamic Banking and Interest: A Study of the Prohibition of Riba and its Contemporary Interpretation". Leiden, Netherlands: E.J.Brill.

[7] Rammal, H. G. and Zurbruegg, R. (2007). Awareness of Islamic Banking Products Among Muslims: The Case of Australia. *Journal of Financial Services Marketing*, 12(1), 65-74.

[8] D. Ahmed Fouad Abdel-Khalek, "Measurement and distribution of profits in Islamic banks," a publication of the Islamic Economy Centre for Research and studies and consultations, the Islamic International Bank in Cairo, 1985. , P. 201

The Islamic bank "is a bank that is committed to apply the provisions of Islamic Sharia in all its financial transactions and investment banking, through the applying the concept of financial brokering based on the principle sharing the profit or loss, and through the public and private framework."[9]

The word "Riba" means according to Islamic Shariah any excess compensation without due consideration, it should be noted that consideration does not include time value of money. The definition of Riba in classical Islamic jurisprudence was "surplus value without counterpart", or "to ensure equivalency in real value", and that "numerical value was immaterial."[10]

The main concern of payment to be considered a Riba when "paying a debt in a higher number of units of money" was not relevant as the jurists only needed to be concerned with the real value of money (determined by weight only) rather than the numerical value.

Islamic banks were came as a result of the needs of Muslim communities for banking services with accordance to the provisions of Islamic Shariah and saves their money and invested without religious suspicious, in addition to providing the necessary funding to investors away from the suspicion of dealing in accordance with the principle of Islam. The spread of Islamic banks in the modern Muslim societies have created a fundamental solution to this problem.

The emergence of Islamic banks is mainly signify a response to the requirement of Muslim communities deposit and investing money in the banking sector through a financial system that able to achieve profits away from the suspicion of usury and avoiding fixed interest rate.[11]

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[9] Timur Kuran (2005), "The Absence of the Corporation in Islamic Law: Origins and Persistence", American Journal of Comparative Law 53, pp. 785–834 [798–9.[

[10] Warde, I. (2000). "Islamic Finance In The Global Economy". Edinburgh: Edinburgh University Press.

[11] D. Kauthar Abdul Fattah Alabjy, the "rules of measurement of profit and its distribution in the Islamic World", 1999, i 3, p. 34

This is the fundamental principle of bank dealing according to the Islamic regulations which creates much of the insurance to invested funds and guarantees the rights of the debtor and creditor, which definitely reduces financial risk, such regulation is not found in the conventional (non-Muslim) bank. One of the important evidences to the correct approach applied in Islamic banks is the recent global financial crisis in 2008, where the collapsed of largest international banks due to the presence of a significant risk and bear the loss from one side which led to the collapse of a large-scale banks in major economies in the world, while Islamic banks remained well-protected and away from financial bankruptcy.

We see that Islamic banks considers should specify their future goals by considering profit is not the main target in order to compete well and can continue competitive in the banking market, providing good and trusted service is the best way to achieve success and attract more investors to deal with Islamic banks

8. Benefits of MIS to Libyan Islamic Banks

Management information systems have changed the dynamics of running businesses efficiently all over the world. The feature of MIS in decentralization is one of the biggest advantages that will remove the bureaucratic obstacles that weakening the performance of employees inside Libyan Islamic banks and delay the functions of banks, MIS allows monitoring of operations at low levels and frees up resources for departmental managers to devote time to strategic activities. Coordination of specialized projects and activities is much better and decision makers in the bank are aware of issues and problems in all departments. Another advantage of MIS is that it minimizes information overload, which can be quite common with conventional businesses in the modern era.

Islamic Banks in Libya are new and still can’t apply the standards banking activities and enable their customer for payments new other payment methods such as Automated Clearing House (ACH), Wire transfers or telegraphic transfer, EFTPOS, and automated teller machine (ATM), and Internet banking. Providing these types of payment activities and services needs for good and strategic decisions adopted by the

managers of Islamic banks and this goal can't be achieved without for implementing an efficient management information system. The information technology is vital to the success of any banking institution including Islamic banks. According to that MIS is an imminent requirement before thinking to improve the performance of Islamic Banks in Libya.

Modern businesses have been leveraging management information systems (MIS) to manage and order, organize and manipulate mass of information generated for various purposes. MIS helps facilitates a better understanding of the functions inside banks, and removes guesswork in financial forecasting (Avison & Fitzgerald, 1995) and helps senior managers to be up-to-date with operations (Gauthier, 1989). MIS will help Libya Islamic banks to optimize the entire banking processes, and address the needed information by bank's employees to take strategic decisions that reflect on the quality of banking services provided to clients. In addition to that Islamic Banks will get the highest benefits from management information systems because of the high efficiency in providing transparent information to investor, which increase their intention to invest. In addition to that MIS also reduce paper reports (Gelford, 1988; Van Dyke et al. (1997); Wang & Strong, 1996) and therefore, the costs associated with reporting will be decreased.

In general, the study affirm that MIS has a great impact on the planning and control systems for the Libyan Islamic Banks and lead to higher levels of banking effectiveness.

The study concluded that the main two advantages of management information systems to Islamic Banks are:

- **Better Control and Planning.** MIS has to be implemented and managed in such way that it collects information, and monitors the bank's activities and internal operations, and improves cooperation and communication among bank's employees.
- **Support Decision Making.** The main aim of Management Information System is to generate creative and processed information for bank's clients

from automated systems. The information distribution is equal to all bank's levels including; CEOs, managers, professional employees and executive managers, therefore provide efficient information for high position employees which improve the decision making process.

9. The characteristics of Islamic Banks

The principle of Islamic banking is based on the Islamic law and regulation and must stay within the limits of this law (Shariah) in all banking transactions and activities. We can summarize the main characteristics of Islamic banking:

- Participation in partnership business is the fundamental function of the Islamic banks. So we have to understand our customer's business very well.
- The absence of interest-based (Riba or Usury) financial transactions;
- Prohibition of financial activities involving oppression (zulm)
- It promotes risk sharing between provider of capital (investor) and the user of funds (entrepreneur).
- The avoidance of economic activities involving speculation (gharar);
- Including the principle of Zakat (an Islamic tax system)
- The discouragement of the production of goods and services which contradict the Islamic value (Haram)
- Islamic banks pay greater attention to developing project appraisal and evaluations.

10. Improving Islamic Banks in Libya through Management Information Systems

Information in today's world represent the most important resources for modern banks because it is a decisive factor for the success of banks and financial institutions due to its high accuracy which is required in achieving high performance for banks and financial institutions.[12]

[12] Al Abid, and the Kurdish Jalal Ibrahim, Manal Mohamed, Introduction to Management Information Systems: Theory applications tools, printing presses University House, Alexandria, 2000. P. 99

The role of management information systems (MIS) is very essential for the development of Islamic banks by addressing the collection and classification of data and archiving, as well as providing information needed by the head management department and decision-making processes, MIS is very important to facilitate management functions including planning and organizing the confidential information within the bank to provide a high degree of control on banking performance.

The implementation of Management Information System will provide the Islamic banks with many facilities that enhance the overall performance. MIS develop the whole banking management activities because utilizing a automated system will reduces the manual efforts and ease banking operations. The implementation of MIS will provide extra features to the service provided by Islamic bank is most of employees and clients being on the same system and share information, another advantage is that information can be accessed by bank's employees from different locations in the bank.

The Islamic banks need to keep pace with the development of management systems used in modern banks in developed countries. The implementation of management information systems will contribute effectively to rationalize the investment decision-making and management decisions by the managers of Islamic banks so as to create favorable investment climate in these banks. The modern management information systems will provide the transparency and accuracy of the information in the highest level and encourage investors to Investment strongly and securely without hesitation.
The main improvement features are:

- The users at the bank would include traders, dealers and risk managers.
- The solution will result in smoother deal processing, with verifying and online risk monitoring mechanism
- It will streamline all operations and the risk mechanism can be monitored

The modern banking system has become too complicated; therefore these systems require information systems to assist in managing the various banking activities, from

here comes the role of management information systems to achieve high efficiency in the management of banking activities and daily financial transactions. [13]

The Islamic banks just like conventional banks are being in urgent need for the applications of modern information systems in order to achieve high efficiency in performance.

The Islamic banks need for the applications of management information systems because of the strong global competition. The reason for this is a relationship between information systems and effective decision-making, and also the efficiency of information systems is reflected on the quality of service and speed of information delivery and not indeed due to achieving profitability (Mohammed Al Nudhary, 2005)

11. The impact of MIS on Libyan Islamic Banks

A management information system is an automated process allow to collect, classify, process, retrieve of saved information in files, this can be done automatically or manually, and now electronically. In addition to that building and producing new information from the old information which originally saved in the system after processing, and due to the facilities provided by computers which is unavoidable in modern information systems, therefore the thinking about building a computerized system for information become an essential matter for many reasons, including[14]:

1) **Speed**.
   As the documentary procedures required for the information become faster when using computers, especially for information retrieval.
2) **Accuracy.** Where the probability of falling into the error much larger than in traditional systems comparing to computerized systems, as a result of tiredness and human stress. The computer has stable and accurate performance in all times.

[13] Yassin, Saad al-Ghalib, management information systems, Arabic books, Damascus, 2006, p. 204

[14] Abu Bakr, Faten Ahmed, "management systems open the next business revolution of the twentieth century atheist," Aatrak for publication and distribution, Cairo, 2001, p 178.

3) **Saving efforts**. Human efforts in the traditional systems is larger than computerized systems, whether at the level of procedures for dealing with information and different sources, processing, storage and control by a specialist documentation, or at the level of retrieval of information, sources and utilized by researchers and other users.
4) **Information Volume**. The volume of information and documents stored by conventional methods is limited, regardless of the volume of work space and human potential, comparing to the large and growing capacity for computer memory, in addition to that the great capacities provided by mass storing medias like hard discs.

The study summarizes the positive and negative impacts of management information systems:

Positive effects:

- Fast performance
- Comprehensive identification of consumer data
- Provide potential services to banks
- Helping banks to develop in several areas
- Fast access to information and retrieval of data

Negative effects

- Stop some jobs
- Breaking of privacy
- Malfunction will stop business
- Extensive use may cause exhaustion
- The distribution of illegal copies

The main managerial difficulties in building information systems in Islamic banks in Libya are summarized in the following:

1) Integration between information systems: it is represented in many sides, the bank should setup multiple systems serving many functions and facing the difficulty in connections between multiple levels inside the Islamic bank. The

financial cost in setup information system is one of the challenges facing the bank for building an integrated system.

2) Expanding managerial thinking. Most of the managers who have been training on production management, and departments or offices, they rarely trained to make the overall performance of the bank in best level, or close to perfection.

12. Recommendation

The main recommendation advised in this study is the need to focus on developing the technical qualifications of bank's employees in all Islamic banks. The research urges to pay more attention to train managers as well as employees about the modern management techniques using Management Information Systems (MISs) and advanced computer applications.

Also it is highly recommended to replace old systems and traditional ways of managing bank activities with new digital systems even it would cost the bank more money but the high advantages of these new systems exceeding its cost and will bring successful future to the bank by providing professional management services at high accuracy and speed. The returned benefits to all parties are enormous.

<u>The study recommended the following:</u>

1. Removing bureaucratic obstacles that prevent applying management information systems
2. Training of employees and managers in Libyan Islamic banks on the use of modern information systems in management and executes all banking jobs using modern information systems
3. Providing full transparency of the information provided to investors in Islamic banks in order to rationalize the interested investors to deal with Islamic banks and increase their intention to invest

13. Conclusion

Islamic banks are financial bodies or financial banks committed to apply the regulations of Islamic Shariah and the Islamic way to obtain profits without Islamic suspicious concerning usury (Riba), or gain profit with presence of a high risk factor. In the era of rapid changes and environmental disruptions and hard global competition, the role of MIS has been increased in banks and private banking

Islamic Banks in Libya facing a low level of knowledge and no experience about the management information system, the top management in these banks need to raise the level of awareness and understanding how to use management information systems in doing the daily banking activities by specialist employees who are fully aware and understand the importance of the new technology and how to use it as well.

The modern banking system has become too complicated; therefore these systems require information systems to assist in managing the various banking activities, from here comes the role of management information systems to achieve high efficiency in the management of banking activities and daily financial transactions.

Applying management information systems in Libyan Islamic banks need a lot of efforts to pave the way for swift implementation, there many obstacles facing professionals who are responsible for installing MIS in Libyan Islamic banks, these obstacles may take different forms, some of these them are administrative obstacles, and dome of them organizational obstacles.

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A PROPOSED MODEL FOR AN EFFECTIVE ASSET LIABILITY MANAGEMENT IN ISLAMIC BANKS ADOPTING GOAL PROGRAMMING

Chong Hui Ling[1]

Abstract

Goal programming enables us to examine the behavior of a real system in a simulated environment to enhance the performance of the system. Looking at its application in promoting the effectiveness of Assets and Liability Management (ALM), the study aims to develop a programming model for the optimization of Economic Value Added (EVA) objectives of the full-fledged Malaysian Islamic banks while constrained by its unique operating scenarios. The programming tasks assume MATLAB and Symbolic Math software for data processing and modeling. The data inputs are the Islamic bank's assets and liabilities management financial data. The outputs of the goal programming are the set of solutions to the Islamic bank's optimal portfolio and a "bogey" model as benchmark for the full-fledged Malaysian Islamic banking population. A triangulation approach is considered for the model's verification and validation whereby interviews with the risk management committees of the respective banks will be conducted to solicit feedbacks needed for the model's improvement and to enhance its practicality. A series of reductionism, repeatability, refutations and revisions will be performed thereafter the interviews. This study is different from the previous studies with respect to the different scope and attributes contained in the ALM effectiveness model. The findings of this research aim to guide managerial planning and policy making as well as to bring implications to future research in the like area.

Keywords: Goal programming, ALM, Islamic banks, EVA

1. Introduction

Every financial institution needs a good asset and liability management (ALM) as an essential tool for survival. ALM is the core treasury function of a bank. The role and importance of ALM is analogous to the function of the heart of a human being. An effective ALM will result in the bank's improved long-term earnings and economic value. Conversely, failure of the ALM function would lead to devastating consequences. A famous example is the liquidation of Microfinance Bank in Africa

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(Abayomi, 2011, para 3), Hokkaidō Takushoku Bank, Ltd. in 1997 (Knufken, 2009), Goldome (New York's largest savings institution went into bankruptcy in 1991) and much more to name. Gruening and Iqbal (2008: 146) provides that an ALM is the management of the overall balance sheet comprised of strategic planning and implementation and control processes that affect the volume, mix, maturity, interest rate risk sensitivity, quality and liquidity of a bank's assets and liabilities. In short, the purpose of ALM is to boost earnings and the value of the firm while managing risks associated with the resources (assets) utilized to achieve the desired returns. The tasks of a bank's ALM is increasingly challenging given the evolving regulatory constraints, unresponsive and inflexible current traditional ALM models to reflect the current changes in the bank's macro- and micro-environment as well as its problems in 'hard' balance sheet structure (p. 278). Adding to these complexities, Islamic bank's unique balance sheet structure and features pushes the challenges higher, leaving critical ALM issues unresolved in the literature to date. Some of the additional challenges in Islamic bank's ALM are the lack of investment in robust treasury management given that majority Islamic banks are still small in size compared to their conventional counterparts. They are also exposed to equity investment risk, mark-up rates risk instead of the conventional interest rate risks (p.145), issues in the two-tier *mudarabah*, and heavy mismatches due to over dependence on short-term financing and limited use of partnership-based financing agreements (p.147). These unique risks arise due to the different mechanisms governing the operations of the Islamic banks. The banks are required to comply with the principles of *Shari'ah*, which is also known as *Fiqh al-Muamalat*[2] (Islamic rules on transactions)(Ibrahim & Hamid, 2007: 21). The *Shari'ah* principles guide the Muslims to path not only leading to *Allah* but also are believed as path shown by *Allah* through His Messenger, Prophet Mohammed (Kettel, 2011: 13). Islamic banks in Malaysia are also governed by the Islamic Banking Act 1983. This research will explore the mentioned unique features in detail by placing the emphasis on building a proper ALM model to manage the risks mentioned and at the same time providing solution to an Islamic bank's optimal portfolio.

2. Literature Review

2.1 Asset and Liability Management (ALM) Model

Modeling enables us to analyze and investigate the interactions between the members within a system in a simulated environment. Chaturvedi (2010: 32) defined modeling as the process of abstraction of a real system. It provides a conceptual framework

[2] The *Muamalat* is within the discipline of Shari'ah and it is concerned with the "man-to-man" relationship. Within this branch, aspects that relates to *Muamalat* activities are such as political, economic and social activities. As such, the banking and finance activities are also linked to *Shari'ah* (Haron & Azmi, 2009: 225).

describing the actual system and it serves as a replica to the real system. He elaborated further by saying that modeling allows us to perform experiments which are near impossible or impossible to perform in the actual context (p.32). For example, it is not possible and expensive to implement an experiment to investigate the effect of a market interest rate increase or decrease on the net profit margin of an Islamic bank. For this reason, the research would develop a mathematical model for all possible elements affecting the effectiveness of the Malaysian Islamic banks' ALM. Then, the components of a system will be studied together and not in isolation.

2.2 Model Origins and Theoretical Framework

The underlying theory that governs the model development for bank's ALM performance optimization is the Markowitz Portfolio Theory founded by Harry Markowitz (1952). The author claimed that it is possible to attain an optimum combination of different assets with different risks and returns by having their risks minimized while maximizing investment returns. The combination set is chosen by a risk adverse investor through combining negatively or low positive correlated assets in a single portfolio. Later in the literature, other researchers emerged to suggest possible ways in coming out with an optimal match of assets for the investment portfolio. Researchers like Bellman (1952, 1957), Tintner (1955), Charnes and Cooper (1959), Dantzig and Wolfe (1961), Bellman and Dreyfus (1962), Merton (1969, 1990) and others continued to expand the usefulness of the portfolio management theory. This theory serves as the foundation to ALM model in many organizations. Later on, the literature continued to expand with such effort being pioneered by Sharpe (1964). The improvements were done based on models for insurance companies (Carino *et al.*,1994 and Ngwira & Gerrard, 2007), commercial banks (DeYoung & Yom, 2008; Dash & Pathk, 2009; Sodhi, 2005; 2004; Gaivoronski & Lange, 2000; Mulvey *et al.*, 1999; Kusy & Ziemba, 1986), commercial banks in China (Yang, Xu & Cai, 2012), pension funds (Chiu, Wong & Li, 2012; Gondzio & Kouwenberg, 2001; Consigli & Dempster, 1998), Norwegein power utility plant (Kung, 2008), farming problem (Sohn, Bricker & Tseng, 2011; Birge & Louveaux, 1997) and so on. These models can be grouped into four common characteristics identified by Zenios and Ziemba (2007) in Trenca *et al.* (2010). The groupings are (1) static model for single period; (2) static model for multi-period; (3) stochastic model for single period; and (4) stochastic model for multi-period. The classifications are based on the level of uncertainty and the period examined for the system. Nevertheless, Ferstl and Weissensteiner (2011) argued that the stochastic linear programming (using stochastic multi-period approach) as the most practical model for asset and liability management problems. The stochastic multi-period model is able to relate to a system outcome that is highly uncertain. Although Santomero (1997) in Ahmed and Khan (2007: 149) said that there is only mild and unavoidable level of uncertainty in the Islamic banking environment, these uncertainties could be managed with the construction of an optimal portfolio. The solution is often proposed within

the optimal trade-off between risk, return and liquidity in ALM (Kusy & Ziemba, 1986). However, on the other continuum, Sodhi (2005) did a survey on the linear programming choices available for asset liability management both in the pension fund and banking industry, recommended the static programming models instead of dynamic or stochastic models. He explained that although the stochastic programming with recourse models provides a flexible and powerful approach to asset and liability management, there are two challenges associated with the use of these models. The first is that the stochastic dynamic models failed to incorporate relevant financial theories and second is the model's difficulty in solving highly complex scenarios involving exponential growths over the time periods analyzed. These thoughts were later challenged by researchers like Ferstl and Weissensteiner (2011), Cornuejols and Tutuncu (2007, p.13), who commented that the static models (i.e. static mean variance optimization models) fail to incorporate the real dynamic nature of assets management and multiple liabilities in the different maturities faced by the financial institutions. Furthermore, the stochastic linear programming model provides a better representation of uncertainty in the real context of portfolio diversification in the Islamic banks.

The stochastic linear programming model should reflect all risks (generic and unique to Islamic banks). Reviewing the current literatures on the Islamic banks' asset and liability management however, leads to ample of researches taken on measures for the Islamic banks' profitability and economic performances. Some used ratios (Masruki *et al.*, 2011; Said, 2011; Htay, 2010; Johnes *et al.*, 2009; Olson & Zoubi, 2008; Siddiqui, 2008; Samad & Hassan, 1999, Khan & Mirakhor, 1990; and the like), data envelopment analysis which is also known as DEA (Johnes *et al.*, 2012; Said, 2012; Shah *et al.*, 2012; Buehler & Santomero, 2008; Isik & Omran, 2005 in Buehler & Santomero, 2008; Fadzlan, 2007; Yudistira, 2004), meta-frontier analysis (Johnes *et al.*, 2012), static and dynamic panels (Buehler & Santomero, 2008), Rosse-Panzar model (Weill, 2011), Stochastic Frontier Approach (Srairi, 2010), the CAMEL model (Kouser & Saba, 2012) and many more. Looking at studies proposed for methodologies in modeling the effectiveness of Islamic bank's ALM, this study found only limited number of literature (Muda *et al.*, 2011; Hadad *et al.*, 2011; Al Janabi, 2008; Ul Haque & Mirakhor, 1987; and Bashir, 1984). In constructing the EVA programming model, Muda *et al.*(2011) conducted a breakdown of the assets and liabilities classes based on the different types of underlying Islamic financial contracts. In their model, only the deposit accounts is being classified as liability. The EVA function in their model is converted using the Hamiltonian system. The major finding of their study is that only the non *mudarabahh* deposit account contributed a significant positive value to the EVA. This is one of the motivations to this research because it shows that a proper asset allocation within the Islamic bank's portfolio would help boost the bank's value. Hadad *et al.* (2011) transformed the DEA to SORM-DEA, a methodology used in Emronznejad *et al.* (2010) in Hadad *et al.* (2011: 849) paper. Their methodology will be scrutinized further in order to retain elements that will be used in the development of the ALM model in this research. Al Janabi

(2008) used the improved value-at-risk (VaR) model guided by software that supports the matrix-algebra function. The objective function in the author's paper is to minimize the risk function represented the VaR of the Islamic banks' assets. This is different from the objective of this research that aims at maximizing the EVA function which leads to improved ALM performance. Ul Haque and Mirakhor (1987) established an optimum profit-sharing function between the Islamic banks and the *mudarabah* account holders of the Islamic banks, which is also not the objective of this paper. Bashir (1984) recommended in his commentary paper on the use of MULTUNCRT software that is not easily available. It is used to find the Islamic bank's optimal decision policy in portfolio management and the implications to those decisions. Nevertheless the MULTUNCRT is to be used in Commodore PET microcomputers, a very old type of computer which was first released in 1977 (Adams *et al.*, 1986).

Therefore, after considering this widely dispersed chronological development of the literature on the research methods for effective ALM models on effective Islamic banks. This study aims to fill the gap with an improved method, through a modified model as a bogey (or benchmark), alongside with recommendations to an optimal asset and liability mix for the full-fledged Islamic bank's portfolio.

The following section of this research paper discusses the research's conceptual framework, hypothesized constraints, research design and methodologies to address the research questions. The research aims, research objectives and the research questions are listed after the conceptual framework section.

2.3 Conceptual Framework

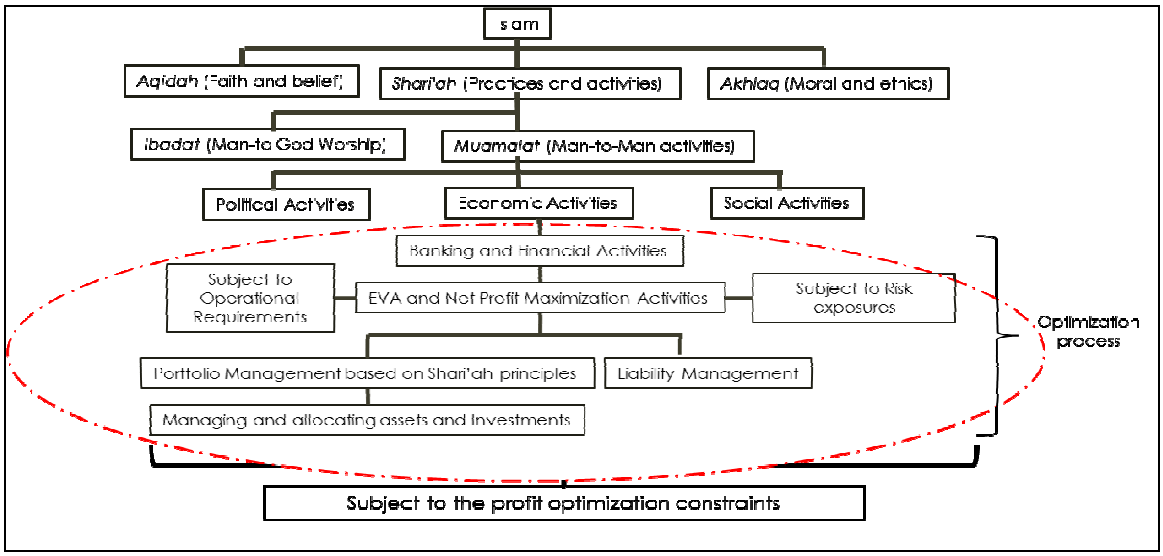


Figure 1.1: Conceptual Framework

Source: Modified from Kettel (2011: 15) for the purpose to illustrate the scope focused for the ALM model of this research.

The research's model would be based on the above conceptual framework. The conceptual framework in Figure 1.1 depicts the aim of this research, that is, to optimize the effectiveness of the Islamic bank's ALM while subject to risk exposures and operational requirements. Figure 1.1 also shows how the objectives of *Shari'ah* based ALM relates to one of the purposes of Muslims in *Muamalat* activities as stated in the Holy book of *Qur'an*. The basic pillars of a Muslim's belief are illustrated in the figure. They are required to observe their faith and belief (*aqidah*), practices and activities within the confines of Islam (S*hari'ah*), and the moral and ethics of Islam (*akhlaq*). Muslims enrich and conserve their relationship with God through *ibadat* (worship) while maintaining their brotherhood relationship among one another through *Muamalat* (man-to-man activities). When Islamic banks follow strictly the *Shari'ah* based ALM, they are also preserving the objectives of *Muamalat* (Kettel, 2011 and Haron & Azmi, 2009). The programming tasks of this research will focus on the above objectives with a model to optimize the Islamic bank's EVA with constraints that are hypothesized to affect the process in the bank's ALM. The hypothesized constraints will be listed and detailed in Section 4 (p.14-15) of this conceptual paper. The, the number and type of constraints will be further improved after conducting the interviews with the senior risk managers to identify unique scenarios facing the banks' ALM process.

2.4 Research aims, objectives questions and a general design that follows to answer these questions.

This is an empirical research and the aim of this research is to promote an approach for the Islamic banks asset and liability management effectiveness attained by model development using the goal programming method. A set of optimal portfolio for the Islamic bank's assets and liabilities will be identified using the new model.

Research Objective (1): To assess the adaptability of the Islamic banks with their current ALM model and their perception on the model's usefulness. **Research Question (1a):** How well are the Islamic banks adapting to their current ALM model. **Research Question (1b):** What is the Islamic banks' perceived usefulness of the currently employed ALM model? **Design**: In order to solicit feedbacks regarding Islamic banks' adaptability to the ALM model, interviews will be performed with the senior risk managers of each full-fledged Islamic bank in Malaysia (they are BIMB, Kuwait Finance Hourse Berhad and Bank Muamalat Malaysia Berhad). The reason for choosing only full-fledged Islamic banks is because the full-fledged banks would better represent the greater level of the Islamic bank's commitment to *Shari'ah* principles in majority areas of decision making. Themes formed from the saturated interviews will be analyzed and the model development would be based on the criteria obtained from the themes.

Research Objective (2): To determine specific factors affecting the Islamic banks' ALM effectiveness and to use these factors as constraints for the Islamic banks' ALM model. **Research Question (2a):** What are the variables affecting the ALM effectiveness of the Islamic banks? **Research Question (2b):** What are the point estimates for those variables identified in Research Question (2a)? **Research Question (2c):** What are the constraint functions formulated representing the effect of those variables on ALM effectiveness? **Design**: The factors affecting Islamic banks' effectiveness will be identified by performing literature search. These factors will then be validated using the pool regression technique, and the significance of the impact of the variables will be determined at a 95% level of confidence. Constraint functions will be formulated using MATLAB and Symbolic Math software.

Research Objective (3): To determine the optimization function for the Islamic bank's goal programming model. **Research Question (3):** What is the modified EVA function of the ALM model? **Design**: The optimization function, represented by EVA would be developed by modifying and/or retaining properties of the EVA model.

Research Objective (4): To promote *Shari'ah* based ALM represented by the modified ALM model using goal programming technique. This model will act as the bogey (benchmark) for other full-fledged Islamic banks in Malaysia. **Research Question (4a):** How will the modified model promote the *Shari'ah* based ALM objectives? **Research Question (4b):** Is the modified ALM model significantly different from the conventional models? **Design**: Model inspection will be performed to identify areas that conform to *Shari'ah* principles as well as areas non-conforming to *Shari'ah* principles.

Research Objective (5): To ascertain the optimally efficient set of assets and liabilities for the full-fledged Islamic banks. **Research Question (5):** What is the optimal portfolio solution obtained from the goal programming technique? **Design**: An optimal solution will be determined for one of the full-fledged Islamic banks (Bank Islam Malaysia Berhad). This can be done using MATLAB programming function using the bogey model developed in Research Objective (4).

2.5 Research significance

The proposed study differs in a few significant ways; first, it identifies the major factors affecting the ALM efficiency of the full-fledged Islamic banks in Malaysia although many studies in the past were undertaken to measure the ALM efficiency. The variables will be used to formulate constraint functions for the goal programming model. Second, the proposed study extends the basic EVA optimization function to include the total returns from the Islamic bank's assets. This captures directly the effect of any change in the portion of individual portfolio assets on EVA. The total assets' return in the portfolio is linked to the risk and return weighted adjustments and their portfolio covariance. A change in the fraction of funds allocated to an asset

would in turn change its associated risks and returns; therefore, affecting the overall portfolio returns and EVA performance. Third, this goal programming function for the full-fledged Islamic banks' ALM effectiveness is exclusively developed to capture specifically their micro-and macro- characteristics. Hence, the carefully tailored model is assumed to provide solutions that are unique to those banks. The findings of this research would be beneficial to the Islamic bank's tactical and operational planning decisions. For tactical considerations, this research suggests an approach in identifying and allocating the proportion/ratio of funds in an investment portfolio while following the *Shari'ah* objectives. On the other hand, the banks' operational managers will benefit from using the model in revising their daily portfolio management decisions and asset allocation. Finally, this research aims to also provide implications for future researches in the like area especially in terms of Islamic banks' ALM modeling.

3. Methodology

3.1 Research Design

The following figure shows the processes proposed to meet the objectives of the research.

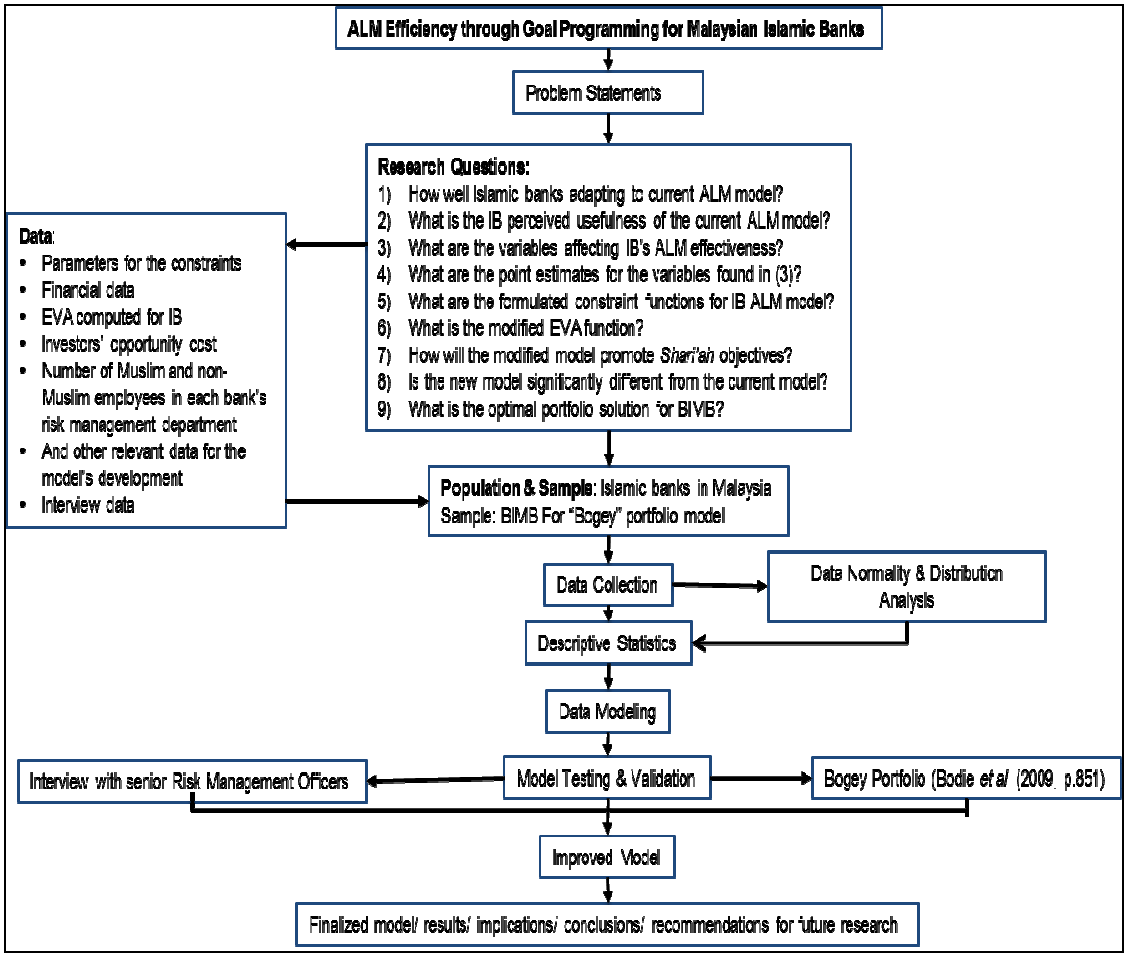


Figure 1.2: Research Design

3.2 Data type, collection and analysis

The above figure depicts the process to be undertaken for this research in order to answer the nine research questions that came up in the problem formulation stage. The population for this research is the full-fledged Islamic banks, namely, Bank Islam Malaysia Berhad (BIMB), Bank Muamalat Malaysia Berhad and Kuwait Finance House Berhad). The population is designed to focus only on full-fledged banks because the scope will help in precisely modeling the nature and scenario of the banks' operating environment besides commercial displacement risks which demands for complex methodologies other than financial modeling like using the VaR model mentioned earlier (Al Janabi, 2008). Besides, Chaturvedi (2010) stated in his book of modeling using MATLAB and Simulink that the modeling tasks need one to narrow the scope of input sources to enable more precise representation of specific scenario or problem of the real environment.

In order to address Research Objective 1, the 3 full-fledged Islamic bank's senior risk officers whose tenure is 5 years and above will be interviewed. At the same time, data types and sources will be identified for the model along with its suitable data collection methodologies. Until date, data inputs clarified for the model are the types of investment assets of an Islamic bank, the five years assets' returns capital gains (or losses) arise from the assets held by the bank, the types of liabilities in the bank's balance sheet, cost of those liabilities, the rate incurred when deposits are withdrawn, legal requirements pertinent to the bank's ALM, the amount of *zakat* contribution for the five years period, invested capital per year for the five years period, relevant parameters for liquidity requirements annual financial publications.

3.3 Data modeling

Various tests of skewness and kurtosis will be performed to understand the descriptive characteristics of the collected data. Once the descriptive statistics are obtained, data modeling will be carried out using MATLAB R2009b with the guide of Symbolic Math software for algebraic function formulation. Constant replication, recursion and model testing will be done to improve the Islamic banks' ALM model. Triangulation method will be used as an additional approach to model testing and validation. Here and again interviews will be conducted with the earlier senior risk management officers of the respective full-fledged Islamic banks and feedbacks on the practicality and suggested improvements for the ALM optimization model will be solicited. And then, a 'bogey' portfolio will be developed for model validation. A benchmark has to be identified to aid this process (Zenios & Ziemba, 2007: 595). Bank Islam Malaysia Berhad (BIMB) is chosen as the benchmark and the accompanying reasons are listed as follows: (1) the benchmark must have at least 5 years data as required for a feasible ALM planning on both strategic and tactical level of management (Sodhi, 2005). Since BIMB is established in 1983, it is able to fulfill this criterion; (2) BIMB is

pioneer of Islamic banking products and services thus having sufficient knowledge about the characteristics and preferences of the Malaysian Islamic financial products and services market; (3) it was recapitalized in 2006 after heavy losses (Kek & Wong, 2010). Besides, it underwent the global financial crises in 1997 and 2008. These events allow better recognition of all possible risk variables affecting the institution's ALM; (4) The research aims to formulate an ALM model based on *Shari'ah* management perspectives, and BIMB has an Internal Audit division reviewing the bank's *Shari'ah* compliance through regular audits (p.6); (5) the bank has also a specialized asset-liability risk management sub-committee (p.8), thus further benefiting the research because the senior executives of that division are able to provide stronger views on the model's practicality based on their exclusive experience in ALM. Data inputs from BIMB will be processed with an outcome of the optimal set of assets and liabilities suggested for BIMB.

4. Expected research outcome

The outcome of this research would be a multistage stochastic programming model to promote the full-fledged Islamic bank's asset and liability management effectiveness. As discussed earlier, stochastic programming deals with environmental context that is uncertain (Ferstl & Weissensteiner, 2011). This is in line with the idea emphasized by Kusy and Ziemba (1986) that mentioned the need of an ALM model to hold features that are operationally adequate and computationally tractable (p.358). There are six features listed in their paper; (1) mutiperiodicity which incorporates all ALM decisions over a period of time; (2) simultaneously addressing both assets and liabilities for accounting and liquidity considerations; (3) transaction costs incurred on securities' trading transactions; (4) uncertainty in cash flows due to the uncertain withdrawal behavior among the depositors. This could account for the deposit run risk that is prevailing in the Islamic banks; (5) the uncertain interest movements so that the bank will deploy appropriate actions to avoid unfavorable interest changes and (6) the legal and policy constraints to reflect the bank's operating environment. These features provide the framework to the model that will be formulated for the Islamic bank's asset and liability management.

Even theoretically Islamic banks do not prohibit any transaction with the element of *gharar*. In real, the operating environment of the Islamic banks is uncertain. Like the conventional banks, Islamic banks are also subject to market risk arising from the macroeconomic environment conditions. For example the movement of commodity prices (Ahmed & Khan, 2007) will affect the Islamic bank's income. Formulation of the multistage stochastic programming model will help to minimize the impact of such problem. Details to the expected form of the model are;

a) The optimization function;

A modification of Muda *et al.* (2011) and Bidabad and Allahyarifard (2008) economic value added (EVA) function will lead to the function (1) below;

Table 1.1: Notations for the EVA function

EVA	Economic value added of the Islamic bank	TY_E	Total income derived from using shareholders' funds from financing, securities investment and other sources of investments
TY_{DIA}	Total income from investment of depositors' funds in securities, financing and other sources of investment	OC_E	Direct operating costs from managing the shareholders' funds
OC_{DIA}	Direct operating costs for investment account funds	NOC	Non-operating costs like personnel expenses and other overhead expenditures, tax and *zakat* due.
ρ	Contribution of the management's expertise in generating the total net income	k_{psd}	price of capital from shareholder's total equity (modified from Bidabad & Allahyarifard (2008) by Muda *et al.* (2011))
w_i	weighted funds where $i = 1, \ldots, 6$	k_{pse}	price of capital from investment account deposits (modified from Bidabad & Allahyarifard (2008) by Muda *et al.* (2011))
r_{MD}	Proportion of income from *mudarabahh* investments	r_{BBA}	Proportion of income from *bai' bithaman ajil* investments
r_{MS}	Proportion of income from *musharakah* investments	r_{IS}	Proportion of income from *istisna* investments
r_{MB}	Proportion of income from *murabahah* investments	r_{IJ}	Proportion of income from *ijarah* investments
β_i	parameters where $i = 1, \ldots, 12$	TE	Total equity
TD_{IA}	Total funds in Deposit Investment Account		

These functions are extracted from Muda *et al.* (2011: 8-9). The functions will be used as a foundation for further development of the EVA model of this research.

$$EVA = \left[(TY_{DIA} - OC_{DIA})(\rho) + (TY_E - OC_E) - (NOC - Tax - Zakat) - (k_{psd}(TD_{IA}) + k_{pse}(TE))\right]$$

..... (1)

$$TY_{DIA} = r_{MD}(\beta_1) + r_{MS}(\beta_2) + r_{MB}(\beta_3) + r_{BBA}(\beta_4) + r_{IS}(\beta_5) + r_{IJ}(\beta_6) + OY \ldots\ldots\ldots (2)$$

$$TY_E = r_{MD}(\beta_7) + r_{MS}(\beta_8) + r_{MB}(\beta_9) + r_{BBA}(\beta_{10}) + r_{IS}(\beta_{11}) + r_{IJ}(\beta_{12}) + YO \quad \text{.....(3)}$$

The optimization function formulation will also be based on an earlier study by Kusy and Ziemba (1986) on ALM model for the Vancouver City Savings Credit Union. Their research has been taken as a foundation to most ALM models in the financial industry. Their model was based on the stochastic linear programs with simple recourse and that their objective function is to maximize the net present value of bank profits minus the expected penalty costs for the financial institution's feasibility. However, as noted by Sodhi (2005: 187), one can choose to have among the four categories of objective functions; (1) *maximizing the expected net present value as those in the scenario based models*; (2) *minimizing initial investment like minimizing the expected cost of funding* (Dert, 1999 in Sodhi, 2005: 187); (3) *maximizing the expected horizon's return or value* and (4) *maximizing risk averse utility***.** This research objective is consistent with the objective of maximizing the Islamic bank's horizon value in terms of EVA. Although this is different from Kusy and Ziemba's (1986) objective function, it will take certain measures that consider the actual dynamic multistage stochastic nature of the Islamic bank's asset and liability management.

b) <u>Constraints</u>

Sodhi (2005) advised that there should be at least two constraint functions in a given model. Here, the research hypothesized six constraint functions for the Islamic bank's ALM model. They are;

The Islamic bank's balance sheet constraint (Muda *et al.*, 2011) or cash flow matching constraint (Sodhi, 2005).

H$_1$: $TE + TD_c + TD_{IA} + \varepsilon_1 = TF + TI + \varepsilon_2$

Here, TE represents total equity, TD_c (total current account deposits), TD_{IA} (total investment account deposits), TF(total funds allocated for financing) and TI(total funds allocated for investment decisions). Whereas ε_1 and ε_2 are residuals for sources and uses of funds respectively. However, this function will need further modifications as Ismail (2010) listed more than three sources of funds like funds from capital and reserves, deposits, funds from other financial institutions and other liabilities besides deposits and investment accounts.

H$_2$: Policy constraint from Kusy and Ziemba (1986)
Kusy and Ziemba (1986) classified this constraint as conditions that are unique to the bank's continuance after the termination of the model.

H$_3$: Duration matching constraint (Sodhi, 2005)
This constraint captures the need of the Islamic bank to satisfy demand deposit withdrawals situations.

H_4: Budget constraint (Kusy & Ziemba, 1986)
Kusy and Ziemba (1986) included this constraint in their model to reflect the "initial conditions as well as the sources and uses of funds" (p. 360).

H_5: Legal constraints (Kusy & Ziemba, 1986)
Kusy and Ziemba (1986) stated that these constraints represent the bank's operations that are within its jurisdiction. On the other hand, Muda *et al.* (2011) provides the assumption on the non-subjectivity of the Islamic banks to policy constraints such as the reserve requirement constraint. This is also the function that will set out the slight dissimilarity between the Islamic and conventional banks in Malaysia.

H_6: Non-negativity constraints (Cornuejols & Tutuncu, 2007)
This is the most basic constraint that must be stated in linear programming models. Cornuejols and Tutuncu (2007) mentioned the introductory steps in drafting optimization models for finance in their 'Optimization methods in Finance'. Their notes will also be used as a guideline in modeling the Islamic banks' asset and liability management.

Further constraints will be identified and formulated after adequate analysis of the past literatures. The model testing and validation will be performed on Bank Islam Malaysia Berhad where an optimal set of assets and liabilities will be identified.

5. Conclusion, research limitations and recommendation for future research

Arriving at this point, there are so far only six hypothesized constraints considered for the full-fledged Islamic banks asset and liability management effectiveness. Mulvey *et al.* (2007) reminded the assets and liability management modeler needs to first specify the constraints that an organization must adhere to before formulating his or her mathematical models (p. 562). The research is confined to a very general scenario of an Islamic bank's asset and liability management environment. Future researchers could take measures to improve the model by incorporating constraints that promote higher portion of *mudarabah* and *musharakah* financing than other modes financing because other modes of financing do not reflect exactly the Islamically desired way of financing. This issue is greatly the concern among scholars (Hassan, 2009; Chong & Liu, 2009; and Gruening & Iqbal, 2008) who argued that the Islamic financial system would provide a better alternative in avoiding possible financial crisis in the future (El Qorchi, 2005).

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ANALYSING ISLAMIC BANK EFFICIENCY IN MALAYSIA USING THE STANDARD AND ALTERNATIVE APPROACHES TO DATA ENVELOPMENT ANALYSIS

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Abstract

The purpose of this paper is to analyse the efficiency of Islamic banks in Malaysia using both the standard approach and the alternative approach to Data Envelopment Analysis (DEA). The standard approach relies on linear averages of outputs and inputs to measure efficiency whereas the alternative approach uses nonlinear averages. Both approaches are tested on 14 Islamic banks in Malaysia for the three-year period, 2008 to 2010. Our overall results for the three years suggest that, the inefficiency level among these banks using the standard approach (SDEA) is much higher than using the alternative approach (ADEA). Implications and future research are also discussed.

Keywords: Efficiency, Data Envelopment Analysis (DEA), standard approach, alternative approach, Islamic banks, Malaysia

1. Introduction

Islamic banking today has become a practical reality and accepted worldwide. The industry has transformed from an infant industry in the 1970s to one of the most viable and efficient alternative models of financial intermediation. It has consistently grown into double-digit with a presence in more than 100 countries. It is estimated that total financial assets of the industry now exceed US$1 trillion. World economic powers such as Great Britain, France, Germany, and even Russia are considering

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amending their financial laws with the purpose of accommodating the establishment of Islamic banks within their financial system.

The integration of Islamic finance into the global economy is discernible by the growing awareness among the population and demand for investing in accordance with *shariah* principles, progress in developing a regulatory framework and enhanced international linkages. However, the success of Islamic banking brings forth new challenges to the industry. These include lack of standard financial contracts and products, illiquidity issues, risks mitigation in the operational aspects and financing portfolios, and co-operation among the players within the industry.

These successes and challenges facing Islamic financial institutions have been widely documented. Nonetheless, there is still an acute dearth of literature which covers concepts and applications of Islamic banking worldwide as well as provides comprehensive illustration of all major aspects of Islamic finance and banking on a more global scale. Having kept a close watch on the developments in Islamic finance and banking over the last two decades, we acknowledge that there are many issues yet to be resolved. Among the major areas that need in-depth study are productivity, efficiency and performance measurement.

2. Literature Review

According to Berger and Humphrey (1997) in their survey of 130 studies on efficiency analyses found that majority of these studies were done in the US banking industry. Despite the fact that efficiency studies are well researched area in the developed countries like USA and Europe, there are still limited studies focussing on the efficiency of Islamic banking.

In the Islamic banking institutions, efficiency studies are still scarce. Several studies in Islamic banking focus on assessing the performance in terms of profitability and determinants of bank performance (Samad and Hassan, 1999; Bashir, 2001; Samad 2004; Haron and Azmi, 2004).

In terms of efficiency using DEA, studies in Islamic banking were done by for example, Sufian (2007), Kamaruddin et al (2008), Sufian et al (2008), and Tahir et al (2011). Sufian (2007) study the efficiency of domestic and foreign Islamic banks in Malaysia for the period 2001 to 2004 using DEA. The study found that domestic Islamic banks are more efficient than foreign domestic banks and suggest that these inefficient banks were operating at the wrong scale of operations. In another study by Kamaruddin et al (2008) on Islamic banks in Malaysia for the period 1998 to 2004, found that Islamic banks in Malaysia) were relatively more efficient at controlling costs than at generating profits.

Tahir et al (2011) study Islamic bank efficiency in four regions; Africa, the Far East and Central Asia, Europe and the Middle East during 2003 to 2008. Their results suggest that the mean efficiency of these banks have declined from 74.6 % in 2003 to 54.4 % in 2008 and that pure technical efficiency has largely resulted in the inefficiency of Islamic banks. Their results also indicate that there are significant differences in terms of the efficiency between sizes but not between regions.

Aik and Tan (2012) investigate the cost and profit efficiency of the full-fledged Islamic banks and Islamic windows in Malaysian from 2002 to 2008 using DEA. Their results show that the full-fledged Islamic banks are relatively more efficient than Islamic windows and that Malaysian Islamic bank are more efficient in generating profits than controlling their costs.

All the research mentioned above employed the standard DEA approach. As far as we are aware only one research has focussed on the alternative approach to DEA. The study was done by Shirvani, Taj and Mirshab (2011). The authors use the ADEA with nonlinear averages to study efficiency of 27 Turkish banks for 2008. The findings of their study show that “the extent of inefficiency among these banks is much smaller than implied by the use of the more standard approach” (page 9).

The aim of this paper is analyse the efficiency of Islamic banks in Malaysia using both the conventional and the alternative approach to Data Envelopment Analysis (DEA). The remainder of the paper is organised as follows. Section 2 focuses on the

review of the literature and the methodology used in the study in Section 3. . Section 4 discusses the empirical findings and Section 5concludes.

3. Methodology and Data

3.1 Standard DEA

The main objective of DEA is to determine which firms are operating on their efficient frontier and which firms are not. If the firm's input-output combination lies on the DEA frontier, the firm is considered efficient; and the firm is considered inefficient if the firm's input-output combination lies inside the frontier.

Consider a general situation where we have n decision making units (DMUs) and each consumes the same m inputs to produce the same s outputs. Precisely, DMU_j uses x_{ij} *(I = 1, 2, 3…., m)* of input *i* to produce y_{rj} *(r = 1, 2…., s)* of output *r* assuming that $x_{ij} > 0$ *and* $y_{rj} > 0$ (Seiford and Thrall, 1990). The specific DMU being evaluated has to solve the following optimization problem:

$$Max h_0 = \sum_{r=1}^{s} u_r y_{ro} / \sum_{i=1}^{m} v_r x_{i0} \qquad (1)$$

subject to the constraints:

$$\sum_{r=1}^{s} u_r y_{rj} / \sum_{i=1}^{m} v_i x_{ij} \le 1,\ u_r \ge 0,\ v_i \ge 0 \qquad (2)$$

for$i = 1,2, …., m; r = 1, 2,…. S; j = 1, 2, …., n$. Where h_o is the ratio of virtual outputs to virtual inputs, the u_r's and the v_j's are the variables an they_{ro}'sand the x_{jo}'*s* are the observed output and input values of the DMU to be evaluated. A set of normalizing constraints guarantees that no DMU, including the one evaluated, can obtain an efficiency score that exceeds unity. Thus, DEA establishes a benchmark efficiency score of unity that no individual firm can exceed. If the efficiency score $h_o = 1$, DMU_o satisfies the necessary condition to be DEA efficient; otherwise it is DEA inefficient.

3.2 Alternative DEA

However, according to Shirvani et al (2011, page 6)," the use of linear weighted averages of outputs and inputs renders the efficiency ratios nonlinear and thus, necessitates the constraint that the denominations of these ratios are all equal to one". To overcome this, the standard DEA is slightly modified with the use of nonlinear weighted averages of outputs and inputs. In other words, instead of using the normal values, we convert all the inputs and inputs in logarithm.

3.3 Data

Data for this study is taken from Bankscope database. The data is for 14 Islamic banks of which 9 are local Islamic banks and 5 are foreign Islamic banks. The list of banks is in Appendix 1. The period chosen is for the three-year period, 2008 to 2010.

Table 1: Outputs, Inputs and Standard DEA Efficiency, 2008

DMUs	Outputs ('000 MYR)		Inputs ('000 MYR)		Standard DEA Efficiency
	Total Loans	Other Earning Assets	Total Customer Deposits	Fixed Assets	
1	2,494,000	1,073,200	4,252,100	3,200	0.76
2	2,073,100	327,300	1,755,700	200	1.00
3	8,363,400	831,100	6,916,100	400	1.00
4	10,458,800	3,846,900	20,754,300	142,400	0.55
5	6,145,489	5,843,767	13,661,386	3,855	1.00
6	4,860,349	353,004	4,735,142	2,162	0.81
7	4,332,100	1,835,400	6,208,100	1,800	0.91
8	12,089,900	782,700	9,622,300	400	1.00
9	5,542,300	2,282,500	7,347,300	19,400	0.92
10	2,914,359	174,721	4,016,941	68,478	0.49
11	259,700	79,200	968,100	5,300	0.26
12	3,000,800	833,300	3,244,300	2,500	0.96
13	6,411,500	984,500	4,293,300	44,800	1.00
14	2,199,400	837,600	2,691,000	1,900	1.00
				Average	**0.83**

4. Empirical Results

4.1 Standard DEA

The choice of inputs and outputs to be employed in estimating the efficiency scores are voluminous. However, in this study, we are not going to discuss on this issue. In

this study we adopt the intermediation approach in which banks provides loans and accepting deposits from the customers. Thus, the outputs for our model are total loans and other earning assets while the inputs are total customer deposits and fixed assets. The data employed in this study are for 14 Islamic banks for the period 2008-2010 and taken from Bankscope database. All the financial data are MYR thousand. The data is presented along with the efficiency measures are presented in Tables 1 to 3. From the results in Table 1 we can see that there are 6 banks that have efficiency scores of 100 % (Banks 2, 3, 5, 8, 13 and 14). In contrast, Bank 11, 10 and 4 have the lowest efficiency scores of 29%, 49% and 55% respectively. These banks are the least efficient banks in our sample. The results also indicate that 8 banks could make substantial improvements in their performance.

The results in Table 2 show that 5 banks that have efficiency scores of 100% (Banks 4, 5, 8, 12 and 13). Two banks are the least efficient banks in the sample for 2009 that is Banks 11 and 10 (45% and 50% respectively). The results further indicate that 9 banks in the sample could make improvements in their productivity.

Table 2: Outputs, Inputs and Standard DEA Efficiency 2009

DMUs	Outputs ('000 MYR)		Inputs ('000 MYR)		Standard DEA Efficiency
	Total Loans	Other Earning Assets	Total Customer Deposits	Fixed Assets	
1	2,951,600	1,386,100	4,627,300	4,200	0.86
2	2,383,000	458,600	2,617,700	700	0.86
3	10,076,000	775,100	10,155,100	400	0.89
4	10,711,000	8,915,900	25,204,600	142,100	1.00
5	16,394,842	6,087,714	17,496,497	2,625	1.00
6	4,777,946	520,637	4,833,735	2,623	0.86
7	3,919,400	2,730,800	7,979,900	1,800	0.98
8	14,590,200	1,359,500	13,073,700	500	1.00
9	6,086,100	2,573,500	8,127,800	23,100	0.91
10	3,883,036	175,983	4,431,772	61,286	0.50
11	686,400	139,700	1,079,300	5,400	0.45
12	3,253,000	511,600	2,472,400	7,500	1.00
13	7,486,900	1,267,600	4,255,100	37,000	1.00
14	2,190,100	1,174,500	3,721,900	6,500	0.90
				Average	**0.87**

In Table 3, we can see that the number of banks in the sample that have productivity ratings of 100% is 6. These banks are Banks 3, 4, 5, 7, 8 and 12. The least efficient

bank is Bank 11 and 10 with efficiency scores of 71% and 75% respectively. Thus, from the table we can see that 8 banks in the sample can improve their productivity during the period.

As a conclusion, the three tables (Table 1 to 3) show that the numbers of banks that are constantly efficient throughout the three-year period are three banks (Bank 5, 8 and 13). Five banks (Banks 4, 6, 7, 10, and 11) have improved their productivity during the period. Further investigations show that 9 banks in the sample could make substantial productivity improvements.

Table 3: Outputs, Inputs and Standard DEA Efficiency 2010

DMUs	Outputs ('000 MYR)		Inputs ('000 MYR)		Standard DEA Efficiency
	Total Loans	Other Earning Assets	Total Customer Deposits	Fixed Assets	
1	3,644,200	1,337,300	5,533,500	2,100	0.77
2	3,474,900	586,100	4,027,800	600	0.81
3	12,008,300	1,412,300	13,398,000	300	1.00
4	12,284,700	15,655,400	26,866,600	181,500	1.00
5	22,757,750	4,998,176	22,677,955	1,862	1.00
6	5,444,415	1,304,432	6,025,709	3,801	0.89
7	4,227,700	3,633,800	7,731,600	2,000	1.00
8	16,589,600	2,441,900	15,306,700	1,500	1.00
9	9,036,000	3,120,900	9,946,600	21,500	0.91
10	4,280,314	392,501	3,907,946	38,215	0.75
11	768,400	339,200	1,125,700	4,400	0.71
12	4,748,800	478,700	3,782,500	16,400	0.93
13	6,603,300	1,567,800	4,546,500	27,300	1.00
14	2,555,700	1,123,800	2,920,900	7,800	0.93
				Average	**0.91**

4.2 Alternative DEA

To compare with the new approach or the alternative approach of DEA (ADEA), we present the results in Tables 4 to 6. We use the same sample banks in the analysis. The results in Table 4 show that the numbers of banks with the efficiency scores of 100% are 9. These are Banks number 2, 3, 5, 7, 8, 9 12, 13 and 14. The other five banks could make productivity improvements during this period.

Table 4: Outputs, Inputs and Alternative DEA Efficiency, 2008

DMUs	Outputs ('000 MYR)		Inputs ('000 MYR)		Alternative DEA Efficiency
	Total Loans	Other Earning Assets	Total Customer Deposits	Fixed Assets	
1	14.73	13.89	15.26	8.07	0.98
2	14.54	12.70	14.38	5.30	1.00
3	15.94	13.63	15.75	5.99	1.00
4	16.16	15.16	16.85	11.87	0.97
5	15.63	15.58	16.43	8.26	1.00
6	15.40	12.77	15.37	7.68	0.98
7	15.28	14.42	15.64	7.50	1.00
8	16.31	13.57	16.08	5.99	1.00
9	15.53	14.64	15.81	9.87	1.00
10	14.89	12.07	15.21	11.13	0.95
11	12.47	11.28	13.78	8.58	0.90
12	14.91	13.63	14.99	7.82	1.00
13	15.67	13.80	15.27	10.71	1.00
14	14.60	13.64	14.81	7.55	1.00
				Average	**0.98**

Table 5: Outputs, Inputs and Alternative DEA Efficiency, 2009

DMUs	Outputs ('000 MYR)		Inputs ('000 MYR)		Alternative DEA Efficiency
	Total Loans	Other Earning Assets	Total Customer Deposits	Fixed Assets	
1	14.90	14.14	15.35	8.34	0.98
2	14.68	13.04	14.78	6.55	0.99
3	16.13	13.56	16.13	5.99	1.00
4	16.19	16.00	17.04	11.86	1.00
5	16.61	15.62	16.68	7.87	1.00
6	15.38	13.16	15.39	7.87	0.98
7	15.18	14.82	15.89	7.50	1.00
8	16.50	14.12	16.39	6.21	1.00
9	15.62	14.76	15.91	10.05	0.99
10	15.17	12.08	15.30	11.02	0.96
11	13.44	11.85	13.89	8.59	0.94
12	15.00	13.15	14.72	8.92	0.99
13	15.83	14.05	15.26	10.52	1.00
14	14.60	13.98	15.13	8.78	0.99
				Average	**0.99**

The results in Table 5 show that the number of banks with 100% efficiency has declined to 6 banks. These are Bank 3, 4, 5, 7, 8 and 13. 8 banks could make improvements during the period. The least efficient during 2009 is Bank 11 with 45% efficiency score. This indicates that Bank 11 has wasted their inputs of 55%.

Further investigation for the period 2010 shows that the numbers of banks that are 100% efficient remain the same as in 2009 that is 6 banks. These banks are Banks 3, 4, 5, 7, 8 and 13. These are the same banks that are efficient in 2009.

As a conclusion, the results from the three tables (Tables 4 to 6) show that the numbers of banks that are constantly efficient throughout the three-year period are four banks (Banks 3, 5, 8, and 13). Only 1 bank (Bank 4) has improved its productivity during the period. Further investigations show that 10 banks in the sample could make substantial productivity improvements.

Table 6: Outputs, Inputs and Alternative DEA Efficiency, 2010

DMUs	Outputs ('000 MYR)		Inputs ('000 MYR)		Alternative DEA Efficiency
	Total Loans	Other Earning Assets	Total Customer Deposits	Fixed Assets	
1	15.11	14.11	15.53	7.65	0.98
2	15.06	13.28	15.21	6.40	0.99
3	16.30	14.16	16.41	5.70	1.00
4	16.32	16.57	17.11	12.11	1.00
5	16.94	15.42	16.94	7.53	1.00
6	15.51	14.08	15.61	8.24	0.98
7	15.26	15.11	15.86	7.60	1.00
8	16.62	14.71	16.54	7.31	1.00
9	16.02	14.95	16.11	9.98	0.99
10	15.27	12.88	15.18	10.55	0.98
11	13.55	12.73	13.93	8.39	0.97
12	15.37	13.08	15.15	9.71	0.99
13	15.70	14.27	15.33	10.21	1.00
14	14.75	13.93	14.89	8.96	0.99
				Average	**0.99**

Table 7: Comparison SDEA and ADEA

	2008		2009		2010	
DMUs	**SDEA**	**ADEA**	**SDEA**	**ADEA**	**SDEA**	**ADEA**
1	0.76	0.98	0.86	0.98	0.77	0.98
2	1.00	1.00	0.86	0.99	0.81	0.99
3	1.00	1.00	0.89	1.00	1.00	1.00
4	0.55	0.97	1.00	1.00	1.00	1.00
5	1.00	1.00	1.00	1.00	1.00	1.00
6	0.81	0.98	0.86	0.98	0.89	0.98
7	0.91	1.00	0.98	1.00	1.00	1.00
8	1.00	1.00	1.00	1.00	1.00	1.00
9	0.92	1.00	0.91	0.99	0.91	0.99
10	0.49	0.95	0.50	0.96	0.75	0.98
11	0.26	0.90	0.45	0.94	0.71	0.97
12	0.96	1.00	1.00	0.99	0.93	0.99
13	1.00	1.00	1.00	1.00	1.00	1.00
14	1.00	1.00	0.90	0.99	0.93	0.99
AVG	**0.83**	**0.98**	**0.87**	**0.99**	**0.91**	**0.99**
Summary of Parametric and Non-Parametric Tests						
ANOVA	129.476	.000	43.852	.000	19.270	.000
Independent Samples Test	-2.375	.033	-2.402	.032	-2.949	.011
Mann-Whitney Test	-1.848	.065	-1.901	.057	-1.535	.125
Two-Sample Kolmogorov-Smirrnov	1.134	.153	1.512	.021	1.512	.021
Note: SDEA = Standard DEA approach, ADEA = Alternative DEA approach						

Table 7 present the comparison between using DEA and ADEA. The results show that by applying the new approach, the level of efficiency is relatively higher. This supports the findings by Shirvani et al (2011). Three banks in the sample i.e. Banks 5, 8 and 13 were efficient under both approaches. We also apply the parametric and non-parametric test to test whether there are any significant differences using the two methods. The results show that as an overall, there is a significant difference using the two methods. In other words, our results show that using the alternative method relatively produces lower level of inefficiency.

5. Conclusions and Future Research

This paper has discussed the comparison between the standard approach of DEA and the alternative approach ADEA in estimating the efficiency of Malaysian Islamic commercial banks for 2008 to 2010. In this approach, instead of using he linear

averages of the input and outputs to estimate the efficiency, we use the non-linear averages of the inputs and outputs.

Our results show that the estimated inefficiency score using the alternative approach are relatively smaller than those using the standard DEA approach. Our study is consistent to that found by Shirvani et al (2011). This implied that, further research should be carried out perhaps in other banking markets to support these findings.

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Appendix 1

Local Islamic banks:

Affin Islamic Bank Bhd,
Alliance Islamic Bank Bhd,
AmIslamic Bank Bhd,
Bank Islam Malaysia Bhd,
CIMB Islamic Bank Bhd,
EONCAP Islamic Bank Bhd,
Hong Leong Islamic Bank Bhd,
Public Islamic Bank Bhd,
RHB Islamic Bank Bhd

Foreign Islamic banks

Al Rajhi Banking & Invst. Corp. (M) Bhd,
Asian Finance Bank Bhd,
HSBCAmanah Malaysia Bhd,
Kuwait Finance House (Malaysia) Bhd,
OCBC Al-Amin Bank Bhd

KECEKAPAN TEKNIKAL TULEN PERBANKAN ISLAM: APLIKASI PRODUK PERKONGSIAN UNTUNG RUGI (PLS)

M.B.Nor-Fadzlin[1]
Nur Azura Sanusi[2]

Abstrak

Mudarabah dan Musyarakah merupakan konsep perkongsian untung rugi (PLS) yang berdaya tahan, iaitu hasil gabungan di antara ciri-ciri intrinsik kewangan Islam yang kukuh dan pelaksanaan piawai dan amalan pengurusan risiko berhemat. Sehubungan itu, Mudarabah dan Musyarakah dijadikan sebagai salah satu saranan di bawah Pelan Induk Sektor Kewangan (PISK)bagi meningkatkan kecekapan sistem perbankan Islam di Malaysia. Justeru, dengan menggunakan *Data Envelopment Analysis* (DEA), kertas kerja ini mengkaji kecekapan teknikal tulen (PTE) perbankan Islam di Malaysia dengan mengaplikasi produk berkonsepkan PLS yang meliputi tempoh PISK(2003-2010). Selain itu, kajian ini berbeza dengan kajian-kajian yang lain kerana mengenengahkan penggunaan input dan output berkonsepkan PLS bagi mengenalpasti punca ketidakcekapan bank-bank Islam terpilih dan menganalisa skor kecekapan purata secara tahunan mengikut status pemilikan bank Islam. Hasil kajian mendapati sembilan bank Islam mencapai skorPTEsempurna sepanjang tempoh kajian. Manakala skorPTE bagi bank-bank Islam yang lain adalah memberangsangkannamun dikategorikan sebagai bank Islam yang tidak cekap. Walau bagaimanapun, bank-bank Islam tersebut berupaya meningkatkan tahap kecekapan jika mereka memperuntukkan sepenuhnya deposit PLS kepada pembiayaan dan pelaburan PLS. Secara perbandingan, skor purata tahunan PTE bagi bank Islam penuh asing adalah lebih tinggi berbanding bank Islam penuh domestik. Manakala skor purata PTEbagi subsidiari Islam domestik dan subsidiari Islam asing meningkat setiap tahun malah hampir menyamai skor purata PTEketika mereka beroperasi sebagai jendela Islam.

Kata kunci: kecekapan teknikal tulen, perkongsian untung rugi, perbankan Islam

1.0 Pengenalan

Sistem perbankan Islam di Malaysia telah beroperasi hampir tiga dekad sejak bank Islam pertama, Bank Islam Malaysia Berhad (BIMB) ditubuhkan pada tahun 1983. Bermula dengan penguasaan aset sebanyak RM0.3 bilion pada 1984 dan jumlah tersebut telah

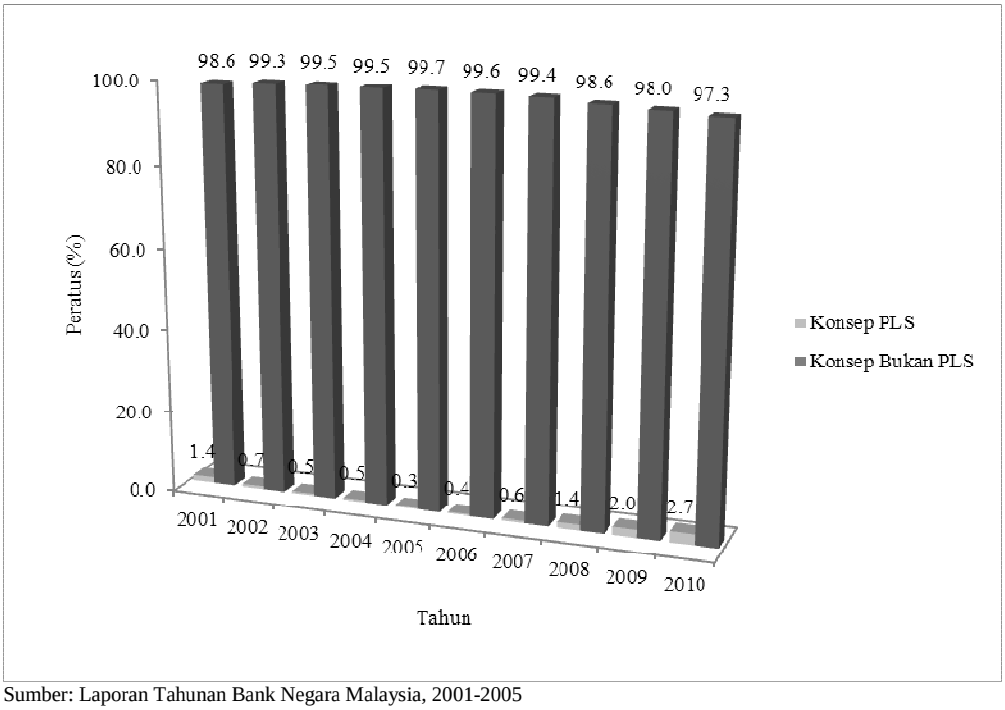
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meningkat kepada RM434.8 bilion pada 2011 (Laporan Kestabilan Kewangan dan Pembayaran, 2011). Aset perbankan Islam Malaysia turut mencapai sasaran Pelan Induk Sektor Kewangan[1] (PISK) pada 2010 dengan menguasai 20.7 peratus daripada juzuk pasaran perbankan negara (Laporan Kestabilan Kewangan dan Pembayaran, Bank Negara Malaysia, 2011). Malah di peringkat antarabangsa, Malaysia diiktiraf sebagai sistem perbankan Islam global pada tahun 2009 dan menduduki tangga ketiga di belakang Iran dan Arab Saudi (*Gateway to Asia: Malaysia, International Islamic Finance Hub*, 2010). Pencapaian-pencapaian ini mengukuhkan sistem perbankan Islam Malaysia untuk bergerak seiring dengan sistem perbankan konvensional.Kini, para peserta perbankan Islam bukan sahaja bersaing dengan peserta-peserta perbankan konvensional malah bersaing sesama peserta perbankan Islam. Terdapat 16 bank Islam yang diperbadankan di Malaysia, lima bank Islam antarabangsa dan 15 bank konvensional yang menyertai Skim Perbankan Islam (SPI) yang lebih dikenali sebagai jendela Islam.[2] Persekitaran persaingan tersebut turut melibatkan persaingan dari segi produk dan perkhidmatan yang ditawarkan.

Produk-produk perbankan Islam adalah berasaskan kepada dua konsep iaitu pertama, konsep perkongsian untung rugi (PLS) merujuk kepada Mudarabah dan Musyarakah. Kedua, konsep hutang seperti Al-Wadiah, Bai' Al-Inah, Bai Bithaman Ajil, Wakalah, Ijarah, Ijarah Thumma Al-Bai, Murabahah dan Istisna'. Walau bagaimanapun, realitinya bank-bank Islam lebih mengaplikasi konsep hutang berbanding konsep PLS terutama dalam pembiayaan (Aggarwal dan Yousef, 2000; Dar dan Presley, 2001). Berdasarkan Rajah 1, jumlah pembiayaan PLS mengalami penurunan pada fasa pertama PISK dan pertengahan fasa kedua PISK iaitu dari 1.4 peratus kepada 0.3 peratus daripada keseluruhan jumlah pembiayaan sistem perbankan Islam Malaysia. Kemudian,jumlah tersebut meningkat semula terutama pada akhir fasa ketiga PISK dengan mencatatkan 2.7 peratus. Namun, jumlah pembiayaan PLS di perbankan Islam Malaysia masih jauh ketinggalan jika dibandingkan dengan pembiayaan hutang.

Rajah 1: Peratusan Pembiayaan Perbankan Islam Malaysia Mengikut Konsep Sepanjang Tempoh Pelan Induk Sektor Kewangan (2001-2010)



Sumber: Laporan Tahunan Bank Negara Malaysia, 2001-2005
Buletin Statistik Bulanan, Bank Negara Malaysia, Disember 2011

Bagi memperkasakan instrumen PLS, melalui Saranan 5.7 di bawah PISK, pengendali perbankan Islam Malaysia adalah digalakkan untuk menggunakan pembiayaan Mudarabah dan Musyarakah. Galakan tersebutbukan sahaja berupaya memperdalamkan pasaran kewangan Islam[3]dalam usaha mempromosikan Malaysia sebagai hub kewangan Islam global bahkan dapat meningkatkan kecekapan perbankan Islam. Kecekapanadalah salah satu pendekatan untuk mengukur prestasi sistem perbankan (Isik dan Hassan, 2003). Bank mampu mencapai kecekapan melalui pengurangan kos, kepelbagaian produk melalui inovasi, penyediaan perkhidmatan terbaik kepada pelanggan, meluaskan asas para pelanggan untuk meminimumkan risiko dan mengekalkan pelanggan dengan menyediakan pulangan pelaburan yang maksimum atau pada kos pinjaman yang paling minimum (Rizvi, 2001). Meskipun secara teori konsep PLS adalah cekap (Dar dan Presley, 2000), namun tiada kajian empirikal yang menyokong kenyataan tersebut (Saaid, Rosly, Ibrahim dan Abdullah, 2003).

Di dalam *Data Envelopment Analysis* (DEA), kecekapan teknikal tulen (PTE) adalah salah satu komponen bagi mengukur kecekapan teknikal (TE) atau keseluruhan kecekapan teknikal (OTE). Kecekapan teknikal (TE) adalah berdasarkan andaian pulangan malar ikut skala (CRS), hanya sesuai jika firma-firma beroperasi pada tingkat skala yang optimum (Coelli, 1996).Manakala kecekapan teknikal tulen (PTE) yang diperkenalkan oleh Banker, Charnesdan Cooper (1984) adalah berdasarkan andaian pulangan berubah ikut skala (VRS).Oleh kerana industri perbankan Islam di Malaysia dilihat beroperasi kurang daripada skala optimum lantaran struktur pasaran persaingan yang tidak sempurna dan mengalami kekangan dari segi kewangan dan kawalan kerajaan(Batchelor dan Wadud, 2004), maka PTE adalah perlu bagi mengukur kecekapan industri perbankan Islam.Kecekapan teknikal tulen (PTE) yang merujuk kepada kecekapan pengurusan (Ahmad, Jusoh dan Rahman, 2012) menggambarkan kebolehan mengurus bagi memaksimumkan pengeluaran output pada sebarang tingkat input atau meminimunkan penggunaan input pada sebarang tingkat output. Skor PTE menunjukkan penambahbaikan amalan pengurusan yang boleh dicapai dalam jangka pendek di mana firma yang tidak cekap boleh melakukan eksperimen dengan menggabungkan input dan output baru melalui pemerhatian terhadap kecekapan operasi pesaing (Avkiran, 2000).

Justeru, dengan menggunakan *Data Envelopment Analysis* (DEA), kertas kerja ini mengukurPTEperbankan Islam di Malaysia dengan mengaplikasi produk berkonsepkan PLS yang meliputi tempoh PISK 2003-2010. Lebih menarik lagi, dengan penggunaan input dan output PLS, kajian ini dapat mengenalpasti punca ketidakcekapan bank-bank Islam terpilih dan menganalisa skor purata PTE secara tahunan mengikut status pemilikan (ownership) bank Islam.

Kertas kajian ini dimulakan dengan bahagian pengenalan yang menjelaskan tentang perkembangan dan pencapaian sistem perbankan Islam di Malaysia. Kemudian diikuti dengan kajian-kajian terdahulu mengenai konsep PLS dan kecekapan sistem perbankan Islam. Setelah itu, metod DEA dibincangkan di bahagian ketiga dengan menggunakan model BCC. Dapatankajian dan perbincangan mengisi bahagian keempat sebelum diakhiri dengan kesimpulan.

2.0 Sorotankajian Lepas

Secara teori, kecekapan konsepPLS adalah berdasarkan ciri-ciri intrinsik kewangan Islam yang dibentuk berdasarkan prinsip Syariah. Perkongsian untung rugi (PLS) mempunyai dua matlamat iaitu pertama, memberi keadilan dan kesaksamaan (Schaik, 2001). Keadilan dan kesaksamaan tercapai apabila kewangan Islam dilarang mengamalkan riba, gharar (spekulasi), dan maisir. Kedua, asas urus niaga kewangan Islam adalah berdasarkan aktiviti produktif yang dapat mewujudkan aliran kewangan yang produktif (Siddiqui, 2010). Di bawah konsep PLS, aktiviti sebenar dapat menjana pulangan yang mencukupibagi menampung risiko. Injunksi Syariah melarang leveraj atau umpilan yang berlebihan dan penglibatan dalam sebarang aktiviti kewangan spekulasi. Aktiviti ekonomi sebenar juga perlu menyokong urus niaga kewangan Islam agar dapat menghasilkan keuntungan yang halal. Untuk memperoleh keuntungan yang halal, bank Islam perlu memperuntukkan risiko secara optimum dengan memastikan dana disalurkan secara cekap dengan membiayai aktiviti ekonomi produktif, melindungi sistem kewangan Islam daripada aktiviti pemberian pinjaman yang berlebihan, pengambilan risiko secara tidak berhemat dan aktiviti-aktiviti spekulasi. Oleh itu, prinsip intrinsik perkongsian keuntungan dan risiko menyediakan kaedah sekatan dan imbangan dalaman (check and balance) terhadap urus niaga kewangan Islam (Aziz, 2008).

Adapun begitu, ketahanan kontrak perkongsian untung rugi boleh tergugat lantaran berdepan dengan risiko kredit akibat konflik agensi, *moral hazard* dan *adverse selection* (Sanusi, 2002). Kos agensi timbul akibat maklumat tak simetri dan kos transaksi yang tinggi (Sarker, 2000) apabila pengusaha mengutamakan faedah peribadi (Bacha, 1995). Pengusaha yang tidak beretika dan tidak bersikap jujur menyebabkan modal yang dibekalkan oleh pemilik modal tidak digunakan secara cekap. Maka, bagi mengatasi masalah tersebut, bank-bank Islam perlu mengoptimumkan kontrak melalui amalan pengurusan risiko yang kukuh dan pemantauan yang berterusan dari segi ketelusan dan penzahiran.

Gabungan ciri-ciri intrinsik kewangan Islam yang kukuh dan diperteguhkan dengan pelaksanaan piawai dan amalan pengurusan risiko berhemat bagi mendisiplinkan peserta-

peserta industri perbankan Islam dapat menjadikan konsepPLS berdaya tahan sekaligus berupaya meningkatkan kecekapan(Aziz, 2008). Menurut Hassan (2009), pembiayaan Mudarabah dan Musyarakah mampu menjadikan sistem kewangan Islam sebagai satu model kewangan yang kukuh dan bebas daripada model perbankan konvensional. Kedua-dua pembiayaan tersebut mampu memelihara kestabilan sistem kewangan dengan menjadikan sektor perbankan Islam lebih berdaya tahan terutama ketika berlaku krisis kewangan (Hasan dan Dridi, 2010). Krisis kewangan yang melanda Amerika Syarikat pada 2008-2009 telah membuka peluang yang luas kepada sektor kewangan Islam sebagai salah satu alternatif penting kepada krisis kewangan global dan sebagai pilihan utama kaedah pemulihan ekonomi global (Ahmad, Noor dan Sufian 2010).Walaupun krisis kewangan global mengakibatkan beberapa institusi kewangan konvensional merudum, namun sistem kewangan Islam masih mampu mencatatkan pertumbuhan positif. Aset kewangan Islam global dijangka meningkat kepada USD1.6 trilion pada 2012 dan dijangka mampu lebih maju dalam pasaran kewangan antarabangsa dengan cirinya yang tersendiri berbanding sistem kewangan konvensional (Bank Negara Malaysia, 2009). Di samping itu, Maurice Allais seorang pakar ekonomi Perancis menyatakan bahawa cara yang terbaik untuk mengatasi krisis kewangan adalah dengan memperbaharui struktur dengan menyelaraskan kadar faedah kepada sifar (Kayed dan Hassan, 2011). Cadangan tersebut jelas menyamai prinsip kewangan Islam yang mengharamkan faedah atau riba malah diberi alternatif dengan menekankan konsep PLS.

Mutakhir ini, kajian mengenai kecekapan sistem perbankan Islam Malaysia mula menarik perhatian para penyelidik. Bermula dengan Samad (1999) sebagai pelopor kajian kecekapan perbankan Islam di Malaysia, menjalankan kajian kecekapan Bank Islam Malaysia Berhad (BIMB) dan membandingkan dengan bank-bank konvensional. Begitu juga kajian Samad dan Hassan (2000) dan Rosly dan Abu Bakar (2003), sebagai kumpulan pertama yang mengkaji kecekapan perbankan Islam di Malaysia dengan menggunakan nisbah kewangan. Kumpulan kedua turut mengkaji kecekapan perbankan Islam namun menggunakan pelbagai pendekatan analisis sempadan (frontier analysis approach) sama ada pendekatan parametrik seperti *Stochastic Frontier Analysis* (SFA) dan pendekatan bukan parametrik seperti*Data Envelopment Analysis* (DEA). Walau bagaimanapun, kumpulan ini boleh dikelaskan kepada tiga tumpuan kajian.

Tumpuan pertama memberi fokus kepada menilai kecekapan bank-bank Islam di Malaysia. Batchelor dan Wadud (2004) menggunakan pendekatan *Data Envelopment Analysis* (DEA) bagi mengkaji kecekapan teknikal (TE) dan kecekapan skala (SE) perbankan Islam Malaysia. Secara keseluruhan, tahap kecekapan perbankan Islam meningkat sepanjang tempoh 1997-2002. Meskipun begitu,PTE secara purata menurun pada 1998 berbanding tahun sebelum ekoran kesan krisis kewangan Asia tetapi kembali meningkatmelebihi90 peratus pada 2002. Kajian Sufian (2006) pula menunjukkan TEperbankan Islam Malaysia bagi tempoh 2001-2004 adalah pada tahap 80 peratus dengan mencatatkan skor PTE yang lebih tinggi. Jika dianalisis dari segi pemilikan, tahap TE jendela Islam domestik dan bank Islam penuh (full-fledge)adalah lebih tinggi berbanding jendela Islam asing. Walau bagaimanapun, PTE jendela Islam domestik dan bank Islam penuh adalah rendah. Ini bermakna jendela Islam domestikdan bank Islam penuh adalahtidak cekap dalam pengurusan kawalan kos.

Selain melihat kesan status pemilikan bank Islam, kesan kemasukan bank asing (foreign bank entry) juga memberi pengaruh terhadap kecekapan perbankan Islam di Malaysia. Kajian Sufian dan Habibullah (2010) mendapati tahap kecekapan perbankan Islam Malaysia menurun sejak tahun 2006 lantarankemasukan bank Islam de novo (Kuwait Finance House (Malaysia) Berhad, Asian Finance Bank Berhad dan Al Rajhi Banking & Investment Corporation (Malaysia) Berhad).Meskipun begitu, bank Islam domestik secara relatif adalah lebih cekap berbanding bank Islam asing dan bank Islam de novo. Sebagaimana kajian Sufian (2006), secara purata PTE bank Islam domestik dan bank Islam de novo juga rendah, makasecara relatifnya adalah tidak cekap dalam mengurus kawalan kos operasi mereka. Kajian Torabi dan Amroabadi (2011) memberi dapatan yang berbeza iaitu kecekapan BIMB meningkat bagi tempoh 1997-2008 dan menyokong kemasukan bank asing yang dapat memberi impak positif. Turut menyarankan agar jendela Islam mentransformasikan operasi perbankan Islam kepada subsidiari Islam bagi meningkatkan tahap kecekapan.

Tumpuan kedua mengkaji pembandingan kecekapan di antara bank-bank Islam dan bank-bank konvensional. Kajian Majid, Md Nor dan Said (2003) yang melibatkan tempoh 1993-2000 menunjukkan tahap kecekapan perbankan Islam menyamai tahap kecekapan

perbankan konvensional. Walau bagaimanapun, kajian oleh Mokhtar, Abdullah dan Alhabshi (2006) yang turut menggunakan pendekatan *Stochastic Frontier Analysis* (SFA) mendapati kesan yang sebaliknya berlaku iaitu kecekapan keseluruhan industri perbankan Islam Malaysia meningkat manakala perbankan konvensional kekal stabil di sepanjang tempoh 1997-2003. Adapun begitu, tahap kecekapan perbankan Islam masih rendah berbanding perbankan konvensional.

Tumpuan ketiga berkaitan analisis perbandingan di antara negara iaitu membandingkan kecekapan perbankan Islam Malaysia dengan negara-negara Islam lain seperti ASEAN, Pertubuhan Persidangan Islam (OIC), Timur Tengah dan Afrika Utara (MENA) dan Majlis Kerjasama Negara Teluk (GCC). Ascarya dan Yumanita (2008) membandingkan kecekapan perbankan Islam Malaysia dan Indonesia bagi tempoh 2002-2005 dengan mengaplikasi pendekatan *Data Envelopment Analysis* (DEA). Didapati perbankan Islam Indonesia adalah lebih cekap berbanding perbankan Islam di Malaysia. Secara terperinci, PTE perbankan Islam di Malaysia lebih rendah berbanding perbankan Islam Indonesia. Seperti yang disarankan oleh Torabi dan Amroabadi (2011), Ascarya dan Yumanita (2008) juga menyatakan bahawa kecekapan jendela Islam di Malaysia dapat ditingkatkan jika berubah status kepada subsidiari Islam sebagaimana yang dilaksanakan di Indonesia.

Yudistira (2004) pula mendapati perbankan Islam di negara-negara Timur Tengah bagi 1997-2000 adalah kurang cekap berbanding perbankan Islam di negara lain yang dianggap masih baru dan mendapat galakan dan sokongan kerajaan. Adapun begitu, ketidakcekapan bagi keseluruhan industri perbankan di 12 negara adalah kecil iaitu sekitar 10 peratus. Bank-bank Islam yang bersaiz kecil dan sederhana juga disarankan bergabung dan diambilalih memandangkan ia beroperasi di dalam disekonomi bidangan. Selain itu, kajian yang sama turut mendapati krisis kewangan yang melanda Asia pada 1997-1998 menyebabkan kecekapan perbankan Islam merosot namun kembali meningkat selepas krisis. Tahap ketidakcekapan perbankan Islam pada tahun 1998 dipengaruhi oleh skor PTE yang rendah. Keadaan yang sama ditemui dalam kajian Sufian dan Noor (2009) iaitu sepanjang tempoh 2001-2006 didapati PTE yang rendah adalah penyumbang kepada ketidakcekapan perbankan Islam negara-negara di Timur Tengah dan Afrika Utara (MENA) dan Asia. Walau bagaimanapun,TE perbankan Islam negara-negara MENA

adalah lebih cekap berbanding negara-negara di Asia. Keadaan tersebut dipengaruhi oleh dua faktor iaitu juzuk pasaran yang kecil dan nisbah pembiayaan tidak berbayar yang rendah. Manakala Ahmad dan Noor (2011) mengkaji dengan lebih meluas dengan menganalisa perbandingan kecekapan perbankan Islam bagi 25 negara. Didapati, PTEperbankan Islam di negara-negara tersebut meningkat bagi tempoh 1992-2009. Kajian tersebut turut mendapati kecekapan perbankan Islam dunia meningkat walaupun ketika dilanda krisis kewangan global pada 2008. Menurut Ahmad dan Noor (2011), perbankan Islam telah mengambil langkah persedian yang mencukupi semasa krisis kewangan global 2008 setelah mengalami penurunan tahap kecekapan akibat krisis kewangan Asia pada 1997-1998.

Meskipun banyak kajian empirikal dibuat bagi mengukur kecekapan perbankan Islam berdasarkan kesan persaingan, status pemilikan, saiz, krisis ekonomi dan kemasukan bank asing, namun kajian empirikal bagi mengukur kecekapan perbankan Islam berdasarkan produk PLSadalah masih kurang berbanding kajian teori. Samad (1999) yang mengkaji kecekapan BIMB dengan menggunakan nisbah kewangan, mendapati BIMB adalah cekap dari segi pemulihan pembiayaan iaitu BIMB berkebolehanuntuk mendapatkan semula bayaran pembiayaan. Keadaan tersebut berlaku disebabkan oleh tiga faktor, salah satunya adalah BIMB terlibat dengan pembiayaan PLS. Walau bagaimanapun, didapati peratus pembiayaan PLS tersebut adalah kecil berbanding keseluruhan pembiayaan BIMB. Samad dan Hassan (2000) pula melakukan analisis data primer terhadap BIMB dan mendapati punca utama produk PLS tidak popular di Malaysia adalah disebabkan staf bank kurang berpengetahuan dalam pemilihan, penilaian dan pengurusan projek PLS yang boleh menguntungkan. Rosly dan Abu Bakar (2003) pula menyarankan agar perbankan Islam di Malaysia perlu kembali kepada etika perbankan Syariah melalui pelaksanaan konsep PLS bagi mencapai kecekapan.

Saaid et al. (2003) dan Ahmed (2005) mengkaji kecekapan sistem perbankan Islam di Sudan. Sistem perbankan Islam di Sudan berbeza dengan Malaysia, iaitu banyak mempraktikkan pembiayaan PLS. Saaid et al. (2003) mendapati bank-bank Islam di Sudan adalah tidak cekap dari segi penggunaan input. Begitu juga kajianAhmed (2005), dengan menggunakan nisbah kewangan didapati prestasi perbankan yang mengamalkan

konsep Musyarakah adalah tidak memberangsangkan kerana keuntungan yang diperolehi adalah rendah padahal terpaksa menanggung risiko yang tinggi. Sepertimana penemuan Samad dan Hassan (2000), masalah tersebut berlaku ekoran kekurangan pengetahuan di kalangan staf bank yang mengendali projek PLS. Oleh itu, kajian tersebut mencadangkan agar staf-staf bank tersebut mengambil kursus kemahiran di samping menambah baik kontrak PLS bagi meminimumkan risiko.

Sugema, Bakhtiar dan Effendi (2010) yang menggunakan pendekatan *Standard Error of Distribution* dan Nisbah Koefisien Gini, mendapati bahawa konsep PLS adalah cekap sebagaimana sistem yang mengamalkan faedah. Namun, apabila berlaku kejutan di dalam produktiviti, didapati hanya konsep PLS yang mampu bertahan kerana berkongsi risiko. Khaldi dan Hamdouni (2011) pula menjalankan kajian di Arab Saudi dengan menggunakan empat model iaitu (1)Liabiliti: Deposit Mudarabah; Aset: Pembiayaan Mudarabah, (2)Liabiliti: Deposit Mudarabah; Aset: Pembiayaan Musyarakah, (3)Liabiliti: Deposit Mudarabah; Aset: Pembiayaan Hutang (Murabahah, Salam, Ijarah, Istisna') dan (4)Liabiliti: Deposit Mudarabah; Aset: Mutajarah. Meskipun Model 3 sering dipraktikkan, namun hasil keputusan mendapati Model 1 adalah lebih cekap.

3.0 Metodologi

Data Envelopment Analysis (DEA) yang dibangunkan oleh Charnes, Cooper dan Rhodes (1978), adalah metod yang sering digunakan bagi mengukur tahap prestasi unit pembuat keputusan (DMU). Pendekatan ini banyak diaplikasi dalam pelbagai sektor termasuk perbankan Islam.*Data Envelopment Analysis* (DEA) merupakan analisis bukan parametrik yang menggunakan teknik linear yang menggabungkan pelbagai input dan output bagi mengukur kecekapan dengan mengenengahkan sistem skor relatif. Maka, kajian ini akan menggunakan pendekatan DEA bagi mengukur tahap PTE perbankan Islam Malaysia berdasarkan input dan output yang telah dikenalpasti. Dalam konteks kajian ini, pendekatan perantaraan (intermediation approach) digunakan kerana bank-bank Islam berperanan sebagai pihak yang mengumpulkan dana dari pihak terlebih dana

(pendeposit) dan menyalurkan dana tersebut kepada pihak yang terkurang dana (peminjam) untuk pembiayaan projek dan pelaburan.

Charnes, Cooper dan Rhodes (1978) memperkenalkan satu pengukur kecekapan DMU yang berorientasikan output iaitu nisbah maksimum pemberat input terhadap pemberat output (Cooper, Seiford dan Zhu, 2004). Versi asal ini lebih dikenali sebagai model CCR berdasarkan andaian pulangan malar ikut skala (CRS). Ia juga dikenali sebagai keseluruhan kecekapan teknikal (OTE) atau kecekapan teknikal CRS (TE_{CRS}) iaitu:

$$\min h_0(v,u) = \frac{\sum_{i=1}^{m} v_i x_{i0}}{\sum_{r=1}^{s} u_r y_{r0}}$$

tertakluk kepada

$$\frac{\sum_{i=1}^{m} v_i x_{ij}}{\sum_{r=1}^{s} u_r y_{rj}} \geq 1 \qquad j = 1, \ldots, n \qquad [1]$$

$$u_r, v_i \geq 0, \quad \forall i, r$$

di mana x_{ij} = jumlah input i yang digunakan oleh DMUj ($x_{ij} > 0, i = 1,2,\ldots,m,\ j = 1,2,\ldots,n$) dan y_{rj} = jumlah output r yang dikeluarkan oleh DMUj ($y_{rj} > 0, r = 1,2,\ldots,s,\ j = 1,2,\ldots,n$) . Pemboleh ubah u_r dan v_i adalah pemberat output r yang dihasilkan oleh DMUj dan pemberat input i yang diberikan oleh DMUj. Walau bagaimanapun, sekiranya model CCR ditambah syarat *convexity* pada pemberat λ_j

$$\sum_{j=1}^{n} \lambda_j = 1 \qquad [2]$$

Maka terhasil pulangan berubah ikut skala (VRS) yang dikenali sebagai model BCC (Banker, Charnesdan Cooper, 1984). Skorkecekapan BCC dikenali sebagai skor kecekapan teknikal tulen (PTE) atau kecekapan teknikal VRS (TE_{VRS}) (Cooper et al, 2000).Dengan andaian VRS, OTE terbahagi kepada dua komponen iaitu kecekapan teknikal tulen (PTE) dan skala kecekapan (SE)

$$OTE = PTE \times SE = TE_{CRS} = TE_{VRS} \times SE$$

Oleh itu, model BCC yang berorientasikan output adalah seperti berikut

$$\emptyset^* = \max \emptyset$$

tertakluk kepada

$$\sum_{j=1}^{n} x_{ij}\lambda_j \leq x_{i0} \qquad i = 1,2,\dots,m; \qquad [3]$$

$$\sum_{j=1}^{n} y_{rj}\lambda_j \geq \emptyset y_{r0} \qquad r = 1,2,\dots,s;$$

$$\sum_{j=1}^{n} \lambda_j = 1$$

$$\lambda_j \geq 0 \qquad j = 1,2,\dots,n.$$

Penyelesaian optimal $\emptyset$ merujuk kepada skor kecekapan yang turut dikenali sebagai PTEbagi semua DMU_j yang berorientasikan output. Nilai $\emptyset$ sentiasa kurang daripada satu atau bersamaan satu. DMU yang mempunyai $\emptyset < 1$adalah secara relatifnya tidak cekap sebaliknya $\emptyset = 1$ dikatakan DMU tersebut adalah cekap dari segi mengurus. Sehubungan itu, kajian ini menggunakan model BCC yang berorientasikan output dengan andaian input adalah tetap.Oleh yang demikian, input yang dikenal pasti dalam kajian ini adalah (1) deposit berasaskan konsep PLS dan (2) deposit berasaskan konsep bukan PLS. Manakala output adalah (1) pembiayaan berasaskan konsep PLS, (2) pembiayaan berasaskan konsep bukan PLS, (3) pelaburan berasaskan konsep PLS dan (4) pelaburan berasaskan konsep bukan PLS.

Kajian ini menggunakan data sekunder yang diperolehi dari laporan tahunan setiap bank Islam yang terpilih bagi tempoh 2003-2010. Jadual 1 memaparkan senarai bank-bank Islam yang terlibat.

JADUAL 1: Senarai Sampel Bank Islam

Kategori Bank Islam	
Bank Islam Penuh (Full-Fledged) Domestik	
1. Bank Islam Malaysia Berhad	
2. Bank Muamalat Malaysia Berhad	
Bank Islam Penuh (Full-Fledged) Asing	
1. Kuwait Finance House (Malaysia) Berhad,	
2. Asian Finance Bank Berhad	
3. Al Rajhi Banking Investment Corporation (Malaysia) Berhad	
Subsidiari Islam Domestik	
1. Affin Islamic Bank Berhad	6. EONCAP Islamic Bank
2. Public Islamic Bank Berhad	7. Hong Leong Islamic Bank Berhad
3. AmIslamic Bank Berhad	8. Maybank Islamic Berhad
4. CIMB Islamic Bank Berhad	9. RHB Islamic Bank Berhad
5. Alliance Islamic Bank Berhad	
Subsidiari Islam Asing	
1. HSBC Amanah Malaysia Berhad	
2. Standard Chartered Saadiq Berhad	
3. OCBC Al-Amin Bank Berhad	
Jendela Islam	
1. Citibank Berhad	

4.0 Dapatan Kajian Dan Perbincangan

Jadual 2 menunjukkan skor PTEbagi bank-bank Islam di Malaysia yang meliputi tempoh PISK(2003-2010). Kecekapan teknikal tulen (PTE)bagi perbankan Islam Malaysia secara purata adalah pada tahap yang membanggakanwalaupun mengalami trend turun naikdi sepanjang lapan tahun tempoh kajian.Meskipun begitu, didapati kesemua bank Islam adalah cekap pada tahun 2004. Jika dianalisis mengikut bank, didapati sembilan bank Islam mencapai tahap PTEsempurna yang terdiri daripadasebuah bank Islam penuh domestik,empat subsidiari Islam domestik, sebuah subsidiari Islam asing, dua bank Islam penuh asing dan sebuah jendela Islam. Manakala,sembilan bank Islam yang lain mencatatkan skor puratadi antara 0.989 sehingga 0.816, menunjukkan bahawa bank-bank Islam tersebut adalah tidak cekap dari segi pengawalan kos operasi. Menariknya di sini, krisis kewangan global memberi kesan kepada skor PTE bagi OCBC Al-Amin dan Standard Chartered Saadiq dengan mencatatkan masing-masing pada 0.707 dan 0.423 pada tahun 2008. Situasi ini menggambarkan kedua-dua subsidiari Islam asing ini berdepan dengan masalah penambahbaikan amalan pengurusan memandangkan dolar Amerika mendasari operasi kewangan mereka.

Adapun demikian, sembilan bank Islam yang tidakcekap dapat dianalisa melalui hasil perbezaan nilai sebenar dan nilai unjuran seperti yang ditunjukkan di dalam Jadual 3. Nilai sebenar merujuk kepada pencapaian sebenar yang diperolehi bank bagi setiap tahun manakala nilai unjuran merujuk kepada nilai yang dianggar menurut cadangan DEA. Dengan andaian memaksimumkan output, didapati bank-bank Islam terbabit tidak memperuntukkan sepenuhnya deposit PLS kepada pembiayaan PLS (499.90 – 999.90 peratus) dan pelaburan PLS (7.33 – 122.33 peratus). Oleh itu, bank Islam perlu menyalurkan deposit PLS secara optimum kepada pembiayaan dan pelaburan PLS.

JADUAL 2: Keputusan Skor Kecekapan Teknikal Tulen DEA
Bagi Semua Bank Islam, 2003-2010

DMU	2003	2004	2005	2006	2007	2008	2009	2010	**Purata Mengikut Bank**
BIMB	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	**1.000**
Muamalat	1.000	1.000	0.851	0.968	1.000	0.943	0.696	0.807	**0.908**
Affin Islamic Bank	1.000	1.000	0.968	0.470	0.609	1.000	0.704	0.923	**0.834**
AmIslamic Bank	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	**1.000**
Hong Leong Islamic Bank	1.000	1.000	1.000	1.000	1.000	1.000	0.955	0.751	**0.963**
Maybank Islamic	1.000	1.000	1.000	1.000	1.000	1.000	1.000	1.000	**1.000**
RHB Islamic Bank	0.845	1.000	0.626	0.970	0.823	0.926	1.000	1.000	**0.899**
OCBC Al-Amin	1.000	1.000	1.000	1.000	0.890	0.707	0.683	1.000	**0.910**
Public Islamic Bank		1.000	1.000	1.000	1.000	1.000	1.000	1.000	**1.000**
EONCAP Islamic Bank		1.000	1.000	0.983	1.000	1.000	0.817	0.948	**0.964**
HSBC Amanah		1.000	1.000	1.000	1.000	1.000	1.000	1.000	**1.000**
CIMB Islamic Bank			1.000	1.000	0.932	1.000	1.000	1.000	**0.989**
Standard Chartered Saadiq			1.000	0.556	1.000	0.423	0.919	1.000	**0.816**
Alliance Islamic Bank				1.000	1.000	1.000	1.000	1.000	**1.000**
Citibank				1.000	1.000	1.000	1.000	1.000	**1.000**
Kuwait Finance House				1.000	1.000	1.000	1.000	1.000	**1.000**
Al-Rajhi Bank					0.866	1.000	0.917	1.000	**0.946**
Asian Finance Bank					1.000	1.000	1.000	1.000	**1.000**
Purata Tahunan	**0.981**	**1.000**	**0.957**	**0.934**	**0.951**	**0.944**	**0.927**	**0.968**	

JADUAL 3: Purata Unjuran Keputusan DEA (%)

DMU	Pembiayaan PLS	Pembiayaan Bukan PLS	Pelaburan PLS	Pelaburan Bukan PLS
Muamalat	644.29	63.24	18.87	49.59
Affin Islamic Bank	799.92	74.09	46.07	57.08
Hong Leong Islamic Bank	499.95	77.90	18.92	72.13
RHB Islamic Bank	799.92	32.23	22.12	63.51
CIMB Islamic Bank	0.00	99.84	7.33	85.95
EONCAP Islamic Bank	666.60	9.86	17.98	98.42
Standard Chartered Saadiq	666.60	99.59	94.89	93.59
OCBC Al-Amin	999.90	53.18	122.33	120.82
Al-Rajhi Bank	499.95	12.25	102.00	140.31

Jadual 4 dan Jadual 5 menunjukkan perbandingan skor PTE purata secara tahunan mengikut status pemilikan bank Islam. Berdasarkan Jadual 4, bank Islam penuh domestik (Panel A)iaitu BIMB dan Muamalat menunjukkan purata PTEsebanyak95.4 peratus. Ini bermakna, purata input yang dibazirkan adalah 4.6 peratus. Dengan kata lain, bank Islam penuh domestik boleh mengeluarkan jumlah output yang sama hanya dengan 95.4 daripada jumlah input yang digunakannya sekarang. Selanjutnya, jika dibandingkan Panel A dan Panel B, didapati purata PTE bank Islam penuh asing adalah lebih tinggi berbanding bank Islam penuh domestikbagi tempoh 2006-2010. Ini menunjukkan bahawa bank-bank Islam penuh asing yang berpengalaman dari Timur Tengah ini lebih menekankan produk-produk PLS berbanding produk-produk berasaskan hutang.

JADUAL 4: Ringkasan Statistik Skor Kecekapan Teknikal Tulen2003-2010

Panel A: Bank Islam Penuh Domestik	Bil. Bank	PTE
2003	2	1.000
2004	2	1.000
2005	2	0.926
2006	2	0.984
2007	2	1.000
2008	2	0.972
2009	2	0.848
2010	2	0.904
Min		0.954
Sisihan Piawai		0.056
Panel B: Bank Islam Penuh Asing	**Bil. Bank**	**PTE**
2003		
2004		
2005		
2006	1	1.000
2007	3	0.955
2008	3	1.000
2009	3	0.972
2010	3	1.000
Min		0.985
Sisihan Piawai		0.021

Panel I dan Panel II dalam Jadual 5 pula menunjukkan purata PTE bagi subsidiari Islam domestik dan subsidiari Islam asing. Berdasarkan Panel I, purata PTEsubsidiari Islam domestik di sepanjang pelaksanaanPISKdidapati semakin meningkat malah hampir menyamai purata PTE ketika mereka beroperasi sebagai jendela Islam. Situasi yang sama turut dialami oleh subsidiari Islam asing di Panel II, bermakna program tranformasi operasi jendela Islam kepada subsidiari Islam berjaya meningkatkan tahap kecekapan bank-bank Islam terbabit.

JADUAL 5: Ringkasan Statistik Skor Kecekapan Teknikal Tulen Subsidiari Islam Domestik dan Asing (Transformasi Operasi Jendela Islam Kepada Subsidiari Islam) 2003-2010

Panel I: Subsidiari Islam Domestik	Bil. Bank	PTE (Jendela Islam)	Bil. Bank	PTE (Subsidiari Islam)
2003	5	0.969		
2004	7	1.000		
2005	6	0.995	2	0.813
2006	4	1.000	5	0.885
2007	4	1.000	5	0.873
2008			9	0.991
2009			9	0.935
2010			9	0.953
Min		0.993		0.908
Sisihan Piawai		0.013		0.064
Panel II: Subsidiari Islam Asing	**Bil. Bank**	**PTE (Jendela Islam)**	**Bil. Bank**	**PTE (Subsidiari Islam)**
2003	1	1.000		
2004	2	1.000		
2005	3	1.000		
2006	3	0.852		
2007	3	0.963		
2008			3	0.875
2009			3	0.894
2010			3	0.939
Min		0.963		0.903
Sisihan Piawai		0.064		0.033

5.0 Kesimpulan

Berdasarkan hasil kajian, dibuktikan bahawa bank yang beroperasi dengan cekap telah memperuntukkan sepenuhnya deposit berkonsepkan PLS kepada pembiayaan dan pelaburan yang juga berkonsepkan PLS. Lantaran itu, disarankan kepada pengendali perbankan Islam yang tidak cekap agar menyalurkan sepenuhnya deposit PLS mereka kepada pembiayaan dan pelaburan PLS agar dapat meningkatkan tahap kecekapan mereka. Adalah dicadangkan agar institusi perbankan Islam menubuhkan dana khas atau anak syarikat bagi mengendalikan pembiayaan PLS di samping melakukan kajian bagi mengenal pasti bidang-bidang yang berpotensi untuk dilaksanakan pembiayaan tersebut

(Pelan Induk Sektor Kewangan, 2011). Selain itu, staf-staf bank yang terlibat perlu mengikuti kursus dan latihan agar lebih berpengetahuan dan mempunyai kepakaran untuk mengendalikan projek-projek PLS. Secara keseluruhannya, dapatan kajian ini membuktikan konsep PLS bukan sahaja berupaya menperdalamkan pasaran kewangan Islam malah dapat meningkatkan kecekapan perbankan Islam negara.

Nota Akhir

1. Pelan Induk Sektor Kewangan (PISK) dilancarkan pada Mac 2001, merupakan hala tuju sistem kewangan Malaysia bagi tempoh 2001-2010. Pelan Induk Sektor Kewangan (PISK) bermatlamat untuk mewujudkan satu sistem kewangan Islam yang cekap, progresif dan lengkap agar dapat memberi sumbangan kepada kecekapan dan keberkesanan sektor kewangan Malaysia serta memenuhi keperluan ekonomi negara.

2.Rujukhttp://www.mifc.com/index.php?ch=menu_know_ibt_ib&pg=menu_know_ibt_ib_list

3. Pelan Induk Sektor Kewangan, 2001, m/s 83

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THE LIMITATION OF OWNERSHIP'S RIGHT IN SUKUK SIMPANAN RAKYAT 2009: FROM SHARIAH PERSPECTIVE

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Abstract

Sukuk has developed as one of the most significant financing mechanism through Islamically acceptable structures. The Sukuk mechanism which has been adopted from the conventional bond system after removing the prohibited activities in order to comply with the Shariah needs has witnessed exponential growth since 2002. Malaysia as a sukuk market leader in ASEAN and one of the largest globally in sukuk issuance represents 73 per cent of total sukuk issued in the world. In 2009, Ministry of Finance Malaysia announced the issuance of Sukuk Simpanan Rakyat 2009 (SSR 2009) amounting RM2.5 billion, whereby Bank Negara Malaysia (BNM) acted as issuer on behalf of Malaysian Government. However, non-transferable and non-assignable criteria of the sukuk have triggered several questions on the ownership's right from Muslim jurists. The objective of this paper is to explore the ownership's right issues based on SSR 2009 from the perspective of Muamalat. The methodology of study in this paper is through qualitative research which combines documents analysis of Muslim jurists' views and opinions regarding this matter as well as interviews with relevant authorities. This study is expected to bring the readers in understanding the tolerance in Muamalat by harmonizing various opinions of Muslim jurists with the sukuk's structure as a new mechanism to stimulate liquidity in Islamic capital market. Eventually, the confidence of stakeholders could be increased by witnessing the comprehensive structure of sukuk parallel with the Shariah's rules and regulations after gratify with the principle of ownership that implemented in the sukuk.

Keyword: Sukuk, Sukuk Simpanan Rakyat 2009, Ownership's Right.

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1. INTRODUCTION

On May 2009, Bank Negara Malaysia (BNM) on behalf of Malaysian Government has issued Sukuk Simpanan Rakyat 01/2009 amounting to RM2.5 billion. This is the first issue of the two series of 3-year RM2.5 billion sukuk each in 2009. The sukuk, which will be scripless and based on Shariah principles, is an additional investment instrument for Malaysian citizens who are 21 years and above. The RM2.5 billion sukuk, which has 3-year tenure, offers a return of 5% per annum and provides the flexibility for early redemption before the maturity date.

Different with Sukuk 1 Malaysia 2010 which issued one year later, Sukuk Simpanan Rakyat 2009 is non-negotiable, non-transferable and non-assignable which effected the philosophy in Islamic ownership when allows the holder or owner to sell or transfer the ownership of the subject to eligible person or party. The problem of ownership always rises from asset based sukuk compare to other type of sukuk, asset backed sukuk which is operated closer to spirit and guidance of shariah principles in transaction[4]. This policy could create a view to stakeholders or public that the sukukholders are restrained by limited right of ownership and it need to be explained in light of Islamic percpective to avoid any misunderstanding towards this sukuk emphasisly, as well to Islamic finance generally.

2. OWNERSHIP IN ISLAMIC VIEW AT GLANCE

Islam as moderate religion practice between the capitalism and communism allows eligible individual or group represents several persons to own all properties other than properties that are specified for public usage such as public roads, bridges, railways, rivers, public gardens and museums, etc because by owning these types of properties could bring harmful and difficulty to society or community when sharing properties were controlled by one party[5], parallel with Islamic legal maxim says "Ad-Dorar Yuzal" brings a mean "any difficulty and harmful should be avoided and eliminated".

[4] See Critical Appraisal On Shariah Issues On Ownership In Asset Based Sukuk As Implemented in the Islamic Debt Market, Asyraf Wajdi Dusuki , ISRA

[5] Financial Transaction in Islamic Jurisprudence , E.Eljamal and Muhammad S.Eissa , 2 / 419

The properties of national treasury or government also could not be owned by individual unless the government decides that they must be sold to meet a necessity of social benefit[6] still consistent with the Islamic legal maxim sounds "The ruler's decision is subjected to social benefit and profitable deed"[7].

All properties exclude from those in that two previous categories are unconditionally eligible for ownership either the properties or assets were tangible or intangible.
Muslim jurist defined the ownership also known as personal property as "an exclusivity over an object vesting the owner , alone and on owner's own behalf with a legal authority of its use and enjoyment and of tis disposal except when legally restricted"[8]. Since that, this definition if ownership gives the owner the right to deal in what he owns in any way which is not legally forbidden[9].

There are two fundamental ownership, total and partial ownership. Total ownership means the owner have both an object and its usufruct differs to partial ownership when he is only owns one either an object or usufruct only. Total ownership can be established through ownership transferring contracts such sales, gifts ,wills and inheritance, unlikes partial ownership that could happen from contracts like leases, simple loans, mortmains (waqf), bequeathed usufruct and permission to use the property[10].

Other that, we should also understand the ownership in Islam unsimilar with theory ownership of capitalism emphasises on individualistic when allows the owner to do unlimited action on the property belongs to him. As a noble way of life, Islam puts some boundaries in ownership like avoidance wasting, exploitation in forbidden actions or intentionally destruct the property because human doesn't carries absolute

[6] Financial Transaction in Islamic Jurisprudence , *E.Eljamal and Muhammad S.Eissa* , 2 / 420

[7] Al-Ashbah Wan Nazair , *As-Sayuti* , p232

[8] The Concept Of ownership In Islam , *Monzer Kahf*

[9] Al-Mulkiyah fil Islam , *Dr. Isa Abduh and Dr. Ismail Yahya*, p131.

[10] See Fiqh Al-Islamiy wa Adillatuhu , *Dr. Wahbah Zuhaili* , 4/2896-2897

ownership on any property but they only entrusted from Allah to use it for life's benefit.

3. LIMITED OWNERSHIP IN ISLAM

In Islamic transaction law, the limitation of ownership can be occur when the owner or property or wealth lost his ability to deal economically with his property directly like insane individuals whom having mentally defect. While the person is insane, he is treated in the same manner as a non-discerning-child *(ghair mumayyiz*) thus losing all legal authority to marry, write wills, trade, etc[11]. There are two types of insanity , permanent and intermittent. Any transaction done by permanent insanity is disregarded and unvalid at all while for intermittent insanity is valid and executed during his episodes sanity in condition they can think and act sanely like norman people[12].

Other type of people who will lose his ability to deal in trading with his property is idiot (*al-ma'tuh*). Muslim jurist defined an idiot as mentally weakness in understand something or realize some condition consciously and it will result in inconsistent statement of verbal, mixing with sane spoken and insane word[13]. In extreme cases of idiocy, the idiot is non-discerning and thus all of their dealings are deemed invalid. For minor idiocy, all harmful dealings are invalid while beneficial dealings are considered valid[14].

The third type of person who was took his ownership into restriction is mentally incompetent individual (*as-safih*) and was difined as someone who does not handle his property appropriately, overspends or spends in unlawful ways[15]. Various opinions have emerged regarding to this discussion according to the different schools of

[11] See Financial Transaction in E.Eljamal and Muhammad S.Eissa , 2 / 368

[12] See Fiqh Al-Islamiy wa Adillatuhu , Dr. Wahbah Zuhaili , 6 / 4489

[13] Ibid , 4 / 2972

[14] Financial Transaction in E.Eljamal and Muhammad S.Eissa , 2 / 369

[15] Ibid

thinking (*mazhab*) that showed us that majority opinion among the Shafi'es (member of As-Shafi'e's school of thinking) preferred to rule any trading transaction from *as-safih* is invalid.

There are also another types of weakness of people that block the owner to exercise or deal with his ownership temporary such as unconsciousness (*ighma*), sleep (*naum*), error (*khoto*), forgetfulness (*nisyan*) and intoxication (*sukr*) except all these impediments disappear and the owner get back his consciousness, and wake up from sleep, or correct the error he has done, his memory has been recovered and regain his awareness after was intoxicated, then he'll get back the right of ownership so permissible to deal and make any transaction on his property[16].

As summary, Islam applies a concept of impediment in ownership on whom not be able to deal with his own property wisely accordance to Shariah objectives to protect the wealth, so it will not be spending in wasting, false and excessively. There is no dispute between Muslim jurists and scholars on it. However, the sukuk policy not allow the sukuk holder to trade or transfer the ownership of sukuk to others could lead us to futher discussion on limitation of sukuk holders after posing the ownership of sukuk which represents true sale of assets and business ventures.

4. SUKUK STRUCTURES AND OWNERSHIP PRINCIPLE

Sukuk is security that represents a financial obligation akin to modern asset backed and asset based securities. Many people perceive that sukuk can be characterized as "Islamic bond", however the reality is that sukuk is something of a hybrid security exhibiting equity and debt characteristics[17]. Sukuk represents certificates of equal value that represent an undivided interest (proportional to the investor's participation) in the ownership of underlying asset (both tangibles and intangibles), usufruct,

[16] See The Philosophy of Islamic Law of Transactions , *Dr. Abdurrahman Raden Aji Haqqi* , Cert Publications ,p116 - 118

[17] See Article Sukuk and the Capital Markets by *Shabnam Mokhtar, Saad Rahman , Hissam Kamal and AbdulKader Thomas* , Sukuk , 2009 , Securities Commission

services or investments in particular projects or special investment activity[18]. Sukuk may be issued according to any of these principles in order to qualify as Islamic securites:

- *Bai' Bithaman 'Ajil* – a murabahah-based transaction
- *Bai' Al-'Inah* – sale and buy back
- *Ijarah* – leasing
- *Ijarah Thumma bai'* – leasing ending in ownership
- *Istisna'* – construction or manufacturing sales
- *Mudharabah or Muqoradhah* – managed partnership
- *Murabahah* – sales contract
- *Musharakah* – partnership
- *Qard Al-Hasan* – interest free loan[19]

The principles of Sukuk are similar with the other shariah compliance products where sukuk should be structured following Islamic Financial Principles that prohibit any form of usury elements (*riba*) and uncertainty or asymmetric information which known arabically as *gharar*[20]. Thus, AAOIFI highlited that the sukuk certificates must represent ownership rights in the underlying assets meet to the prohibitiojn of riba which also leads to a prohibiton on trading in debt receivables (*bai' Ad-Dayn*). In February 2008, the AAOIFI Resolution was issued as a response to the developments in the sukuk market includes six rulings dealing with several shariah issues raised. In its first ruling in regard to the ownership requirement, the AAOIFI resolution confirmed that sukuk, in order to be tradeable, must be owned by sukuk holders with all rights and obligations of ownershsip in the underlying tangible assets[21]. However, this resolution contradicts with the policy of Shariah Advisory Council (SAC) and Securities Commission (SC) in Malaysia where they allow debt trading or selling of

[18] Malaysian Sukuk Market Handbook , RAM Rating Services Berhad , p23

[19] See Article Regulatory Issues : Innovations and Application in Sukuk , *Mohamed Ridza Abdullah* , Sukuk , Securities Commission

[20] See The Islamic Debt Market For Sukuk Securities , *Mohamed Ariff , Munawar Iqbal and Shamser Mohamad* , p46 -48 , Edward Elgar Publishing Ltd.

[21] S ee The Islamic Debt Market For Sukuk Securities , *Mohamed Ariff , Munawar Iqbal and Shamser Mohamad* , p 60 , Edward Elgar Publishing Ltd.

debt (*bai' Ad-Dayn)* based on the premise of Ibnul Qayyim who said that debt trading is permissible because there was no evidence in Al-Quran and Sunnah that disallows debt trading. By contrast, Gulf countries disallow (*bai' Ad-Dayn)*, as the debt money represents cash and when cash is traded with cash over premium or discount, it is tantamount to riba[22].

5. ASSET BASED SUKUK VS ASSET BACKED SUKUK

There are three sources of Islamic securitization and instruments, debt securities, asset based securities and asset backed securites. Murabahah debt securities and Istisna' debt securities are the instruments which based on debt securities. The asset based sukuks are like sukuk al-ijarah, sukuk al-Musyarakah and sukuk al-Mudharabah. These three sukuks also can be operated based on asset backed securities as well as murabahah and istisna' debt securities[23].

The main differences between asset based sukuk and asset backed sukuk lies in the ownership and sales of the assets. Asset based securities allow the inclusion of actual asset which may not legally recognised to be owned outright by sukukholders[24]. The originator typically transfers only the beneficial ownership or equitable interest in the asset to the SPV issuer (Special purpose vehicle), therefore there is no true sale[25]. This instrument is most like debt that allow the investors to have recourse to the originator in case of a shall in payments[26]. The sukuk would not be survived in case of bankcruptcy.

Asset backed sukuk grants the sukuk holder a share of the concrete asset or business venture, and a share of the risk commensurate with the true sale ownership of the

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[22] See Article : Shariah Polemic of sukuk tradings , *Jhordy Kashoogie* , in Opalesque Islamic Finance Intelligence , Issue 15 / 2012

[23] See Islamic Capital Market, *Dr. Saiful Azhar Rosly*

[24] www.mifc.com/index.php?ch=footer_faq&pg=footer.updated on 10 may 2010

[25] Article Sukuk – An Evolution *by Fawaz El-Maliki and Dennis Ryan* published on 4 January 2010 in conyersdill.com.

[26] http://financecareers.about.com/od/rz/g/sukuk.htm published on 4 december 2010

asset. In this case, sukuk securitisation is structured around the sukuk holders' legal ownership of the underlying asset, which forms the sole source of profit and principle payments[27]. This concept of sukuk could be understood by the example shown below.

The originator sells the assets to a special-purpose vehicle (SPV) that holds them and issues the sukuk. The buyers of the sukuk do not have recourse to the originator if there is a shortfall in payments. Asset-backed sukuk, which are closer to equity than debt, represent a minority of sukuk issues. An issue of contention in recent defaults has been whether the SPV (and thus the sukuk holders) truly have complete ownership of the assets[28]. In case of bankcruptcy, the sukuk that issued on this concept should be survived.

According to Khalid Howladar 2009, most of sukuk issued in market are based on asset based instrument where majority of these sukuk applied ijarah, musyarakah dan mudarabah conceptually. These all sukuks indentical in credit risk to a conventional unsecured bond that hint a question whether this concept is acceptable as shariah compliant product or just to replicate the risk and return charactheristics of a fixed income bond[29].

According to Tan Wan Yean 2009, although the concepts of 'asset-based' and 'asset-backed' may be identical interminology, both have significant differences in credit risks. This can be seen in the case of Tamweel PJSC, where two types of *sukuk* had been issued. In the

Tamweel asset-backed *sukuk*, the freehold titles to the properties were transferred to the *sukuk* holders along with the associated ijarah cash flows. The property/land titles are registered in the name of the investors. Any losses on those cash flows (that arise from the sale of distressed property) are passed on to *sukuk* holders, who are exposed to the asset risk. Nevertheless, upon the insolvency of Tamweel, the assets will

[27] www.mifc.com/index.php?ch=footer_faq&pg=footer.updated on 10 may 2010

[28] http://financecareers.about.com/od/rz/g/sukuk.htm published on 4 december 2010

[29] Article The Future of Sukuk : Substance over form by *Khalid Howladar* published on 6 may 2009 in www.moodys.com

continue to pay the *sukuk* investors. As for the unsecured or asset-based *sukuk* issued by Tamweel, the *sukuk* would not survive the insolvency of Tamweel. Investors in these two sets of *sukuk* are taking very different risks[30].

6. SUKUK SIMPANAN RAKYAT 2009 STRUCTURE AND ITS OWNERSHIP STATUS

This sukuk that was issued on 14 may 2009 and was operated based on *murabahah commodity* instrument. The tenure of contract is three years and its total size is RM 5 billion. The profit will be paid to investors quarterly and could be expected to gain profit 5 percent per annum[31]. The buyers of this sukuk will obtain murabahah certificates upon buying the sukuk and these documents represent equal value issued for the purpose of financing the *murabahah commodity* and eventually the certificate holders become the owners of *murabahah commodity*[32].

Murabahah sukuk is most likely to be used in respect of purchases of goods by public sector. In case the government needs items of huge price, it may purchace them through credit sale by paying in instalments. The seller will amortize his cost and return profit margin over the period of instalments. The government will issue certificates according to the number of instalments. Each certificate have maturity date would represent property right of the seller that can change hand provided amounts of the claim does not change[33].

This kind of sukuk can be categorized as asset-based securities which only provides artificial ownership rights to the 'usufruct' or certain physical underlying assets. It is better to determine the sukuk to perform instead of relying on the obligor's credit

[30] Article Sukuk : Issues and The Way Forward by *Tan Wan Yean* published for the clients and members of International Lawyer Network with an update on The Islamic capital market.

[31] http://www.bnm.gov.my/index.php?ch=en_ssr&pg=en_ssk_all&ac=672

[32] See Common Structure Of Sukuk, *Mughess Shaukat* , in Global Islamic Finance Megazine , 2010

[33] Securitization, Sukuk and Fund Management Potential To be Realized By Islamic Financial Institutions , *Muhammad Ayub*

quality[34]. This means the sukuk holders are merely creditore not owners of the asset. Even if they have a charge on the asset, legally they are not the owners of the asset [35]. So that, the sukuk holders shouldn't trade or transfer their certificates to others due to partial ownership that they hold and to determine the progress of sukuk is moving smoothly for obtaining the expected return as *maslahah* (profitable deeds) for all the sukuk holders.

According to the procedure for sukuk issuance approved by Bank Negara Malaysia as well as Securities Commision (SC), a domestic or foreign sharia adviser shall be appointed to advice on all aspects of sukuk issuance. The sukuk will be monitoring and evaluating in order to ensure it will be issued accordance to Islamic principles. Once it was released by these two authority governing bodies under the capacity of sukuk, it means the sukuk is shariah compliance product.

7. CONCLUSION

The ownership status in Sukuk Simpanan Rakyat 2009 or other sukuks is one of the issues in sukuk that has been written by several Muslim economist who some of them do not agree with the concept that restrict the ownership rights on sukuk like the Accounting and Auditing Of Islamic Financial Institutions (AAOIFI) while the rest of them agree and consider it as permissible instrument like Shariah Advisory Council of Securities Commision (SC) Malaysia. The simple reason is to protect wealth which *maslahah* for the other sukuk holders and applying a prophet tradition in buying contracts which sound "*Al-Muslimun 'inda Syurutihim"* that allows putting some condition when conducting buying and selling contract for the betterment of both parties without causing harmfulness and breaking the objectives of sales in Islam.

[34] See Article Implication Of Sukuk Structuring : The Comparison On The Structure On Asset Based And Asset Backed Ijarah Sukuk by *Nurul Aini Muhamed and Rafisah Mat Radzi*

[35] See Critical Appraisal On Shariah Issues On Ownership In Asset Based Sukuk As Implemented in the Islamic Debt Market, Asyraf Wajdi Dusuki , ISRA

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INSTITUTIONAL INVESTOR'S EFFECT ON SUKUK RATINGS

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Abstract

Number of institutional ownership of corporate shares across the countries is currently increasing and the same trend also expands their roles. These large investors are highly in the form of fund management companies, pension funds and insurance (including Takaful) companies. In the countries that adopt the Anglo Saxon approach of corporate governance, they are considered as external parties, rather than directly involved in the investee companies through "supervisory board" as in the European approach. Many studies show that institutional investor's large stakes in investee companies forced them to be involved in investee companies to influence the company's performance (in term of share market value and dividends), management and disclosure. This paper looks at the different aspects on the purpose of involvement, which is one of the performances of the debt of the capital structure, in the context of Anglo Saxon corporate governance environment. Specifically this paper examines the potential effect of the institutional investors on sukuk ratings of the issuers, which reflect the performance of these sukuk.

Keywords: Institutional investors, corporate governance, sukuk ratings

1. Introduction

The Shariah based assets plays an important role in the global financial market and is estimated to be about $400 billion to $500 billion. The potential market for Islamic financial products and services had reached close to $4 trillion (Al-Amine, 2008). As per Ariff, Iqbal, and Mohamad (2012) the Malaysian Islamic financial institutions stand at 12 percent market share in Malaysia and comprises of 17 percent market share in the GCC countries.

This paper proposes the theoretical framework of the potential effect of institutional ownership in issuers' Sukuk ratings. Institutional investors are becoming more and more important in the global financial markets. Institutional investors increase the functioning of the market by contributing efficient allocation of savings. Global

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institutional investors have also substantially increased their exposure to emerging market economies (EMEs) in recent years. Domestic institutional investors in EMEs, although small in an absolute sense, are significant relative to the size of local markets and have considerable growth potential (Broadbent, Grande, Thompson, & Zollino, 2006).

Institutional investors have become increasingly important participants in global financial markets, including emerging markets. Institutional ownership is defined as the percentage of shares held by all the reporting institutions as a group or the number of outstanding shareholders. Companies that have a high percentage of institutional ownership are thought to have better prospects for long term earnings growth. Stability of institutional ownership plays an important role in determining the cost of debt. The rationale is that long-term institutional investors are in a good position to learn about the firms they own and also have a stronger motivation to monitor them since they can reap larger benefits from it. Many opinions were given by previous researchers like Millon and Thakor (1985), Baker and Mansi (2002), and Jorion, Liu and Shi (2005) over the conflicting view on the importance of ratings. Thus the following research question is provided by the researcher to investigate on the role of institutional investors on sukuk ratings: *Is there potential effect of the institutional investors in Sukuk issuers on the Sukuk Ratings?*

This study is structured as follows: Section 1 provides the introduction of sukuk; section 2 provides the development of sukuk in Malaysia. Section 3 discusses on institutional investors and section 4 proposes the theoretical framework of the study and Section 5 concludes the paper.

2. Sukuk Growth and Development

What is Sukuk?

Sukuk are basically referred as Islamic bonds in the form of Islamic investment certificates. Sukuk is a product that offers a wide scope of innovation and creates large potential for the growth of Islamic market. The structure of sukuk is based on Ijarah, Musharakah, mudarbah, and many combinations of sukuk products. Iqbal and Mirakhor, (2011), defined sukuk as certificates of equal value that represents an

undivided interest in the ownership of an underlying assets or special investment activities.

Sukuk are among the financial instruments for raising funds and are vital vehicle for resources mobilization. Sukuk refers to investment products and can be defines as "certificates of equal value representing undivided shares in ownership of tangible assets, or special investment activity. As a certificate sukuk is documented the undivided pro-rated ownership of underlying assets and the sukuk is freely traded at par, premium or discounted. Based on the above mentioned two definitions, sukuk can also be further defined as commercial papers that provide investors with ownership in an underlying asset. It is an asset backed trust certificate.

Similar to conventional bonds, sukuk can be issued in the form of short, medium and long term notes and are universally referred as Islamic Commercial papers, Islamic medium term notes or sukuk respectively. Sukuk may be in the form of combination of several Islamic contracts (RAM, 2011).

Shariah compliant considered as the heart of sukuk as it requires a process of Shariah approval. A key development within the Islamic capital markets products and their acceptance into the global financial system is the increased use of credit ratings in *sukuk* (Al-Amine 2008). However, almost all conventional rating agencies are using conventional methodologies to rate Islamic financial instruments including *sukuk* despite the acknowledgement of these rating agencies. The advantage fundamentally can be extracted from the structure of such Islamic financial product itself. (Al-Amine 2008) stated that Islamic products provides an avenue for the Islamic investors to invest in the product based on Shariah compliant financial investment providing potential lower pricing to issuers and guaranteeing large investor base.

Difference between Bond and Sukuk

There is a key difference between bond and sukuk that bonds are the securities in the form of debt that will be paid back after a certain period of time, termed as date of maturity along with interest on principal value.

Whereas, sukuk are the financial fixed income certificates that are provisioned under the shariah law and are raised on trading, construction of identifiable and specific assets instead of interest based like bonds. In the simplest form, bond is a contractual debt obligation where the issuers are contractually obliged to pay to bondholders on certain specified dates, interest and principal, whereas under sukuk, the holders each hold an undivided beneficial ownership in the underlying assets. Sukuk holders consequently are entitled to share in the revenue generated by the Sukuk assets as well as able to share in the proceeds of the realization of the Sukuk assets (Tariq & Dar 2007).

Bonds are a proof of debt, whereas sukuk are the proof of ownership. Bonds includes fixed rate of interest regardless of loss or gain, whereas sukuk is related to original legal contract that governs the relationship between the sukuk provider and customers.

Bonds that undertakes to pay its amount with an interest related to its face value is strictly prohibited in Shariah. Their issuance, their purchase, and their negotiation are all prohibited because they are interest-bearing loans, no matter whether their issuing authority belongs to the private sector or is a public entity related to the state. The change in the name of bond, such as calling the bonds "certificate" or "investment securities" or "saving certificates" or calling the interest "profit" or "income" or "service charge" or "commission" has no effect on the aforesaid ruling.

The "zero coupons bonds" are also prohibited because they are loans sold at a price inferior to their face value, and the owners of such bonds benefit from the difference in their prices which is considered a discount on the bonds.

Similarly, "prize bonds" are also prohibited because they are loans in which a liability to pay a pre-determined profit or an additional amount is undertaken in favour of their bearers as a whole, or in favour of an undermined number of persons out of them. Moreover, these bonds have a resemblance with gambling (*Qimar*).

Sukuk securities have some similar features with conventional bonds, which is probably the reason why the financial press describes them as if they are the same. Furthermore, since issuance of some types of sukuk securities, especially in large

amounts, may affect balance-sheet of the issuer (e.g. case of ijarah sukuk), the risk structure of the issuer might be affected. In other words, by issuing sukuk (particularly asset-backed sukuk such as ijarah), ownership of some certain parts of the assets of the issuing entity is transferred to the intermediating entity (i.e. Special Purpose Vehicle, or SPV) which is owned by the sukuk-holders (Ariff & Safari 2012, Muhamed & Mat Radzi 2011).

Types of Sukuk

The market for Sukuk is now maturing and different Sukuk structures have been emerging over the years; they can be of many types depending upon the type of Islamic modes of financing and trades used in its structuring. The AAOIFI issued standard for different types of Sukuk, classifying some of these Sukuk as tradable and others as non-tradable based on the type and characteristics of the issued Sukuk. The most important and common among those are Murabahah, Mudarabah, Mudarabah, Ijarah, Salam and Istisna'a. There are also other diversified and mixed assets Sukuk that emerged in the market such as hybrid Sukuk, where the underlying pool of assets can comprise of Murabahah, Ijarah as well as Istisna'a.

Murabahah Sukuk

In the case of Murabahah Sukuk, the issuer of the certificate is the seller of the Murabahah commodity, the subscribers are the buyers of that commodity, and they are entitled to its final sale price upon the re-sale of the commodity. Murabahah Sukuk cannot be legally traded at the secondary market, as the certificates represent a debt owing from the subsequent buyer of the commodity to the Sukuk holders and such trading in debt on a deferred basis is not permitted by Shari'ah.

Mudarabah Sukuk

Mudarabah Sukuk is investment Sukuk that represent common ownership of units of equal value in the Mudarabah equity; the holders of Mudarabah Sukuk are the suppliers of capital (Rabb al-mal) and own shares in the Mudarabah equity and its returns according to the percentage of ownership share. Mudarabah Sukuk holders have the right to transfer the ownership by selling the deeds in the securities market. Mudarabah Sukuk should not contain a guarantee from the issuer or the manager for

the fund, for the capital or a fixed profit, or a profit based on any percentage of the capital.

Musharakah Sukuk

Musharakah Sukuk are investment Sukuk that represent ownership of Musharakah equity. It does not differ from the Mudarabah Sukuk except in the organization of the relationship between the party issuing such Sukuk and holders of these Sukuk, whereby the party issuing Sukuk forms a committee from the holders of the Sukuk who can be referred to for investment decisions. Musharakah Sukuk are ideal for borrowing to finance large commercial ventures, such as a factory expansion or construction projects. A special purpose vehicle company (SPV) can purchase, commission or construct Musharakah assets owned, or to be bought or constructed by the issuing entity.

The SPV pays cash towards the capital of the Musharakah and then leases the underlying Musharakah assets to the issuing entity, for a period equal to the maturity of the Sukuk, at agreed regular fixed or floating rentals. Upon default or maturity, the issuing entity issues a promise to Musharakah units from the SPV at an agreed price. Musharakah Sukuk can be treated as negotiable instruments and can be bought and sold in the secondary market.

Ijarah Sukuk

Ijarah Sukuk represents ownership of equal shares in a rented real estate or the usufruct of the real estate. Holders of Ijarah Sukuk have the right to own the real estate, receive the rent and trade their Sukuk in the secondary markets; in exchange they bear all cost of maintenance of and damage to the real estate. The rental rates of return on those Sukuk can be fixed or floating depending on the agreement (Ali Arsalan Tariq 2004); it does not need to be linked to the period of taking usufruct by the lessee. The issuance of Ijarah Sukuk necessitates the creation of an SPV to purchase the assets, issue Sukuk to the investor, and make payment for purchasing the asset. Upon default or maturity, the issuing entity issues a promise to purchase the assets from the SPV at an agreed price. These certificates are issued on stand-alone assets identified on the balance sheet. The assets can be parcels of land to be leased or leased equipment such as aircrafts and ships. The rental rates of returns on these

Sukuk can be both fixed and floating depending on the particular originator (Tariq 2004).

Salam Sukuk

Salam Sukuk are certificates of equal value issued for the purpose of mobilizing Salam capital. The issuer of the certificates is a seller of the goods of Salam; the holders are the buyers of the goods; they are entitled to the sale price of the certificates or the sale price of the Salam goods sold through a parallel Salam, if any. Investors pay in an advance funds to the SPV in return for a promise to deliver a commodity at a future date. SPV can appoint an agent to market the promised quantity at the time of delivery at a possible higher price. The profit of the holders of the Sukuk is the difference between the purchase price and the sale price.

Istisna'a Sukuk

Istisna'a Sukuk are certificates that carry equal value and are issued to mobilize funds required for production of goods products that will be owned by the certificate holders. The issuer of these certificates is the manufacturers; the subscribers are the buyers of the intended product, while the funds realized from subscription are the cost of the product. The Islamic bank funding the manufacturer during the construction of the asset, acquires title to that asset and up on completion either immediately passes title to the developer on agreed deferred payment terms or, possibly, leases the asset to the developer under an Ijarah Sukuk. Shari'ah prohibits these certificates to be traded in the secondary market.

Worldwide Sukuk Development and Growth

The Sukuk market has emerged during the previous three years, first Bahrain issuing domestic sovereign fixed-rate Ijara and Salam Sukuk. It was followed by the issuance of floating rate Ijara Sukuk as well as pooled Sukuk by both corporate bodies and sovereigns in several countries. These Sukuk are based on Salam, Ijarah, Istisna, Istisna-cum-Ijarah and on the basis of pooled portfolios. The present size of the market of the Sukuk is estimated to be over 4 billion dollars growing at rate more than 90%. As (Wilson 2004) argues, the vast majority of *Sukuk* is held by Islamic banks because these financial instruments represent the backbone for the development of a much needed secondary Islamic capital market. If market participants view *Sukuk* as

different financing instruments compared to conventional bonds, then it is likely that the financial stability of Islamic banks might also be affected.

The development of sukuk in the Muslim countries is widely spread, but also motivated for the development of Islamic products like Sukuk in countries outside the muslim world are numerous. In fact, the European governments including France and United Kingdom has taken legal steps for the issuance of Sukuk in their countries (Godlewski, Turk-Ariss, & Weill 2010).

The largest issuance of Sukuk was of $ 750 million mandate that was awarded to Dubai Islamic Bank by the Department of Civil Aviation. UAE raised funds for the expansion of Dubai International Airport. Qatar Global Sukuk was incorporated in October 2003 and is established as a joint venture special purpose vehicle by the government of Qatar. The government of Qatar issued $750 million to the Qatar International Islamic Bank in order to develop and construct the Hamad Medical City located in Doha, Qatar. The SPV buys the parcels from the government and resells them to the buyers of the issues in the form of trust certificates known as Sukuk. The certificates were rated A+ by the Standard & Poor's (S&P) and applications were proposed for the issuances on Luxemburg Stock Exchange and Labuan International Financial Exchange (Malaysia).

3. Development of Sukuk in Malaysia

Malaysia has been developing a more extensive capital market after the Asian financial crisis to ensure a more resilient financial system. In this issue, we look at the Malaysian bond market in general and the Islamic bond market in particular. The Islamic bond, or Sukuk, was introduced in the 1990s. Its popularity in Malaysia has been increasing from year to year. For example, Sukuk made up only 7% of the corporate bonds issued in 1999 but had jumped to 58% by 2006. In the first half of 2007, 19 Sukuk with an issuance amount of RM9.99 billion were approved by the Securities Commission (SC), representing almost 42% of the total bond issuance in Malaysia.

In 2008, the world economy experienced the worst financial crisis in the post-war period arising from the collapse of the sub prime mortgage market in the United

States. The global crisis not only led to the failures of several major financial institutions but also monetary losses suffered by investors and house owners. While financial market conditions have normalized, following aggressive policy measures by national authorities worldwide, the global financial stability is tested again by the emergence of sovereign debt problems in Europe. While Malaysia has not been fully insulated from the global crisis, Malaysia recovered rapidly to register positive growth in the fourth quarter of 2009 and moderate contraction of 1.7% for the whole of 2009. This would not have been achieved, if not for the swift response of proactive monetary policies and the introduction of two economic stimulus packages totaling RM67 billion, which succeeded in reviving business confidence and encouraging consumer spending. With regard to the bond market, Malaysia is the bond market leader in ASEAN and one of the largest in Asia with outstanding bonds of RM643.8 billion as at end-December 2009.

Sukuk Ratings

As with other types of ratings, Sukuk is also rated by the rating agencies like Standard & Poor's of scheduled payments according to the terms of the bond. It is not necessary that the rating of the bond recommend the investors to buy the bond.

There are only two rating agencies in Malaysia viz. RAM (Rating Agency Malaysia Berhad) and MARB (Malaysian Rating Corporation Berhad). The main role of these credit ratings is to evaluate the existence of mandatory credit ratings in Malaysia of an emerging corporate debt market where investors are less sophisticated and disclosure standards are low.

4. Institutional Investors: Theories and Their Influences

Institutional ownership has much incentive to monitor companies that they own than individual investors because of their larger stakes in those companies, especially if exit is costly (i.e., large trading costs). Bushee and Noe (2000) suggested that institutional investors prefer firms with better disclosure rankings to reduce monitoring costs. To the extent that companies that have better governance structures require less outside monitoring, institutional investors are likely to prefer companies with better governance mechanisms to those with poor governance mechanisms. Chung, Elder and Kim (2010) argue that good governance improves financial and

operational transparency and thus reduces information asymmetry between insiders and outside investors. They find that firms with better corporate governance exhibit higher stock market liquidity and lower trading costs.

To investigate on the role of institutional investors on sukuk ratings widely, two theories (Agency theory and Stakeholder theory) were proposed by the researchers.

Agency Theory

In agency theory, the framework can also be used by managers to either strengthen or weaken their boards' powers of monitoring, ratification and sanctioning of managerial decisions. It can also be used by shareholder groups to design effective contractual structures.

Stability of institutional ownership plays an important role in determining the cost of debt. The rationale is that long-term institutional investors are in a good position to learn about the firms they own and also have a stronger motivation to monitor them since they can reap larger benefits from it. Moreover, with the support of long-term institutional investors, managers can avoid their myopic behavior and focus on long-term firm performance. In this study, we shed light on the relation between institutional ownership and governance using comprehensive measures of governance quality (Mohd Hafizuddin et al. 2010).

Agency theory assumes that the interests of owners and managers or board members (principals and agents, respectively) are not aligned. Agency theory is concerned with devising structural and behavioral measures that minimize inefficiencies in the contractual structure of the firm that arise from imperfect alignment of interests between principals and agents.

Failures of the agency relationship can result whenever managers make decision for which they either do not have the right information to reach optimal conclusions (failures of competence) or where they have incentives to take actions that decrease the value of the shareholders' holdings. More generally, agency failures occur whenever decision rights, the necessary specific and general information and incentives are not co-located in the same person.

The problem of designing efficient governance mechanisms is the problem of redressing (or at least addressing) the inefficiencies caused by the corporate. These inefficiencies are brought about by the separation of ownership and control - more precisely, of authority and responsibility that the mechanisms that create and maintain the triple corporate veil set up and cultivate.

Stakeholder Theory

Stakeholder theory states that corporations should serve all groups or individuals who have a stake in the corporation. It has long been held that corporations have legal obligations to serve the interests of their shareholders. Since shareholders own the firm's equity, they have certain rights and privileges over other groups, and any action taken by management must ultimately be justified by whether it furthers the interests of the firm's shareholders. The shareholder perspective has its roots in the principle of private property rights - the foundation of capitalism. The traditional wisdom is that private ownership is fundamental to social order as well as economic efficiency.

The relatively new stakeholder theory clearly rejects the view that shareholders have a privileged place in the business enterprise. It argues that corporations should serve all groups or individuals who have a stake in the corporation, typically including employees, customers, suppliers, and local communities. While shareholder theory espouses the "free market" doctrine, stakeholder theory argues that the problems of free rider, moral hazards, and monopoly power inherent to the free market justify government intervention and corporate social responsibility. In the stakeholder view, corporations cannot maximize the shareholder interests at the expense of other stakeholders because doing so is neither moral nor economically efficient. Descriptive stakeholder theory aims at describing specific corporate characteristics and behaviors. It addresses, for instance, how economic activity is structured through legal and other institutions. How do managers think about management? What do managers actually do in practice? Instrumental stakeholder theory intends to build up the connection between stakeholder management and firm performance. It concerns whether managers can meet specific performance goals through adopting the stakeholder approach. Normative stakeholder theory essentially attempts to provide guidelines for corporate governance, particularly on how firms ought to be governed and to whom managers ought to be responsible (Monks, Miller & Cook 2004).

Incentive plans reward executives financially for maximizing shareholder interests, thus aligning the interests of managers with those of shareholders (Monks et al. 2004). Furthermore, if all these mechanisms fail, the market for corporate change such as hostile takeovers and leveraged buyouts can be the last resort. Put together, the agent model emphasizes the role of the markets, particular the markets for capital, managerial labor, and corporate control, in ensuring managers and directors to act in the interests of shareholders in the firm. (Jensen 2001) proposes that stakeholder theory can add the specification that the objective function of the firm is to maximize the total long-term firm value, and when the total long-term value is maximized, the array of satisfaction as a whole satisfaction can be achieved. By this way, corporate executives can be in a better position to assess the tradeoff among competing constituencies (Jensen 2001).

Within this conceptual framework, agency theorists prescribe a number of governance mechanisms, such as large share holdings, independent boards of directors, alternative executive compensation, and the takeover market. Large shareholders are considered a solution to the agency problem because they not only have a big interest in profit maximization, but also have enough power to control the assets and the management of the firm (Shleifer & Vishny 1996).

The fundamental challenge to the agent model comes from the stakeholder perspective, which claims that the objective of corporate governance is to maximize the interests of all stakeholders rather than shareholders alone. Another crucial task of corporate governance, in the stakeholder model, involves encouraging “the active participation of all or many of its stakeholders” and ensuring “effective negotiation, coordination, cooperation, and conflict resolution” between the firm and its stakeholders as well as among stakeholders (Kochan & Rubinstein 2000) Specifically, (Blair 1995) argues that corporations should “enhance the voice of and provide ownership-like incentives to those participants in the firm who contribute or control critical, specialized inputs (firm specific human capital) and to align the interests of these critical stakeholders with the interests of outside, passive shareholders.

5. Proposed Theoretical Framework

The paper proposes framework for governance mechanism that can be played by institutional investors towards good ratings of sukuk. Given that the institutional investors' strong voice to monitor the issuer company and their financial assets.

Institutional investors are in a unique position to exercise influence over companies and to hold them accountable for good governance. Thus institutional investors have a critical and proactive role to play in the governance of companies. They have better access to information and possess the resources to build the necessary monitoring capabilities. Given their unique position of influence, there is a need to prioritize their leadership role in governance.

Institutional investors are professional investors who act on behalf of beneficiaries, such as individual savers or pension fund members. The categories of institutional investors are wide and can include collective investment vehicles, which pool the savings of many, and licensed fund managers to whom these funds are allocated. Active participation of institutional investors in the exercise of shareholder rights raises the level of governance as a result of increased shareholder engagement. Institutional investors should therefore continually assess their approach and invest in the necessary expertise and resources that enables them to play a more effective role in monitoring and engaging the companies they invested in, leading by example and influencing good governance practices.

Gillan and Starks (2000) conferred that as institutions' ownership has increased, their role as shareholders has also evolved. Some institutional investors, particularly public pension funds and union pension funds, began to abandon their traditional passive shareholder role and become more active participants in the governance of their corporate holdings. The role of institutional shareholder activism arises due to the conflict of interest between managers and shareholders. To control such conflicts, special market and organizational mechanisms have evolved.

Exercise of ownership rights ranges from contributing to improvements to the functioning of boards, to promoting information disclosure and transparency as well as supporting market discipline by rewarding better governed companies. To a large

extent the performance of the role of institutional investors is influenced by company mandates. The differences in investment objectives and strategies can lead to different approaches and levels of shareholder activism. Performance evaluation systems and incentive structure of fees and commissions which encourage short-term strategies will discourage any meaningful levels of shareholder engagement. Thus, where permitted by their mandate, a revamp of the performance metrics can encourage long-term thinking and active ownership. These results suggest that block holders and active institutional shareholders lead to more efficient monitoring of management and less managerial opportunistic behavior, which benefits all stakeholders.

Bhojraj and Sengupta (2003) find that firms with a higher percentage of outside directors on the board and with greater institutional ownership enjoy lower bond yields and higher ratings on their new debt issues. We extend these two studies by evaluating a broader set of governance variables thereby providing a more comprehensive analysis of the relevance of corporate governance from the perspective of bondholders.

Baker and Mansi (2002) posits that issuers and institutional investors differ in terms of assessment about the rating agencies. Specifically the majority of the institutional investors require only one policy as a matter of formal policy, when they buy bonds or securities, but most issuers receive two or more ratings. Issuers and institutional investors also differ in their assessment of whether the rating reflects creditworthiness and whether the agencies maintain timely ratings.

6. Conclusion

Sukuk market has grown both in terms of size and sophistications rapidly over the last few years. Sukuk has confirmed their viability as an alternative means to mobilize medium to long term investment savings from a huge investor base. Sukuk not only attracted the corporate, but also showed deep interest for institutional investors of the country to invest on the shariah Islamic product Sukuk. The involvement of Institutional investors may increase the trust of both corporate and the individual investor’s protection. Tight rules and regulations by the rating agencies and central bank had bind sukuk market and have protected capital market from negative

perceptions of investors. In the current scenario the demand of Sukuk product in the market is significant exceeding.

Prior researches have highlighted that institutional investors could influence bonds and debt ratings. Yet, there is no study focuses on the effect institutional investors on sukuk ratings and their issuers. The rapid growth of sukuk, especially in Malaysia, raised an interesting question of this issue. This provides an avenue for future research.

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ISLAMIC HEDGING INSTRUMENTS: A FIQHI SYNTHESIS OF STRUCTURES USING TWO-UNILATERAL PROMISES (WA'DAN)

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Marjan Muhammad[1]

Abstract

Most of financial investments and businesses, whether conventional or Islamic, are exposed to risk. Hedging is recognized as one of the risk management tools to neutralize and minimize risks (Suwailem, 2006). Despite continuous debates on the use of derivatives in Islamic finance, many Shariah scholars admit the dire need of Shari'ah-compliant hedging instruments to mitigate risks associated with financial exposure and currency fluctuation. Hence, a wide range of sophisticated Islamic hedging instruments, such as Islamic FX forward, Islamic FX swap, Islamic FX cross currency swap, Islamic profit rate swap, have been developed. These instruments employ various contracts and principles, namely sale and buy-back (inah), commodity murabahah (tawarruq), earnest deposit (urbun) and unilateral promise (wa'd). This paper focuses on the Islamic hedging instruments that utilize wa'd as the underlying principle. The main objective of the paper is to explore fiqhi rulings on two-unilateral promises (wa'dan - also known as wu'ud mutabadalah). Thereafter, the paper examines the compliance of Islamic hedging instruments that employ the wa'dan principle. The study relies on the theoretical approach in explaining juristic opinions on wa'dan.

Keywords: Islamic Hedging, risk management

1. INTRODUCTION

The application of wa'd in several Islamic financial products, though recent, has witnessed spectacular developments. It has been widely applied in several Islamic financial products, namely murabahah lil amir bis shira', ijarah muntahiya bi tamlik, ijarah thumma al-bay', musharakah mutanaqisah, and also sukuk structures. With the recent development of all the sophisticated hedging instruments, wa'd is also applied as the underlying principle of some of the treasury products. Some of the above

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mentioned structures employ only one-way wa'd while others use two-way wa'd. As the term wa'dan has newly been introduced in the current Islamic finance market to denote the practice of two-way unilateral promises (commonly known as double wa'd) thus it is important to examine both principles of wa'd and muwa'adah in order to identify whether structures that utilize two-way wa'd comply to the rules of wa'd or they resemble the features of muwa'adah (bilateral promise). It should, however, be noted that this research focuses only on the application of wa'dan (two-way unilateral promise) in Islamic hedging instruments and will provide a comprehensive analysis on the two-way unilateral promise in these treasury products. The study aims to seriously examine the fiqhi rulings on the two-way unilateral promises (*wa'dan* – also known as wu'd mutabadalah). In order to achieve this aim, the following steps will be taken:

- Further investigate and understand the meaning of wa'd, wa'dan and muwa'adah and identify the features of these three terminologies
- Further inspect on the bindingness of wa'd and muwa'adah from the legality aspect.
- Further inspect on the concept of wa'dan and its ruling.
- Further study the comparison and contrast of wa'd, wa'dan and muwa'adah.
- Further explore and explain on the usage of two-way wa'd in Islamic hedging instruments.
- Further explore the fiqhi rulings of two-way wa'd focusing on its utilization in Islamic hedging instruments.

The research is organized as follows. The introduction sets out the framework of this research. Section two presents the literature review and progresses to explain the concept of wa'd and its legality; the concept of muwa'adah and its legality; and most importantly the concept of wa'dan and its ruling. Section three represents the crux of the paper and sheds light on the usage of two-way wa'd in Islamic hedging instruments. It further explains the fiqhi rulings on the usage of two-way wa'd in Islamic hedging instruments. Section four provides the conclusion of the paper by summarizing the paper and proposes some recommendations for future research.

2. THE CONCEPT OF WA‘D AND MUWA‘ADAH

This section delineates briefly an overview of wa’d and muwa’adah principles, beginning with their conceptual understanding, which includes definition, main features and legality from the perspectives of Shari’ah before providing a special focus on the concept of wa’dan and its ruling. The section also touches on the comparison and contrast of wa’dan to the wa’d and muwa’adah principles. Studying these aforementioned principles is vital as it helps to further comprehend the application of wa’d in modern Islamic banking and finance practices.

Definition of Wa‘d and Its Features

Wa‘d, which is translated as a promise, originates from the Arabic root word of ‘wa‘ada’[2] that connotes both good and bad meanings. Technically, there are two main definitions given by the scholars. According to Ibn ‘Arafah, wa‘d means “an expression of the person (who give the expression) to do something good in the future” ('Allish, 1989, p. 5:436). Likewise, al-‘Aini defines wa‘d as: “the expression of delivering something good in the future” (Al-Aini, n.d, p. 1:220).[3] From this definition, one can say that wa‘d is unilateral, as it occurs when only one party gives a promise to the other party that he will perform a certain action in the future. The acceptance of the promise is merely an approval to benefit from the promise but not a promise to do something in exchange for it (Abu Ghuddah, 2010).

Example 1 illustrates the concept of wa‘d based on the definition given by the scholars.

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[2] According to Ibn ManĐËr, apart from wa‘d, there are several other verbal nouns derived from the word wa‘ada, namely ‘idah, maw‘id, maw‘idah, maw‘Ëd and maw‘Ëdah. He says that:

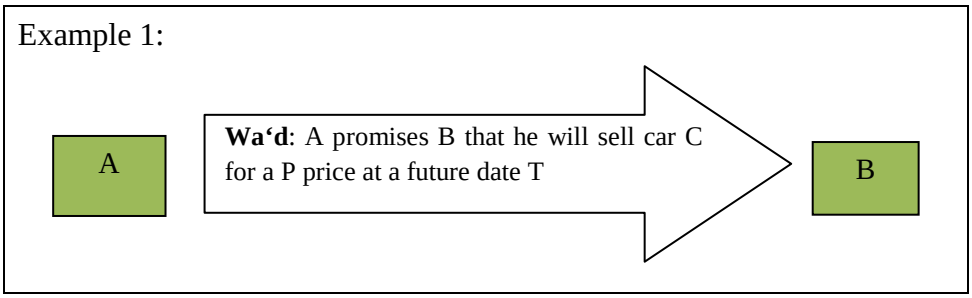
وعَدَه الأَمر وَبِهِ عِدةً ووَعْداً ومَوْعِداً ومَوْعِدةً ومَوْعوداً ومَوْعودةً، وَهُوَ مِنَ المَصادِرِ الَّتِي جاءَت عَلَى مَفْعولٍ ومَفْعولةٍ

Refer: Ibn ManĐËr, *LisÉn al-‘Arab*, Beirut: DÉr ØÉdir, 1414H, 3/461.

[3] Ibn ‘Arafah says that: الْعِدَةُ إِخْبَارٌ عَنْ إِنْشَاءِ الْمُخْبِرِ مَعْرُوفًا فِي الْمُسْتَقْبَلِ

Meanwhile, Al-‘AinÊ mentions that: الْوَعْد فِي الِاصْطِلَاح الْإِخْبَار بإيصال الْخَيْر فِي الْمُسْتَقْبل

Figure 1: Illustration of Wa‘d



The implication of giving a wa‘d in the above example is that A (i.e. the promisor) has to sell car C to B (i.e. the promisee) when the future date T approaches. Based on the definitions and illustration given, the main features of wa‘d are as follows:

i. It is a verbal expression/action put forward by a single party, and thus unilateral in nature.
ii. It is generally related to performing good actions on a voluntary basis (based on the technical definitions of Ibn ‘Arafah and ‘Allish), or it may simply relate to the performance of any permissible (*mubah*) action.
iii. It is related to doing something in the future, not at present (the time of giving the promise). Therefore, some scholars mentioned that a person who gives a promise should use the imperfect tense (fi‘l al-muÌÉri‘), which is used for the present and future, not the not the perfect tense (fi‘l al-mÉÌÊ), which is used for the past ('Allish, n.d.).

The Legality of Wa’d

A promise to perform a permissible act in the future is permissible (*mubah*), provided that the person (i.e., the promisor) makes an exception that it will only happen if Allah wills,[4] while having the intention to fulfill it (al-Jassas, 1994). Muslim jurists unanimously agree that it is impermissible to make a promise to do something prohibited. Likewise, it is impermissible to make a promise without any intention of fulfilling it, as the act is a lie, which is an attribute of hypocrites (al-Hamawi, 1985), based on the hadÊth of the Prophet, reported by BukhÉrÊ, who says: “The signs of a

[4] Editor’s note: This is to comply with the Qur’anic injunction, “Do not say about anything, ‘Indeed, I will do that tomorrow,’ except [when adding], ‘if Allah wills” (18:23-24).

hypocrite are three: When he speaks he lies, when he makes a promise he breaks it, and when he is entrusted he betrays the trust" (al-Bukhari, 1422H, p. 1:16).

Contemporary Resolutions on the Bindingness and Enforceability of Wa'd

Most of the contemporary resolutions issued by some international organizations deem wa'd as binding morally and legally,[5] particularly in cases where the breach of promise will cause harm and damages to the promise. Observations upon them can be summarized as follows:

i. WaÑd is legally binding upon one party only (i.e. the promisor) if it is made contingent upon a condition or it is attached to a cause, and the promisee has relied upon the cause of the promise and has incurred some expenses.
ii. The effect of a binding waÑd will either be:
    a. Actual fulfillment of the promise
    b. Monetary compensation for the actual damages incurred if there is a breach of promise without a valid excuse. The actual damage refers to the difference between the cost of acquiring the item to the promisee and its selling price to a third party.
iii. A binding waÑd is allowed in several Islamic financial products such as murÉbaÍaÍ for a purchase orderer (MPO), lease ending with ownership (ijÉrah muntahiyah bi al-tamlÊk), diminishing partnership (mushÉrakah mutanÉqiÎah), Islamic forward foreign currency exchange, and other products.

[5] OIC Fiqh Academy: Decision No. 40 (5/2) Regarding Fulfilling Promise and Murabahah lil Amir bil Shira':

"The promise (that is put unilaterally forward by either the purchase-orderer or the bank) **is binding upon the promisor from a religious point of view** except in case of a [valid] excuse. It is also **legally binding in a court of law if it is made conditional upon a cause**, and if the one whom the promise was made undertook actions entailing expense due to the promise…"
OIC Fiqh Academy: Decision No. 136 (15/2) Regarding Musharakah Mutanaqisah and its Shari'ah Parameters:"*Musharakah mutanaqisah* is uniquely characterized by the presence of a **binding promise** by only **one of the two parties** to effect multiple purchase contracts by which he/she will gain possession of every portion of the [other party's] stake".
AAOIFI: Shari'ah Standard No. 1: Trading in Currencies: "A promise from one party is permissible even if the promise is binding".
AAOIFI: Shari'ah Standard No. 9: Ijarah and Ijarah Muntahia Bittamleek"A promise to transfer the ownership by way of one of the methods specified in item 8/1 above is a binding promise is binding on one party only, while the other party must have the option not to proceed".
Shariah Advisory Council (SAC) of Bank Negara Malaysia Resolution: "The SAC at the 49th meeting dated 28 April 2005 resolved that the IFIs are allowed to perform transactions in forward foreign currency based on wa'd mulzim (binding promise) which binds on the contracting party. In addition, the party facing the losses may recover damages due to breach of promise".

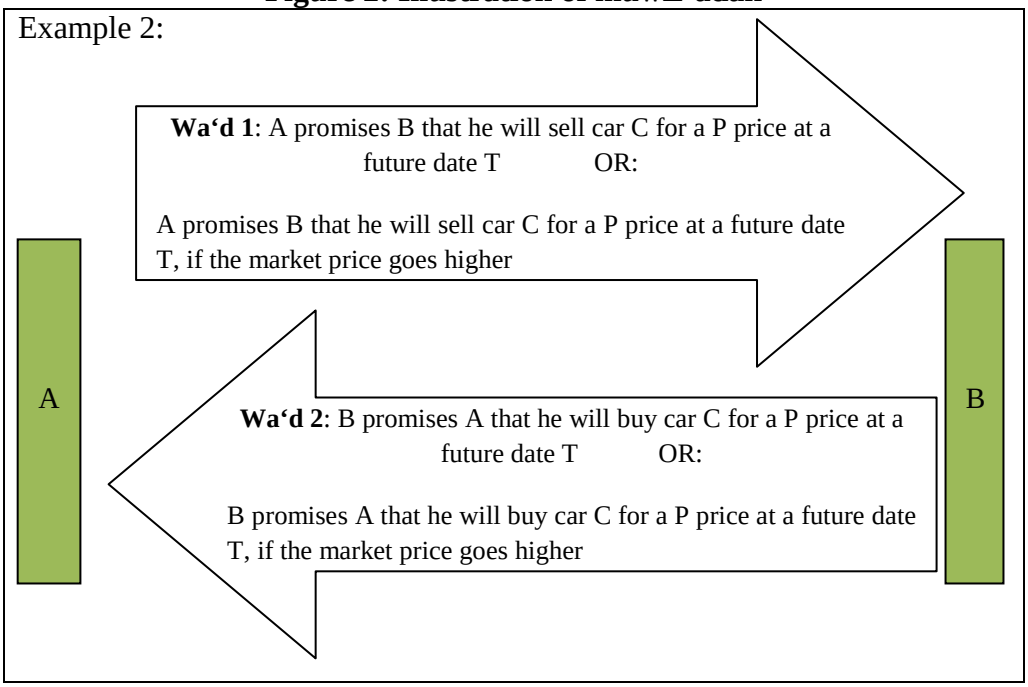
iv. The promisee should have an option not to proceed with the promise upon the execution of the contract.

v. A bilateral promise between the customer (promisor) and the institution (promisee) is permissible only if there is an option to cancel the promise which may be exercised either by both parties or by either one of them.

Definition of MuwÉ‘adah and Its Features

MuwÉ‘adah is derived from the word wÉ‘ada which connotes a mutual relationship between the two parties involved[6]. Technically, according to Ibn ‘Arafah, Ibn Rushd defined muwÉ‘adah as both parties promising to each other [to do something] (Al-Abdari, 1994).[7] In other word, it is a bilateral promise or undertaking by two parties to do something to each other in the future, either with a condition or without any condition (Hasan, 2008). Taking the same example given previously, an illustration of muwÉ‘adah based on the definitions given is shown in example 2.

Figure 2: Illustration of muwÉ‘adah



[6] According to Ibn ManÐËr, the difference between wa‘d and muwÉ‘adah is that the former comes from one party while the latter comes from two parties on a mutual basis. Refer: Ibn ManÐËr, *LisÉn al-‘Arab*, 3/462.

قَالَ أَبو مُعَاذٍ: وَاعَدْتُ زَيْدًا إذا وعَدَك ووَعَدْته. وَوَعَدْتُ زَيْدًا إذا كَانَ الْوَعْدُ مِنْكَ خَاصَّةً

[7] Please refer to the original text:

الْمُوَاعَدَةُ، قَالَ ابْنُ رُشْدٍ: أَنْ يَعِدَ كُلُّ وَاحِدٍ مِنْهُمَا صَاحِبَهُ لِأَنَّهَا مُفَاعَلَةٌ لَا تَكُونُ إلَّا مِنْ اثْنَيْنِ.. وَالْعِدَةُ أَنْ يَعِدَ أَحَدُهُمَا صَاحِبَهُ بِالتَّزْوِيجِ دُونَ أَنْ يَعِدَهُ الْآخَرُ

The implication of giving two wa‘d in the above example is that in wa‘d 1, A (i.e. the promisor) has to sell car C to B (i.e. the promisee) when the future date T approaches or if the market price turns higher. On the other hand, in wa‘d 2, B (i.e. the promisor) has to buy the car C from A (i.e. the promise) when the future date T approaches or if the market price goes higher.

Based on the above definitions and illustration, the main features of muwÉ‘adah can be summarized as follows:

i. There are two reciprocal promises given by two parties to each other, hence they are bilateral in nature. In other words, if there is a promise (from A) to sell and the promise (i.e. B) also makes a counter promise to purchase, then each of them is a promisor as well as promise (Abu Ghuddah, 2010).
ii. Both promises are on the same subject matter and based on the same condition, if any. Thus, they are inter-dependent and inter-related
iii. The delivery of both promises will occur in the future.

Therefore, muwa‘adah is different from *wa‘d* in terms of parties giving the promise, whereby in the former both parties give promises to each other while in the latter only one party involves in giving the promise (Mohamed, 2010).

Legality of Muwa’adah

Muslim scholars, particularly Malikis, have extensively dealt with the principle of muwÉÑadah in their discussion of a number of topics. In his book entitled “Idah al-Masalik ila Qawa‘id al-Imam Abi ‘Abdillah Malik”, al-Wansharisi (2006, p. 114) mentioned in the 69th principle that:

الأَصْلُ مَنْعُ المُواعَدَةِ بِمَا لا يَصِحُّ وُقُوْعُه فِي الحَالِ حِمَايَةً. ومن ثَمَّ مَنَعَ مَالِك المُواعَدةَ في العِدَّةِ، وعلى بَيْعِ الطَّعَامِ قَبْلَ قَبْضِه، وَوَقْتِ نِدَاءِ الجُمُعَةِ، وعَلَى مَا لَيْسَ عِنْدَك، وَفِي الصَّرْفِ مَشْهُوْرُها: المَنْعُ، وثَالِثُها: الكَرَاهَةُ، وَشُهِّرَتْ أَيْضًا، لِجَوَازِهِ فِي الحَالِ وَشُبِّهَتْ بِعَقْدٍ فِيْه تَأْخِيْرٌ.

> The original [ruling] is to disallow a bilateral promise to do something that would be invalid if it were done at present; [the rationale for it is] to prevent [abuses]. Therefore, (Imam) Malik disallowed a bilateral promise [to marry given] during the ‘iddah period, to sell food before taking possession, [to trade given] during the call for Friday prayer, and to sell something one doesn’t own. In the case of [a promise to conduct] a currency exchange (sarf), the famous view is prohibition; the third view—which is also well known —is that it is reprehensible (makruh), [based upon the fact that] it is allowed if done at present; but at the same time [the promise makes it] similar to a deferred contract.

Most Maliki scholars agree that it is impermissible to make muwaÑadah to do something that be invalid if it were done at present, the reason being to block the means (sadd al-dhari’ah) that lead to *ShariÑah* violations. However, they disagree on its pemissibility with regards to a currency exchange contract. There are three main opinions: the majority of Malikis disallowed muwaÑadah to conduct a currency exchange, Imam Malik and Ibn al-Qasim regarded its application as reprehensible (makruh), whereas Ibn NafiÑ considered muwaÑadah permissible (al-Khurashi, n.d.). Although MÉlikÊs did not specifically mention what type of muwaÑadah is allowed in currency exchange, it is evident from the following statement that the permissible muwaÑadah is one which is nonbinding.

According to al-ÑAdawi (al-Khurashi, n.d., p. 5:38):

> "... وأما **لَوْ أَرَادَا أَنْ يَعْقِدَا** بَعْدَ ذَلِكَ فَلَا ضَرَرَ كَأَنْ يَقُولَ لَهُ سِرْ بِنَا إِلَى السُّوقِ بِدَرَاهِمِك فَإِنْ كَانَتْ جِيَادًا تَصَارَفْنَا أَيْ أَوْقَعْنَا عَقْدَ الصَّرْفِ بَعْدَ ذَلِكَ، وَيُوَافِقُهُ الْآخَرُ فَلَا ضَرَرَ فِيهِ، وَالْحَقُّ أَنَّ الْمُرَادَ الْمُوَاعَدَةُ بِدُونِ عَقْدٍ، وَالْعَقْدُ بَعْدَ ذَلِكَ".

> If both parties would like to enter into the contract [of exchange], there is no harm in it. One of the parties says, “Let’s go to the market with your silver money; if it is good, then we will exchange it,” and the other party agrees. This actually means that a bilateral promise [takes place] without a contract; rather, the contract [of exchange] happens after that.

Meanwhile, Ibn Hazm, a Zahiri scholar who allowed muwÉÑadah in a currency exchange contract (n.d, p. 7:465), noted:

"وَالتَّوَاعُدُ فِي بَيْعِ الذَّهَبِ بِالذَّهَبِ أَوْ بِالْفِضَّةِ، وَفِي بَيْعِ الْفِضَّةِ بِالْفِضَّةِ، وَفِي سَائِرِ الْأَصْنَافِ الْأَرْبَعَةِ بَعْضِهَا بِبَعْضٍ جَائِزٌ **تَبَايَعَا بَعْدَ ذَلِكَ، أَوْ لَمْ يَتَبَايَعَا**؛ لِأَنَّ التَّوَاعُدَ لَيْسَ بَيْعًا".

> "A bilateral promise to buy gold with gold or silver, or to buy silver with silver, or to [buy other ribawi items] from the remaining four groups, one for another, is allowed, whether or not the two parties enter into a contract after that, because a bilateral promise is not a contract."

In other words, although muwÉÑadah is different from a contract (Ñaqd), its implication is similar to that of contract if it is made binding. Therefore, a binding bilateral promise (muwÉÑadah mulzimah) is not allowed in currency exchange contracts as it resembles a forward contract in which all parties are bound to enter into the contract without any option to cancel it. However, if the muwÉÑadah is non-binding (muwaÑadah ghayr mulzimah)—whereby one party or both parties have an option whether or not to exercise the promise in the future and, consequently, conclude the exchange contract or otherwise—then it is permissible.

Contemporary Resolutions on Muwa'adah

The majority of contemporary Muslim scholars also opine that muwa'adah is morally binding but not legally binding, and thus disallow muwa'adah mulzimah in financial contracts except in some necessary cases, particularly documentary credits for import and export transactions. In this regard, OIC Fiqh Academy in its 17th session (resolution no. 157 (6/17) resolved that:

"The **basic rule for bilateral promises** is that **they are binding from a religious point of view but they are not legally binding**. **There may be cases where it is impossible to conclude a sales agreement due to the commodity not being in the**

possession of the seller while a general need exists to oblige both parties to implement a contract in the future, either by legislation or some other means, such as the recognized practices of international commerce. An example of the latter would be opening a letter of credit in order to import goods. **In such cases it is permissible to oblige both parties to fulfill their promises**, either through governmental legislation or by the agreement of both parties to a clause in the agreement that will make **the promises binding on each of the two parties**". With regards to muwa'adah mulzimah in the contract of currency exchange, most decisions resolve that it is impermissible.[8] The observations that can be summed up from these resolutions are that bilateral promises in murÉbaÍah sales are allowed on the condition that either one party or both parties have the option to annul the promise and, hence, cancel the sale contract. Nevertheless, a binding bilateral promise (muwÉÑadah mulzimah) in murÉbaÍah sales is forbidden as it bears a similarity to the sale contract itself in terms of the implications. Nevertheless, a binding bilateral promise in murÉbaÍah sales is allowed for exceptional and necessary cases where it is impossible to conclude a sales agreement due to the commodity not being in the possession of the seller while a general need exists to oblige both parties to implement a contract in the future, either by legislation or some other means, such as a documentary credit for import and export. The majority of scholars agree on the impermissibility of binding bilateral promises in the currency exchange even for the purpose of hedging. However, a binding promise from one party and non-binding bilateral promises (muwÉÑadah ghayr mulzimah) are allowed in the currency exchange.

[8] **AAOIFI Standard on Currency Trading (Standard no. 1)**:A bilateral promise to purchase and sell currencies is forbidden if the promise is binding, even for the purpose of hedging against currency devaluation risk. However, a promise for one party is permissible even if the promise is binding

Dallah Barakah Conference: Fatwa no. 13:Question: What is the position on a bilateral promise for the purchase of various currencies at their price on the day of the agreement (the day of the promise) with both the exchanged currencies to be paid at future date, and with the exchanged of both being on the spot at that time? All of that will be either on the basis that the bilateral promises are binding or on the basis that they are not binding. **Fatwa**: If the bilateral promise is binding then it enters into the prohibition of selling a debt and is, thus, not permitted. However, if it is not binding on either party then it is permitted.

Kuwait Finance House: *Shari'ah* Fatwa no. 96: Question: A bilateral promise to buy a specified amount of a specified currency at a specified price within a specified period, with the seller pledging to deliver the amount.

Fatwa: This transaction is not permitted in the Shariah because it is a promise to buy currency. The format that is permitted in the Shariah for currency transactions is a decisive sale that is completed on the spot (i.e., the immediate transfer of one form of money for another).

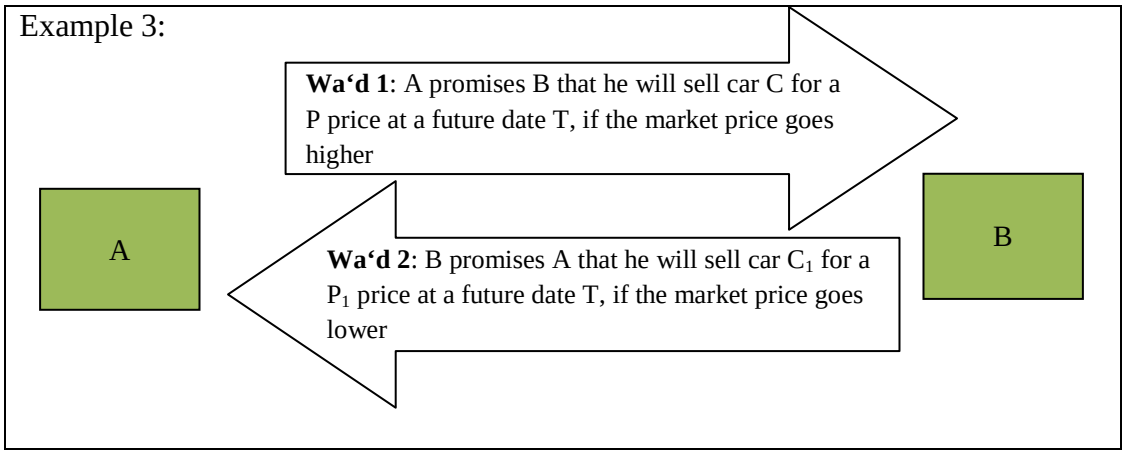
Definition of Wa'dan

The term wa'dan is newly introduced by contemporary scholars in order to differentiate two unilateral wa'd from muwa'adah. Hasan (2008) defined wa'dan as two unilateral promises, given by one party to another, that are not inter-related, and their application depends on two different conditions.
From this definition, wa'dan has two main features, namely:

i. Both promises (wa'd 1 and wa'd 2) are independent (not interrelated) from each other
ii. The application of the two promises depends on two different conditions

A simple example to illustrate the concept of wa'dan based on the above definition and requirements is depicted in example 3. Based on this example, both promises in the waÑdan will have different implications; whereby in waÑd 1, A (i.e. the promisor) has to sell his car to B (i.e. the promisee) if the market price is higher. On the other hand, in waÑd 2, B (i.e. the promisor) has to sell his car to A (i.e. the promisee) if the market price is lower. In both cases, the sale price is also different.

Figure 3: Illustration of Wa'dan



Application of this form of waÑdan does not raise any *SharÊÑah* issue, as the two promises are completely independent from each other (Mohammad & Muhamad, 2010). In this case, the ruling of waÑd applies. However, it is argued that this form is not practical for application in structuring Islamic financial products. Thus, current

applications of waÑdÉn in Islamic financial products differ slightly from the above example. They can be illustrated in the following scenarios:

1. Both promises are made about the same subject matter but have different conditions leading to two different economic effects; and
2. Both promises are done on the same subject matter but have different conditions leading to one economic effect only.

It is apparent that the two promises of waÑdÉn are deemed independent even though they are done on the same subject matter. Their independence is, rather, related to their conditions. As long as two unilateral promises have two different conditions and are exercised exclusively, they can be categorized as waÑdan rather than muwÉÑadah. Therefore, the only feature that will differentiate waÑdan from muwÉÑadah is the conditions, which must be different in the former but similar in the latter. Hasan (2008, pp. 6-7), however, argued that two-way waÑd can only be qualified as waÑdan if its conditions lead to two different economic effects, so as to ensure that the conditions are genuine.

In short, waÑdan is different from waÑd with regards to the number of parties giving the promises. While, in waÑdan, there are two parties giving two promises that have different conditions on the same subject matter, only one party gives the promise in waÑd. However, both are similar in a sense that only one promise will be ultimately exercised in both *waÑd* and waÑdan. As for comparing waÑdan with muwÉÑadah, both are different in terms of conditions and the number of promises exercised upon the time of execution. In waÑdan, two parties give two promises that have different conditions on the same subject matter, but only one of either will be executed in accord with the relevant condition. On the other hand, in muwaÑadah both parties give two promises that have same condition(s) on the same subject better, and both will be exercised simultaneously. Nevertheless, both waÑdan and muwaÑadah are similar in that the two parties involved become promisor and promisee at the same time.

After knowing the features of waÑdan, the similarities and differences between it and waÑd and muwÉÑadah, respectively, one question remains: what is the ruling on waÑdan?

The Ruling of Wa'dan

The determination as to whether waÑdÉn is permissible or impermissible depends on identifying the most appropriate principle that waÑdÉn falls under: is it closer to waÑd or muwÉÑadah? In this regard, there are two elements that require consideration:

i. The number of parties involved in giving the promise
ii. The number of promises to be executed in the future

From the definition and the criteria of waÑdÉn discussed earlier, there are two parties who give promises to each other (at the time of undertaking) and both assume the role of promisor and promisee at the same time. From this aspect, waÑdÉn resembles *muwÉÑadah*, except that the promises in waÑdÉn have different conditions and are independent. The other difference is that only one promise will ultimately be exercised in the future. From this second aspect, waÑdÉn resembles waÑd. Since waÑdÉn wears two hats (waÑd and muwÉÑadah) at the same time, there is another element that needs to be examined, i.e., the option (khiyÉr) to cancel the promise in this format so as to avoid it having an equivalent implication to that of a muwÉÑadah.

Compare and Contrast: Wa'd, Wa'dan and Muwa'adah

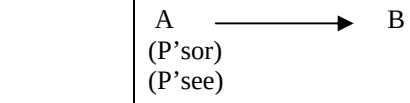
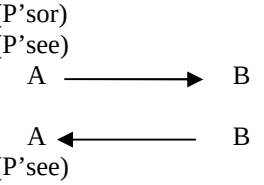
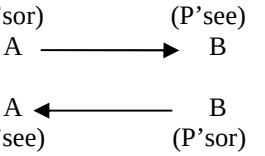
Table 1 further illustrates how an option (khiyar) to cancel a promise is applied in the principles of waÑd, waÑdan and muwaÑadah: It is as illustrated below.

Although the likelihood of a promise not being executed is very minimal when an option is given to the promisee in waÑd and waÑdÉn, and only to one promisor in muwÉÑadah, it is obvious that the option serves as a mechanism to avoid any conclusion of a contract based merely on a promise.

When the option is given to one promisor only in muwÉÑadah, it becomes a binding *waÑd*, i.e., binding on the other promisor. On the other hand, when both promisors are

given the option, then it can be regarded as a non-binding muwÉÑadah (muwÉÑadah ghayr mulzimah) in which both parties will have a complete freedom not to execute the promises.

Table 1: The Option to Cancel the Promise in Wañd, Wañdan and Muwañadah

	Wa'd Mulzim	**Wa'dan**	**Muwa'adah**
To whom the option is given	Promisee  	Promisee in each *wa'd*  	To one promisor or both promisors 
When is the option given?	At the time the wa'd is executed; Thus: The promisee may choose whether to execute the wa'd and enter into the contract or not)	At the time of executing the wa'd that matches the condition; Thus: The promisee may choose whether to execute the wa'd and enter into the contract or not)	At the time of execution of the muwa'adah*;* Thus: i. One party (the promisor will exercise the wa'd while the other (promisee) has the option to cancel it – as in the case of wa'd, OR ii. Both parties (in their capacity as promisors) may choose not to execute the muwÉ'adah and not to enter into the contract)
Why the option is given?	To avoid the conclusion of a contract merely based on a binding promise	To avoid the conclusion of a contract merely based on a binding promise	To avoid the conclusion of a contract merely based on a binding bilateral promise

Since options are given to both promisees in waÑdan, it appears at first glance to share a feature of muwÉÑadah. However, a closer examination reveals that the option given in waÑdan complies to the rule of a binding waÑd. This is due to the fact that the option is only effective in the future, i.e., at the time of executing the promise. In other words, upon the execution of the promise in waÑdan, the promisee still has the option to annul the promise and decide not to conclude the contract. Thus, the waÑdan documentation should not eliminate in any way the element of option that the promisee has upon the execution of the promise.

Hence, the paper strongly believe that waÑdan is a legal trick (*hilah*) to avoid two promises on the same subject matter becoming a binding muwÉÑadah, which is not allowed by most scholars. The legal trick works through having different conditions

that will eventually lead to the exclusive execution of one binding waÑd in the future. Since the majority allows a binding waÑd if it is made contingent upon a condition, it is inaccurate to deem waÑdan as impermissible. A summary of the elements in determining the principles under which the ruling of waÑdÉn falls is depicted in Table 2.

Table 2: Elements that Determine the Ruling on WaÑdÉn

Elements	**Wa'd Mulzim**	**Wa'dÉn**	**MuwÉ'adah**
Parties giving the promise	1 party	2 parties	2 parties
Conditions	1 (if any)	2 different conditions	Same conditions (if any)
Promises executed	1 promise	1 promise	2 promises (if no option is given)
To whom the annulment option is given	Promisee A ⟶ B (P'sor) (P'see)	Promisee in each wa'd (P'sor) (P'see) A ⟶ B A ⟵ B (P'see) (P'sor)	Promisor (either one or both) (P'sor) (P'see) A ⟶ B A ⟵ B (P'see) (P'sor)

An analysis of various Shari'ah-compliant hedging instruments that utilize two-way wa'd in the next section will further comprehend whether the instruments are employing two-way wa'd (wa'dan) or muwa'dah (as has been earlier explained). In addition, the Shari'ah issues involved will also be critically analyzed. The hedging instruments discussed are Islamic FX Forward and Islamic Profit Rate Swap (IPRS). A more detailed discussion can be found in the following section.

3. HEDGING INSTRUMENTS – AN INTRODUCTION

Hedging is identified as a type of risk management stratagem that is used in limiting or offsetting probability of loss from the instability that arises in the prices of commodities, currencies, or securities. Hedging is also known to be a transfer of risk without the presence of any insurance policies. In addition, it utilizes various techniques but mainly involves in taking equal and opposite positions in two different markets (such as cash and futures markets). Hedging is also used in protecting one's

capital against the effects of inflation through investing in high-yield financial instruments (shares, bonds, and notes), real estate, or precious metals.[9]

In the case of Islamic finance, to address the concern of the treasury management and the importance of the future development of the industry, the Islamic financial institutions (IFIs) need financial products that can be utilized for hedging against the various financial risks (Suwailem, 2006).[10] These products play a prominent role in helping to guarantee the industry's long-run viability as a genuinely distinct business model. Moreover with the rapid progress of Islamic finance, IFIs can no longer afford to leave their positions un-hedged. Thus there is greater consensus now on shaping the Islamic financial services industry on the risk-hedging tools. Hence there are many hedging instruments now which are becoming more known and common across the Islamic jurisdictions. As stated by Wardrep and Buck (1982), hedging instruments are recognized to be a more effective mechanism to alleviate certain types of risks, which otherwise cannot be efficiently managed using other natural risk management strategies like diversification and concentration.[11] In addition, hedging will also increase liquidity management, enhanced the cash markets at lower funding cost, and ensure an efficient transmission of funds from lenders to borrowers.[12] However from the standpoint of fiqh muamalah (Islamic jurisprudence), certain essence of Islamic financial contracts are absent in the conventional hedging instruments. Derivatives are not commonly accepted by Shari'ah scholars as permitted financial instruments due to their speculative nature.[13] Thus it is noteworthy to point out that unlike the conventional hedging instruments, the Islamic hedging instruments are strictly used for hedging purposes only and not for speculative trading activities.

[9] http://www.businessdictionary.com/definition/hedging.html

[10] Sami Al-Suwailem, "Hedging in Islamic Finance", Occasional Paper No. 10, Islamic Development Bank, Jeddah, 2006

[11] Wardrep, B. N. and J. F. Buck, "The Efficacy of Hedging with Financial Futures: An Historical Perspective," *Journal of Futures Markets*, vol.2, pp.243-254

[12] Andreas A. Jobst and Juan Sole, "The Operative Principles of Islamic Derivatives – Towards a Coherent Theory", IMF Working Paper, WP/12/63

[13] *Shari'ah* is not a codified body of law but a principle-based legal system that is subject to interpretation in the way it governs social, economic and political relationships and institutions (Tredgett and others, 2008).

Presently, there are several Islamic hedging instruments that are being structured and widely used in treasury to mitigate the investment risks. To date, there are at least four different types of hedging instruments which are prominently used in the Islamic finance industry, and are verified as fulfilling the Shari'ah principles. The instruments are identified as Islamic Foreign Exchange Swap (hereafter Islamic FX swap), Islamic Foreign Exchange Forward (hereafter Islamic FX forward), Islamic cross-currency swap and Islamic Profit Rate Swap (hereafter IPRS). Despite the present reservations, both Shari'ah scholars and practitioners do acknowledge the vital advantages of the viable hedging instruments.

Since the main objective of the paper is to explore the fiqhi rulings on two-unilateral promises (wa'dan – also known as wu'd mutabadalah), the paper will only focus to study the hedging instruments that utilizes two-unilateral wa'd. Presently the hedging instruments are Islamic FX forward and IPRS. It needs to be elucidated here that the comprehensive observation of the Shari'ah principles and structures relating to these products is vital to ensure that the products are truly in content with the obligations of Shari'ah. Thus to get a clearer picture of the hedging instruments that are recognized as Shari'ah compliance and utilizing the two-unilateral wa'd, the following section will explain the products available in the market. The paper will explain its utilization in the conventional stream first before moving to explain its utilization as a type of Islamic hedging instrument.

Islamic Foreign Exchange Forward (Islamic FX Forward)

In a conventional FX forward, both settlement and delivery by the two parties will only happen at a future agreed date while the contract is agreed today. The FX forward contract slightly differ from the FX Swap contract mainly because the exchange only takes place once in the former while there is an involvement of both exchange and re-exchange of currency in the latter. However the main aim of both is to manage and hedge against the fluctuation risk of the currency exchange rate. The conventional FX forward led to Shari'ah issues of bay' al-sarf. The requirement of bay' al-sarf is that the exchange of the two different currencies should be transacted on a spot basis, and not according to the normal practice of the conventional FX forward. This eventually led to the structure of Islamic FX forward (Shari'ah-

compliant and customized hedging solutions), which is developed to achieve the similar objectives as its conventional counterpart, but most importantly adhering to the rules and principles of Shari'ah. The three main structures commonly offered in the Islamic finance market are firstly, the structure based on bay' al-tawarruq (as a commodity murabahah transaction), secondly the structure utilizing the concept of wa'd and thirdly the structure based on the concept of two-unilateral promises (wa'dan). The paper will further delineate the third structure.

Islamic FX Forward Based on Wa'dan Structure

To further understand how these two unilateral promises (wa'dan) are being utilized in the structuring of the Islamic FX forward, it is as depicted in Example 4.

Let us now assume that the SGD/MYR rate on the 22nd August 2011 falls below 3.4 (say 3.3). The customer will exercise its right according to Scenario 2 above. This is because the customer will get more MYR from the IFI than going to the market and selling it at 3.3. Alternatively if the SGD/MYR rate on the 22nd August 2011 is above 3.4 (say 3.5), the IFI will exercise its right according to Scenario 1 above. This is because it is cheaper for the IFI to purchase from the customer at 3.4, than going out to the market and purchasing it at 3.5. In both of the scenarios above, the actual trade of currencies will only take place at the maturity date 22nd August 2011. This does not violate the Shari'ah ruling of currency trading where the currencies traded has to be made on a spot basis.

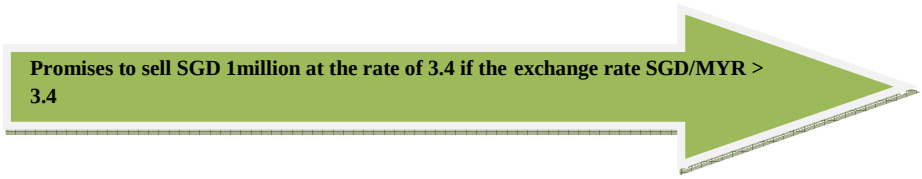
Figure 4: Islamic FX Forward Based on Wa'dan (Two-Unilateral Wa'd)

Example 4

At Dealing Date

Customer

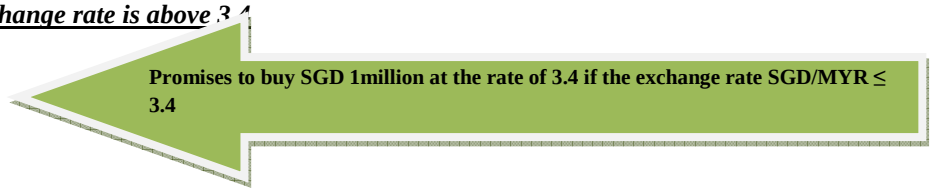
IFI



Scenario 1: The customer undertakes wa'd (promise) with the IFI that it will sell SGD 1million for MYR at a SGD/MYR exchange rate of 3.4 (i.e. for MYR 3.4m) **on 22nd August 2011**, ***if the SGD/MYR exchange rate is above 3.4***

Customer

IFI



Scenario 2: The IFI undertakes wa'd with the customer (promise) that it will buy SGD 1million at a SGD/MYR exchange rate of 3.4 (i.e. for MYR 3.4m) **on 22nd August 2011**, ***if the SGD/MYR exchange rate is below or equal to 3.4***

Islamic FX Forward – Possible Shari'ah Issues

The possible Shari'ah issue that might occur in this above structure is the similarity of the two-unilateral wa'd (wa'dan) to a bilateral promise (muwa'adah), which has been a contentious Shari'ah issue for a long time. Muwa'adah is a bilateral promise or undertaking by two parties to do something to each other in the future, either with a condition or without any condition (Hasan, 2008). In other words, it is a pair of promises given by two parties to each other on similar subject matter with the effects of the promises taking place at the same time.

For example, in the muwa'adah diagram (Figure 2), the implication of giving two wa'd is that in wa'd 1, A (i.e. the promisor) has to sell car C to B (i.e. the promisee) ***when the future date T approaches or if the market price turns higher***. On the other hand, in wa'd 2, B (i.e. the promisor) has to buy the car C from A (i.e. the promise) ***when the future date T approaches or if the market price goes higher***. The objection to this kind of promise is due to the fact that such promise is similar to that of the contract itself. This is based on the view which says that a promise is binding.

Although muwa'adah is different from a contract (aqd), its implications is similar to that of contract if it is made binding. Therefore, a binding bilateral promise (muwa'adah mulzimah) is not allowed in currency exchange contracts as it resembles a forward contract in which all parties are bound to enter into the contract without any option to cancel it. However, if the muwa'adah is non-binding (muwa'adah ghayr mulzimah) – whereby one party or both parties have an option whether or not to exercise the promise in the future and, consequently, conclude the exchange contract or otherwise –it is then permissible. ***In the above Islamic FX forward structure (based on wa'dan), only one scenario will take place upon the maturity date – either the customer will exercise its right or IFI will exercise its right.*** In this structure, ***Scenario 1 will take place on the 22nd August 2011, if the SGD/MYR exchange rate is above 3.4*** and ***Scenario 2 will take place on the 22nd August 2011, if the SGD/MYR exchange rate is below or equal to 3.4***. Thus it is clear that both of the scenarios are different, thus leading to different implications. In addition, it is also being exercised exclusively as only one scenario will take place (either the SGD/MYR exchange rate is above 3.4 or SGD/MYR exchange rate is below or equal to 3.4). Thus this differs from the muwa'adah structure (Figure 2), whereby both A and B promises to sell and buy the car respectively if the market price goes higher. Instead it is more inclined to the features of wa'dan.

However there are still ongoing debates, criticisms and unresolved Shari'ah issues towards the structuring of the Islamic FX product with the utilization of the two-unilateral wa'd. In addition, many IFIs are utilizing the above structure as many scholars have approved it, and deemed it as different from muwa'adah. But these structures are utilized mainly on the condition that it has to be used for hedging purposes only, and not for speculative activities which are widely used in conventional finance (Dusuki and Mokhtar, 2010).

Islamic Profit Rate Swap (IPRS)

The conventional profit rate swap does not involve the exchange of capital value and there is also no exchange of different currencies. Instead, it only involves the exchange of the cash flow in the same currency, between the flows of the fixed rate with the flow of the floating profit rate.

A clearer understanding of the Islamic Profit Rate Swap (IPRS) is as stipulated below. Assuming an agar wood company named Al Tamimi Ltd has bought a machine priced at JOD5 million using the ijarah form *of* financing. The rental that needs to be paid every month is based on LIBOR. Supposedly the current LIBOR rate is at 3%. However due to the uncertainty in the market conditions of the economy, there is a high probability that LIBOR will increase, leading to higher machine rental payment by Al Tamimi Ltd. Without any hedging mechanism, and since it is based on LIBOR, Al Tamimi Ltd will be exposed to the risk of rental-rate fluctuations. For example, if LIBOR increases to 4% after a year, Al Tamimi Ltd will be forced to pay a higher rental rate of JOD200, 000 per year, as compared to JOD150, 000 per year before the increment took place. In this scenario, the increment in rental fees amounted to JOD50, 000 per year. Al Tamimi Ltd may wishes to change the financing from a floating rental rate into a fixed-rate financing; so as to ensure that the company's operating costs are controlled. Thus to ensure that Al-Tamimi Ltd can evade from the increment risk in rental rate, Al Tamimi Ltd can do a profit rate swap with IFI without changing the original agreement.

In the present Islamic hedging market, there are two variations or structures of IPRS employed by IFIs. They are:-

1) IPRS based on wa'd and musawamah principles
2) IPRS based on wa'd and murabahah principles

Both the products mentioned above involve a commodity sale transaction. However there is a slight difference between the musawamah and murabahah version. In the former, the cost is unknown to the investor whereas the investor knows the cost up front in the latter. The price can be fixed from the start in the murabahah version, whilst for the musawamah version, the wa'd which is given at the beginning will only be executed on the transaction day after the cost has been identified. For the sake of discussion of this paper, it will only focus on the musawamah version as there an involvement of two unilateral promises in the structure (wa'dan), unlike the murabahah version where there is only one use of wa'd from the investor only.
Further explanation of the IPRS based on wa'd and musawamah principles can be found below:

Islamic Profit Rate Swap (IPRS) Based on Wa'd and Musawamah Principles

There are 3 stages involved in the IPRS based on the wa'd and musawamah principles. ***The first stage***, which is also identified as the initiation period involves the actions of wa'd. At this stage, the IFI will give wa'd to the investor to execute a series of musawamah contracts by paying the price based on a fixed rate for a certain period of duration. Concurrently, the investor will give wa'd to the IFI to execute a series of musawamah contracts by paying the price based on a floating rate for a certain period of time. The two *wa'ds* given are two independent promises that are free from each other. Wa'd is being utilized here to prevent any withdrawals from the contract.[14] ***The second stage*** is known as the transaction period. Using the similar illustration earlier, for example Al Tamimi Ltd needs to pay for its machine financing based on the LIBOR rate. But the company wishes to make its rental rate fixed, Al Tamimi Ltd will then buy from the IFI a commodity that is valued at a fixed rate (for example 4%). With that, Al Tamimi Ltd needs to pay to the IFI a monthly payment of JOD16, 667. The IFI will then purchase the commodity from the investor, and the price will be fixed based on LIBOR (monthly). For example, the payment that needs to be made by the IFI is at floating rate of 2.75% (JOD11, 459). The effect is that Al Tamimi Ltd needs to pay a fixed rate to the IFI and will obtain a floating rate from the IFI (monthly). The floating rate received will protect Al Tamimi Ltd from any increase in its operating costs (that is based on the floating rate).

Entering into a profit-rate swap will ensure that the investor is protected from the possibility of an increase in the floating rate. For example if the floating rate continues to rise, the company will end up paying a higher rental every year. To ensure that this will not happen and to protect itself from the increment in LIBOR, the company enters into a profit rate swap with the IFI. Al Tamimi Ltd will pay a fixed rate of 4% (JOD 12,500) no matter how much the floating rate increase or decrease. It must be reminded in the profit rate swap, even if the floating rate is below the fixed rate or above the fixed rate; the company must still pay the fixed rate amount. ***Finally the third stage*** is the net settlement on the transaction date. During this date, neither

[14] If the company wishes to cancel the *wa'd*, it must pay *ta'widh* (compensation) on the actual cost that is borne by the bank, if any. See *Majallat Majma' al-Fiqh al-Islami*, Resolution nos. 40 & 41 (2:5 & 3:5), 10-15 December, 1998, Kuwait.

the IFI nor the investor will pay the real value, but it will only be offset off the net value. A positive net value to the investor means that the IFI will pay the investor and vice versa. A more comprehensive understanding of the IPRS Cash Flow can be found in Table 3 below:-

Table 3: Cash Flow of Islamic Profit Rate Swap (IPRS)

Month	1	2	3	4	5	6	7	8	9	10	11	12	
Floating Rate (%)	3%	2.9%	3.05%	3.10%	4%	4.2%	4.3%	3.05%	3%	3.4%	2.75%	3%	
Fixed Rate (%)	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	4%	
Floating Rate	12,500	12,083	12,709	12,917	16,667	17,500	17,917	12,709	12,500	14,167	11,459	12,500	
Fixed Rate	16,667	16,667	16,667	16,667	16,667	16,667	16,667	16,667	16,667	16,667	16,667	16,667	
Net Value for Investor	(4,167)	(4,584)	(3,958)	(3,750)	0	833	1,250	(3,958)	(4,167)	(2,500)	(5,208)	(4,167)	**(34,376)**

IPRS – Possible Shari'ah Issues

The IPRS that has been discussed contains a combination of numerous contracts into one transaction. For example, based on the above discussion, a series of musawamah contracts are effected between the contracts based on a floating rate and fixed rate value price. This may lead to some issues of Shari'ah whereby the Prophet (peace be upon him) prohibit the consolidation of the two contracts.[15] Imam Malik in his Al-Muwatta' stated that the Prophet (peace be upon him) prohibited the combination contracts of both sale and debt, that is combining two sales contracts in one contract and combining two transactions in one transaction.[16] Even though the Prophet (peace be upon him) banned the incorporation of several contracts, there are some views that permitted it but only with restricted conditions.

Amongst them is the narrated story of Sayyidina Umar (r.a.) ibn al-Khattab, while dispatching Ya'la ibn Munyah to Yemen. Sayyidina Umar (r.a.) was reported to have list down the following requirements in purchasing cultivable land. He stated that if

[15] Ahmad, al-Musnad, 1:198; *Nayl al-Awatar*, 5:152

[16] Imam Malik, *al-Muwatta'*, 2:663

the seeds, cows and cultivating instruments are from Umar (r.a.), they will get one-third and Umar (r.a.) will get two-thirds. If however, all these were from them, they will get half and Umar (r.a.) will get half. In a similar instance, he (Umar) gave date palms and grape vines such that Umar (r.a.) would get two-thirds and they would get one-third.[17] This transaction done by Umar (r.a.) has raised some queries as it may involve two contracts into one contract. However it might be possible that an array of choices was offered, and the other party was asked to choose between them before the agreement which then took effect on the option of choice. With regards to the permission of combining more than one contract, some views allowed as long as the contract itself is permitted in the Shari'ah and it is to remain independent. The contracts should not link to one another. Among the resolutions issued are as follows:

(i) AAOIFI (2007) Guidelines and Conditions for Combining Several Contracts into One Single Transaction:

1) Combining contracts should not include the cases that are explicitly banned by Shari'ah. For example, contracts that combine a sale and loan into one contract.
2) Combining contracts should not be used as a ploy to commit usury (riba'), such as an agreement between two parties to practice a sale and buyback transactions (bay' al-inah) or riba al-fadl.
3) It should not be used as an excuse for practicing riba'. The two parties could misuse, for instance, contract combining when they conclude a lending contract that, at the same time, facilitates some other compensatory gains to them. For example, they could stipulate in the contract that the borrower should offer accommodation in his house to the lender, or grant him a present. Contract combining could also be used misused by imposing excess repayment in terms of quantity or quality on the borrower.
4) Combined contracts should not reveal disparity or contradiction with regard to their underlying rulings and ultimate goals. Examples of contradictory contracts include granting an asset to somebody as a gift and selling/lending it to him simultaneously, or combining mudarabah (profit-sharing contract) with

[17] Al-Bayhaqi, al-Sunan al-Kubra, (in al-Maktabah al-Shamilah, 3rd edition), 6:135

lending the mudarabah capital to the mudarib, or currency exchange with ji'alah, or salam with ji'alah for the same contract value or leasing with selling (i.e. hire-purchase in its traditional form)

(ii) Kuwait Finance House Shari'ah Fatwa No. 23: Ijarah/Rental-Rate Swap based on wa'd mulzim min taraf wahid (unilateral binding promise) in the Musawamah and Tawarruq:

1) The agreements in that structure are actual (e.g. there is no fictitious contract).
2) It has its effects. For example, a sales agreement gives the effect of ownership. There should not be any obstacle to exercising the rights of ownership (milkiyyah tammah). It is up to the buyer to either sell it or keep it and use it.
3) The agreements are separate.
4) The agreements are not conditional upon one another.[18]

In addition to the above, another form of hindrance towards the development of IPRS is the legal disability that it faces which has put many investors and institutions dealing with Islamic finance at a disadvantage. This usually prolongs the execution of transactions in the Islamic finance industry. However with the recent completion of the first standard derivatives documentation assures the alignment of Shari'ah in this area. In the year 2010, both the Bahrain-based International Islamic Financial Market (IIFM) and the International Swaps and Derivatives Association (ISDA) published the most awaited Tahawwut (Hedging) Master Agreement (TMA). This agreement standardizes the Shari'ah-compliant swap-based hedging activity and signifies an important step towards a greater transparency and standardization of Shari'ah-compliant risk management.[19]

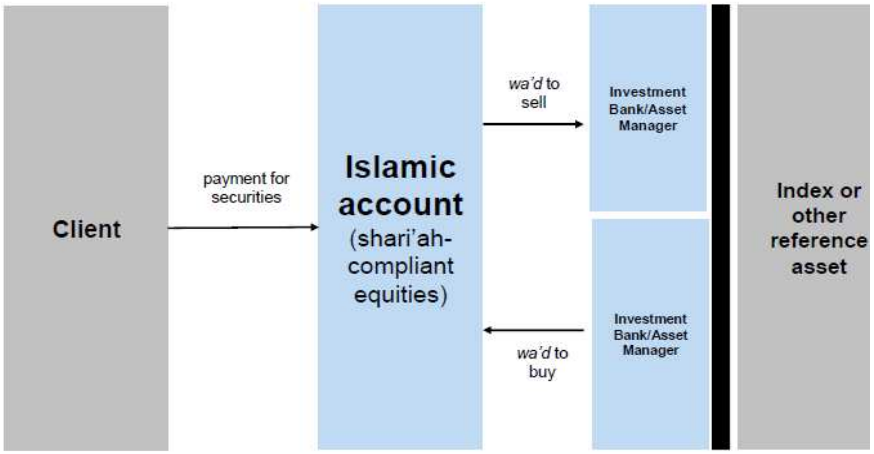
In addition, the table below also shows that this Shari'ah-compliant derivative which utilizes the two-unilateral *wa'd* has also been linked to controversial *Shari'ah* issues as the swaps which involves both *Shari'ah*-compliant asset portfolio and designated

[18] See Ahmad Suhaimi Yahya (2008) Hedging Mechanism in Islamic Finance According to *Shari'ah* Perspective. Presented in the 3rd Shari'ah Advisors Islamic Finance Dialogue, organized by Centre for Research and Training (CERT). 17 November, 2008. Kuala Lumpur.

[19] Andreas A. Jobst and Juan Sole, "The Operative Principles of Islamic Derivatives – Towards a Coherent Theory", IMF Working Paper, WP/12/63

index (reference investment portfolio) may contain conventional assets, thus permitting the investors to gain access to assets proceeds that are against the principles of Shari'ah. This swap structure does not abide to the rules of Shari'ah as the proceeds from the investment portfolio are not from religiously acceptable activities. A clearer arrangement of the two-unilateral wa'd can be found in the Table 4.[20]

Table 4: Islamic Total Return Swap (Wa'd) Arrangement (Adapted from IMF Working Paper/12/63)



4. CONCLUSION

As has been earlier explained, this paper was prepared to mainly explore the *fiqhi* rulings of hedging instruments that utilizes the two-way unilateral promises (wa'dan – also known as wu'ud mutabadalah). Thus this paper analyzes the concepts and mechanisms of Shari'ah compliant FX forward and swaps that utilize two-way wa'd as the underlying principle by initially providing an overview of the similar products offered by the conventional financial institutions. However before understanding further on the utilization of the two-way wa'd as the underlying principle for these abovementioned products, the paper has looked into the bindingness of wa'd and muwa'adah from the Shari'ah dimension first for greater clarity, and to further comprehend whether structures that utilize two-way wa'd comply to the rules of wa'd or they resemble the features of muwa'adah (bilateral promise) Most importantly, the paper explored on the concept of wa'dan and its ruling.

[20] DeLorenzo, Yusuf Talal, 2007, "The Total Returns Swap and the 'Shariah Conversion Technology' Stratagem," *Dinar Standard* (available at: www.dinarstandard.com/finance/DeLorenzo.pdf)

With regards to the concept of waÑd, many classical jurists, particularly from the MÉlikÊs, use the term within the context of unilateral contracts such as a loan or gift. The majority considers fulfillment of a waÑd not to be obligatory; therefore, it is not religiously or legally binding on the promisor. On the other hand, a minority opines that fulfilling a waÑd is obligatory under all circumstances. Some ×anafÊ and MÉlikÊ scholars hold a middle position that fulfilling a waÑd is legally binding upon the promisor if the promise is contingent or the promise is attached to a cause and the promisee has acted upon that cause. In the modern era, especially with the vast growth of Islamic banking and finance, waÑd is deemed religiously and legally binding by most SharÊÑah scholars in many Islamic financial transactions. Muslim scholars in the past, particularly the MalikÊs, have also discussed the concept of muwÉÑadah in relation to marriage and some exchange contracts such as trading something which is not owned, trading food before taking possession, trading during the call for Friday prayer and currency exchange (Îarf). They disallow muwÉÑadah if it is related to something that would be invalid if it were executed at the very time the promise is made. The basis for the prohibition is to block the means leading to forbidden acts (sadd al-dharÊÑah). With regards to muwÉÑadah in a currency exchange, they had divergent views. While the majority disallowed it, some scholars considered it lawful but disliked it. On the other hand, a minority considered muwÉÑadah in a currency exchange as neutrally permissible, but in a non-binding context. WaÑdÉn is a relatively new term introduced by modern scholars as a legal trick (ÍÊlah) to avoid two promises on the same subject matter on becoming a binding muwÉÑadah. This is not allowed by most scholars. The legal trick works through having different conditions that will eventually lead to the exclusive execution of one binding waÑd in the future.

Subsequently, the paper then focuses on hedging instruments that utilized two-way wa'd that have been structured and altered to meet the requirements of Shari'ah. The most important aspect which differentiates the Islamic hedging instruments from the conventional ones are the requirement for the hedging instruments to adhere to the principles of Shari'ah and the contract forms and procedures it permits. Although the implication and economic effects of the Islamic hedging instruments tend to be similar with the conventional ones, the most important that differentiate between the two is that the former must be in accordance with the principles and objectives of

Shari'ah. This is to prevent any types of deviation or abusive use of this instrument for a reason that is not permitted in Shari'ah. The paper then briefly investigates the Shari'ah issues that potentially arise with the utilization of the two-way wa'd on Islamic FX forward and IPRS - whether it is similar to muwa'adah where majority of the scholars disallowed it, or similar to wa'dan where eventually will lead to exclusive execution of one binding *wa'd* in the future. However further comprehensive investigation by the Shari'ah scholars and jurists are highly initiated to ensure that the products of this type truly fulfill the requirements of Shari'ah, including its principles and objectives. Lastly, the release of the IIFM/ISDA Tahawwut (Hedging) Master Agreement (TMA) represent a step in the right direction. However it is yet to be known if this transaction standard will be used on other newly devised risk management techniques to ensure better accountancy for Shari'ah principles.

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THE VOLATILITY OF STOCK MARKET INDEX RETURN: A COMPARATIVE STUDY BETWEEN ISLAMIC AND CONVENTIONAL STOCK MARKET INDICES

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Abstract

This paper aims to compare between Islamic stock market and conventional stock market index volatility. Since the stock market has strong relation with monetary policy condition, this study would like to investigate which monetary policy variables most influence volatility in both Islamic and conventional stock market. The variables that are tested in this study include money supply (M3), interest rate (TBR), exchange rate (MYR) and Industrial Production Index (IPI). Apart from that, Federal Fund Rate (FFR) also is included as one of the monetary policy variables for the proxy of international influence. In an attempt to compare the volatility between Islamic and conventional index, FTSE Bursa Malaysia KLCI and FTSE Bursa Malaysia Emas Indexes are used as proxies for conventional and Islamic stock market respectively. Monthly historical data that are being utilized is from January 2000 to December 2010. This study adopts Generalized Autoregressive Conditional Heteroscedasticity (GARCH) model as the volatility estimation technique for both Islamic and conventional stock market indices. The study found that interest rate does affect the volatility of both Islamic and conventional stock market index return. This is due to the behavior of investors in managing their investment allocation. However, the rate of inflation has no effect on both Islamic and conventional stock index return. Besides, 2008 financial crisis does not give an exception to our country, Malaysia. The crisis also affects both Islamic and conventional stock market volatility. The government's move to react with monetary expansion was a great action to curb the financial crisis.

Keywords: Monetary policy, GARCH, Stock market index

1. INTRODUCTION

A stock market index is a hypothetical basket of securities designed to track market changes. Stock market indexes measure the general behavior of stock prices over time. The word indexes tend to be used when people discuss market behavior as it has

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been used to measure the current price behavior of a representative group of stocks in relation to a base value set earlier.

Many investors realized that stock market is a volatile place to invest money. By committing with high level of risk, the investors expect to gain high return too. Volatility is the measure of dispersion around the average return of a security. In term of modeling and forecasting, volatility means the conditional variance of the underlying asset return (Tsay, 2005). As volatility is unobservable in financial market, usually the investors will measure volatility through standard deviation or variance of return. The higher the standard deviation the higher the risk they are exposed to and the larger the expected return. However, risk can also move in negative side, meaning the larger the loss expected.

The stock market volatility appears to move rapidly across countries. In financial economics, the interdependence degree between the international equity markets became an important issue. Not only that, volatility also influenced investment, security valuation, risk management and monetary policy making (Poon and Granger, 2003). In economic terms, changes in volatility will give respond to stock market (Guidi and Gupta, 2012). During the past three decades, volatility has attracted attention of many researchers. Several studies such as Syriopoulos (2005), Ciner (2006), and Mukherjee and Bose (2008) have concluded that market volatility, integration and volatility transmission have increased rapidly.

Day by day investors are exposed to volatile market environment. The financial markets are witnessing liberalized capital movements and financial reforms. In Malaysia, the stock market volatility has been affected by various macroeconomics variables such as interest rate and inflation rate. Apart from that, there also exist other macroeconomic variable which is rarely being focused by other past studies on stock index volatility, namely monetary policy variables.

While lot of studies incorporate to conventional stock market index, less attention given to Islamic counterpart, especially regarding to its volatility. Hence, there is a need to study the linkage between both Islamic and conventional to its volatility. Thus, this study is conducted to show the existence of volatility relationship of Islamic and conventional stock market index by considering interest rate, inflation

rate and other monetary policy variables. The study will verify more on the effect of macroeconomic variables on both Islamic and conventional stock market index volatility from January 2000 to December 2010. The monetary policy which acts as the independent variables includes broad money supply (M3), Treasury Bills Rate (TBR) for interest rate, exchange rate (MYR), Consumer Price Index (CPI) for inflation rate and Industry Price Index (IPI) for real output. The study also includes variable Federal Funds Rate (FFR) for foreign monetary policy changes.

Therefore, this study intends to focus on the following objectives:

a) To evaluate the impact of selected macroeconomic variables on the Islamic and conventional stock market volatilities.
b) To examine the relationship between Islamic and conventional stock market volatilities and the volatilities of the monetary policy variable
c) To observe the effect of 2008 financial crisis on the Islamic and conventional stock return in Malaysia.

The paper is organized as follows. Chapter one is an introduction of the study. The chapter mentions the problem statements, limitation, significant of the study and its objectives. Chapter two focuses on literature review of previous studies. Chapter three describes research methodology employed in the study. The chapter introduces data set and alternatives model for modeling volatility. Chapter four illustrates the results obtained. The chapter also briefly explains on the analysis of the result provided with some discussion. Chapter five concludes the study by giving summary of the study outcomes.

2. LITERATURE REVIEW

Stock market volatility

Numerous related studies can be found focusing directly or indirectly to the volatility of both Islamic and conventional stock market indices. As the stock market indexes fluctuate very volatile, investors believe that the higher the stock market index volatility indicates higher in return. Fang and Miller (2002) investigate empirically the effects of daily currency depreciation on Korean stock market returns. There were three channels of currency depreciation which affect Korean stock market. The

positive cumulative effect of exchange rate depreciation on the stock return means the higher is the volatility exchange rate depreciation, the higher is the stock market return. The study found that the higher exchange rate volatility should reduce the demand for dollar assets and increase the demand for domestic stock.

Similarly, there exists other research on Islamic stock market index volatility. Using a well-designed econometric study based on time series methods supported by cointegration analysis, Hakim and Rashidian (2005) examined how DJIMI affected the performance of Islamic investments represented by the W5000 index. The findings help investors to evaluate the performance of the most popular Islamic index availability, motivate money managers to look beyond interest rates and the broad market in identifying the drivers for the fluctuations in the Islamic index. The study also revealed that on a risk-return basis, there is no loss from the restriction criteria that the Muslim index requires.

Factors affect stock market

There are several factors that influence the stock market price and return in Malaysia and other country. In Lithuania, there are external factors expected to influence stock price including US stock market, the German stock market, and the euro area government bond yield. Yu (2011) study the macroeconomic determinants on Lithuania's stock market index by formulating more comprehensive model incorporating fiscal policy, monetary policy, the exchange rate, the world interest rate, and the world stock market indexes. The study found that the lower ratio of the government deficit to GDP, the higher M2/GDP ratio while the lower LTL/USD exchange rate, the lower domestic interest rate, the lower expected inflation rate, the lower euro area government bond yield, the higher US stock market index or higher German stock market index leads to a higher stock market index in Lithuanian.

Several other study highlight macroeconomic variables as indicator which affect the stock market return. Shah et al. (2011) examines the hypothesis that diffusion of information is not uniform across all sectors of a market. The relationship between industry returns and market returns was examined by liquidity factor, size factor, and the information diffusion hypothesis focused on some of the large industries in Pakistan. They used total paid-up capital as a proxy for size of an industry while the

proxy of stock index for market returns. The results found explained that large industries do originate information, but the information diffusion process is quicker than the time lags used.

However, not all macroeconomic variables found to give positive impact to the study. Based on multifactor model and using time-series regressions, Ghoilpour (2011) examines the effect of oil and gas prices on Iranian industry stock returns. The findings indicate that oil prices were an important determinant of returns in the banks, credit and other financial institutions, basic metals, electric machinery and apparatus and refined petroleum products and nuclear fuel industries. With the capital asset pricing model (CAPM), evidence found that macroeconomic information does not provide much incremental information beyond the market portfolio regarding to the behavior of industry stock return.

Monetary policy

Macroeconomic variables consist of all macroeconomic factors such as interest rate, inflation rate as well as exchange rate. Several numbers of macroeconomic factors define a common policy namely, monetary policy. Monetary policy is often used as variable in volatility investigation. Bartolini et al. (2000) propose interbank money market model in studying the interaction of profit-maximizing banks with high frequency interest rate targeted by central bank. Supporting monetary policy effect on federal funds interest rate volatility, results found that the study is consistent with interest rate volatility in US market.

Investigating the monetary policy variables impact, Albaity (2011) studies the effect of interest rate, and the use of stock market indices as a hedge against inflation. Not only that, it also examines the volatilities of monetary policy variables, interest rates and inflation rate on two Islamic stock market indices. He found that the interest rate influence the volatility of DJIMI but not KLSI. This might be due to the stability of the interest rate in small economies in Malaysia compared to US. This finding gave evidence that investing in KLSI was a good hedge against inflation but not in DJIMI.

By using similar approach in Malaysia, Majid and Yusof (2009) on the other hand found evidence that when interest rate rise either domestically (TBR) or

internationally (FFR), the Muslim investors will buy more Shariah compliant stocks, thereby escalating the Islamic stock price. The study explores the extent to which macroeconomic variables affect the Islamic stock market behavior in Malaysia in the post 1997 financial crisis period. The findings suggest that real effective exchange rate, money supply M3, Treasury bill rate (TBR) and federal fund rate (FFR) seem to be suitable targets for the government to focus on, in order to stabilize the Islamic stock market and to encourage more capital flows into the market.

Based on previous related study in the above, there were evidences to support monetary policy as indicator in volatility investigation. Thus, this study selects several macroeconomic factors in defining its variables. The volatility of stock market index will be analyzed using several selected methods.

Analyzing stock market volatility

There are a few methods adopted by researcher to analyze the stock market index volatility. Yusof and Majid (2007) explored the extent to which the conditional volatilities of both conventional and Islamic stock markets in Malaysia are related to the conditional volatility of monetary policy variables. Narrow Money Supply (M1), the broad money supply (M2), interest rates (TBR), exchange rate (MYR), and Industrial Production Index (IPI) were used as variables test. The volatility in the US monetary policy variable were measured by incorporated the Federal Funds Rate (FFR) in order to involve the international influence on both stock markets. Unlike the previous study (Yusof and Majid, 2006) that employ GARCH-M, GARCH (1,1) framework together with Vector Autoregressive (VAR) analysis were employed in this study. The result also indicated that both RHB II and KLCI have similar volatility by standard deviation of 0.097.

Using different approach, Kovačić (2008) focuses on econometric modeling of volatility and family of GARCH model. The study examined the behavior of Macedonia Stock Exchange (MSE) and also investigated the relationship between returns and conditional volatility. Through daily closing market index of Makedonski Berzanski Index (in Macedonia) together with MSE, the study found that the asymmetric models show a little evidence on the existence of risk premium.

Similarly include symmetric and asymmetric distribution as well as family GARCH models, Shamiri et al. (2008) study the density forecasts of Kuala Lumpur Composite Index (KLCI) daily return. The study analyzed and used the Kullback-Leibler Information Criterion (KLIC) as a statistical tool to evaluate and compare the density forecasts. Empirical findings based on KLCI return series give evidence on heavy-tailed and asymmetry in financial return distributions.

Using similar approach, Abdalla (2012) model the daily stock return volatility in Saudi stock market by different type of GARCH model. The study captures main characteristics of stock return such as volatility clustering and leverage effect. Including both symmetric and asymmetric models, the study found that asymmetric GARCH models show the existence of leverage effect. Besides, GARCH-M shows increase in volatility which indicates increase in stock return.

Therefore, this study adopts ARCH model following by GARCH (1,1) in order to evaluate the impact of monetary policy variables on both Islamic and conventional stock market index. Besides that, regression model are employed to examine the relationship between stock market volatility and monetary policy variable volatility.

3. RESEARCH METHODOLOGY

Data

The study will utilize monthly data covering the period January 2000 to December 2010. Data used for conventional stock market will be from FTSE Bursa Malaysia KLCI while FTSE Bursa Malaysia Emas Indexes for Islamic stock market. Measure of money, namely broad money supply (M3), Treasury Bill Rate (TBR), exchange rate (MYR) and Consumer Price Index (CPI) represent monetary policy variables in the study. Industrial Product Index (IPI) will be used as proxy for real output. To test the international influence on the volatility of stock returns, we will include the Federal Funds Rate (FFR) variable.

In the study, the volatility will be defined as the variance of stock returns. Therefore the stock return will be calculated as the log of the price relative:

$$R_t = ln\left(\frac{P_t}{P_{t-1}}\right) \qquad (3.1)$$

Where P_t is the index value of the stock at the end of month t and P_{t-1} is the index value of stock for previous month-end, $t-1$.

Explanation of Variables

The dependent variables used in the study are FTSE Bursa Malaysia KLCI and FTSE Bursa Malaysia Emas. The proxies of monetary policy will represent the independent variables. Therefore, the independent variables in the study are broad money supply (M3), Treasury Bill Rate (TBR), exchange rate (MYR), Industrial Product Index (IPI), Consumer Price Index (CPI) and Federal Funds Rate (FFR). Each of these variables should give impact on stock return.

Methodology

Based on previous study, most researchers employed Generalized Autoregressive Conditional Heteroscedasticity (GARCH) model. By GARCH model, Stenius (1991) analyses the volatility of stock prices and evaluates whether there exists a relationship between increased volatility and the risk premium. Su and Fleisher (1998) also apply the GARCH model to estimate the empirical model which captures the effects of local and global information variables on the conditional mean of the stock market excess returns. Not only that, Yusof and Majid (2006) also apply GARCH model to examine the market volatility transmission in Malaysia and further their study by applying both GARCH model and Vector Autoregressive (VAR) analysis.

Therefore, the study will employ GARCH model to generate the estimated volatility of stock returns and monetary policy variables growth rates. Both the conditional mean and the conditional variance equations in this model will incorporate monetary policy variables namely broad money supply (M3), Treasury Bills Rate (TBR) for interest rate, exchange rate (MYR), Industry Price Index (IPI) for real output, Consumer Price Index (CPI) for inflation and Federal Funds Rate (FFR) for foreign monetary policy changes. This procedure will be conducted for both conventional and Islamic stock market.

GARCH (1,1) Model

The estimated volatility for stock return and monetary policy variables growth rates will be generated based on the GARCH (1, 1). The standard mean equation is as given below;

$$R_t = \sum_{i=1}^{m} \alpha_1 R_{t-1} + \delta_1 d_{i,t} + \varepsilon_t \qquad (3.2)$$

Where R_t is the dependent variable, $d_{i,t}$ is independent variable, ε_t is the error term, α_1 and δ_1 are the coefficients. The ARCH model is as follow;

$$h_t^2 = \beta_0 + \hat{a}_1 \varepsilon_{t-1}^2 + \beta_2 h_{t-1}^2 \qquad (3.3)$$

Where h_t^2 is the conditional variance, ε_{t-1}^2 is the lagged term of the squared error term from the mean equation (2), and β_i is the coefficient.

Regression Analysis

To further the study of the relationship between stock market volatility and monetary policy volatility, regression analysis will be conducted for conventional stock markets followed by Islamic stock market. The empirical models are as follow;

Conventional Stock Market

Model 1:

$$Ln\,KLCI_t = \alpha_0 + \alpha_1 Ln\,M3_t + \alpha_2 Ln\,IPI_t + \alpha_3 Ln\,MYR_t + \alpha_4\,TBR_t + \alpha_5\,FFR_t + \alpha_6 Ln\,CPI_t + \pi_t \qquad (3.4)$$

Islamic Stock Market

Model 2:

$$Ln\,Emas_t = \beta_0 + \beta_1 Ln\,M3_t + \beta_2 Ln\,IPI_t + \beta_3\,MYR_t + \beta_4\,TBR_t + \beta_5 FFR_t + \alpha_6 Ln\,CPI_t + \varepsilon_t \qquad (3.5)$$

Where $KLCI$ is FBM KLCI, $Emas$ is FBM Emas, $M3$ is broad money supply, IPI is Industrial Production Index, MYR is exchange rate, TBR is Treasury Bills Rate, FFR is Federal Fund Rate and CPI is Consumer Price Index.

Statement of Hypotheses

In the study, macroeconomic volatility is hypothesized to have significant effect on both conventional and Islamic stock return volatility. Thus, the hypotheses stated as follow;

Conventional Stock Market

H_0: Macroeconomic volatility has no significant effect on conventional stock return volatility.

H_1: Macroeconomic volatility has significant effect on conventional stock return volatility.

Islamic Stock Market

H_0: Macroeconomic volatility has no significant effect on Islamic stock return volatility.

H_1: Macroeconomic volatility has significant effect on Islamic stock return volatility.

4. RESULTS AND ANALYSIS

This section is presenting the summary statistics for stock returns as well as the monetary policy variables. The section then discuss on empirical result based on GARCH (1,1) estimation model. The relationship between stock return volatility and the volatility of monetary policy variables will also be provided through regression analysis. Finally, the study will highlight the effect of 2008 financial crisis on the stock market index return.

Summary Statistic

Table 1 below reports the descriptive statistics for both Islamic and conventional stock index returns as well as the macroeconomic variables namely, KLCI, Emas, M3, MYR, FFR, CPI, IPI and TBR. The first row represents the variables while the rest of

the rows represent the result of test statistics including mean, standard deviation, skewness and kurtosis.

Table 1: Descriptive Statistic for Islamic and Conventional Stock Index Returns and Macroeconomic Variables

	KLCI	Emas	M3	MYR	FFR	CPI	IPI	TBR
Mean	0.0005	0.0026	0.0070	1.2899	0.5016	4.6654	4.9874	1.0145
Std. Dev	0.0072	0.0522	0.0084	0.0604	1.2366	0.0414	0.2975	0.1692
Skewness	-0.5180	-0.5280	0.4640	-1.1010	-0.9230	0.3910	0.0860	-0.5820
Kurtosis	0.9300	0.9260	2.4290	-0.0610	-0.9230	0.3910	-1.5490	-0.0570

It is clear that FBM Emas has higher returns of 0.0026 compared to FBM KLCI which returns of 0.0005. Similarly based on standard deviation of 0.0522, result shows that FBM Emas has higher risk compared to FBM KLCI with 0.0072. Both indices are negatively skewed which indicates that there is greater probability of large decrease in return than increase. Both stock market indices have kurtosis less than three which indicate platykurtic distribution.

Regarding macroeconomic variables, all variables have positive averages. The mean ranges between 0.007 for broad money supply (M3) and 4.9874 for inflation. Similarly with positive outcomes, the volatility of macroeconomic variables ranges between 0.0084 for M3 and 1.2366 for federal fund rate. The skewness of M3, inflation and industrial production index are positive. Otherwise for exchange rate, federal fund rate and treasury bills rate are negatively skewed. In addition, all kurtosis are less than three which lead to platykurtic distribution.

Analysis for GARCH (1,1)

The study adopts GARCH (1,1) to generate the volatility of macroeconomic variables on both Islamic and conventional stock index volatility. Table 2 and Table 3 display the model estimation of GARCH (1,1) for monetary policy variables based on equation 3.2 and 3.3. For the lags considered in both table, the Ljung-Box statistics indicates that the study fail to reject the null hypothesis of no autocorrelation at 5% level of significance.

Table 2 reports the estimation of GARCH (1,1) model for conventional stock returns together with monetary policy variables. Based on result summarized in the table, ARCH effect is not significant for all variables except M3 and CPI. However, GARCH effect is significant in all monetary policy variables. The sum of ARCH and GARCH effect are 0.946, 0.945, 0.945, 0.946, 0.948 and 0.950.

Table 2 Estimation of GARCH (1,1) Model for Conventional Stock Return

		M3	IPI	TBR	MYR	FFR	CPI
α_1		-0.035 (0.235)	0.007 (0.537)	0.006 (0.134)	-0.002 (0.888)	0.001 (0.183)	-0.050 (0.485)
δ_1		0.003 (0.229)	-0.001 (0.561)	-0.005 (0.156)	0.002 (0.865)	-0.001 (0.045)	0.011 (0.481)
β_0		0.000 (0.209)	0.000 (0.229)	0.000 (0.268)	0.000 (0.234)	0.000 (0.248)	0.000 (0.217)
β_1		0.117 (0.038)	0.106 (0.053)	0.093 (0.119)	0.101 (0.068)	0.102 (0.065)	0.110 (0.039)
β_2		0.829 (0.000)	0.839 (0.000)	0.852 (0.000)	0.845 (0.000)	0.846 (0.000)	0.840 (0.000)
Skewness		-0.360	-0.416	-0.389	-0.450	-0.343	-0.401
Kurtosis		0.808	0.767	0.554	0.752	0.684	0.799
Normality	JB Test	2.599 (0.273)	0.9772 (0.303)	2.473 (0.290)	3.655 (0.484)	2.478 (0.290)	2.857 (0.240)
	SW Test	0.979 (0.416)	3.273 (0.195)	0.982 (0.586)	0.976 (0.231)	0.983 (0.653)	0.978 (0.349)
Ljung-Box	Standardized	11.280 (0.505)	11.330 (0.5007)	11.080 (0.5217)	11.530 (0.4844)	11.430 (0.4924)	11.850 (0.4579)
	Squared standardized	8.561 (0.740)	8.831 (0.717)	8.523 (0.743)	9.586 (0.652)	7.408 (0.830)	8.119 (0.776)
$(\beta_1 + \beta_2)$		0.946	0.945	0.945	0.946	0.948	0.950
ARCH test		18.080 (0.644)	18.936 (0.589)	19.819 (0.533)	20.508 (0.489)	17.872 (0.657)	19.029 (0.583)
ARCH LM	F-Stats	0.837 (0.702)	0.847 (0.692)	0.800 (0.738)	0.919 (0.623)	0.705 (0.827)	0.783 (0.754)
	Observed R^2	8.538 (0.742)	8.639 (0.733)	8.186 (0.770)	9.31 (0.676)	7.274 (0.839)	8.026 (0.783)

Table 3 represents the estimation of GARCH (1,1) model for Islamic stock return together with monetary policy variables. Result shows that there is no ARCH effect in all monetary policy variables. However, there is GARCH effect exists in all monetary policy variables. In addition, summation of both ARCH and GARCH effect give

result of 0.944, 0.950, 0.949, 0.953, 0.943 and 0.952. In general, the results show that volatilities in all monetary policy variables indicate the monetary policy variance.

Table 3 Estimation of GARCH (1,1) Model for Islamic Stock Return

		M3	IPI	TBR	MYR	FFR	CPI
α_1		-0.294 (0.165)	0.062 (0.419)	0.039 (0.171)	0.004 (0.964)	0.006 (0.228)	-0.418 (0.413)
δ_1		0.022 (0.162)	-0.012 (0.433)	-0.036 (0.189)	0.181 (0.039)	-0.008 (0.035)	0.090 (0.411)
β_0		0.000 (0.269)	0.000 (0.313)	0.000 (0.366)	0.000 (0.313)	0.000 (0.308)	0.000 (0.298)
β_1		0.108 (0.060)	0.089 (0.091)	0.076 (0.192)	0.087 (0.106)	0.096 (0.107)	0.097 (0.070)
β_2		0.836 (0.000)	0.861 (0.000)	0.873 (0.000)	0.866 (0.000)	0.847 (0.000)	0.855 (0.000)
Skewness		-0.379	-0.431	-0.402	-0.450	-0.356	-0.412
Kurtosis		0.801	0.768	0.523	0.753	0.638	0.783
Normality	JB Test	2.525 (0.283)	3.459 (0.177)	2.313 (0.315)	3.461 (0.177)	2.076 (0.354)	2.689 (0.261)
	SW Test	0.978 (0.323)	0.976 (0.231)	0.980 (0.423)	0.978 (0.326)	0.982 (0.555)	0.977 (0.287)
Ljung-Box	Standardized	12.840 (0.381)	12.960 (0.372)	13.570 (0.329)	13.370 (0.343)	13.310 (0.347)	13.550 (0.331)
	Squared standardized	10.910 (0.537)	11.20 (0.512)	10.980 (0.531)	11.710 (0.469)	9.653 (0.646)	10.420 (0.579)
$(\beta_1 + \beta_2)$		0.944	0.950	0.949	0.953	0.943	0.952
ARCH test		21.407 (0.434)	21.172 (0.449)	22.011 (0.399)	22.539 (0.369)	21.095 (0.453)	21.948 (0.403)
ARCH LM	F-Stats	1.091 (0.473)	1.108 (0.459)	1.015 (0.536)	1.152 (0.427)	0.904 (0.638)	1.019 (0.533)
	Observed R^2	10.890 (0.538)	11.050 (0.525)	10.20 (0.598)	11.440 (0.491)	9.169 (0.904)	10.230 (0.595)

Regression Analysis

This section will discuss regression analysis results based on equations 3.4 and 3.5 empirical model. Table 4 illustrates the summary of regression result for both conventional and Islamic stock index return.

For conventional stock market index, while other variables hold constant, increase in M3 will increase stock return by 0.716 unit, increase in CPI reduce stock return by 0.219 unit, increase in IPI will make stock return goes up by 0.218 unit, increase in TBR will decline stock return by 0.105 unit, increase in FFR will incline stock return

by 0.054 unit, increase in MYR will decrease stock return by 2.288 unit. The intercept value of 0.272 means that when all variables equivalent to zero than the stock return will be 0.272. Other than that, the value of R^2 about 0.880 means that about 88 percent of the conventional stock returns is explained by monetary policy variables. Besides, at 5% confidence level, all the variables are significant except Consumer Price Index (p value=0.691).

Table 4 Summary of Regression Result for Conventional and Islamic Stock Index Return

Constant	M3	CPI	IPI	TBR	FFR	MYR	R^2
Conventional Stock Market							
0.272	0.716	-0.219	0.218	-0.105	0.054	-2.288	0.880
(0.911)	(0.000)	(0.691)	(0.001)	(0.000)	(0.000)	(0.000)	
Islamic Stock Market							
5.093	0.548	-0.350	0.238	-0.127	0.051	-0.832	0.834
(0.064)	(0.000)	(0.576)	(0.001)	(0.000)	(0.000)	(0.000)	

Regarding Islamic counterpart, holding other variables constant, increase in M3 will make stock return incline by 0.548 unit, increase in CPI will reduce stock return by 0.350 units, increase in IPI will increase stock return by 0.238 unit, increase in TBR will make stock return decline by 0.127 unit, increase in FFR will make stock return goes up by 0.051 and increase in MYR will decline stock return by 0.832. The intercept value of 5.093 means that when all variables turn to zero than the stock return will become 5.093. Not only that, the R^2 value of 0.834 means that about 83 percent of Islamic stock index variation can be explained by the monetary policy variables. As observed at 5% significant level, all variables are significant except Consumer price index (p value=0.576).

As a conclusion, all monetary policy variables introduced influence both conventional and Islamic stock index except inflation rate. In contrast, previous study by Yusof and Majid (2007) give different result. Monthly RHBII data taken from January 1992 to December 2000 indicates that interest rate does not influence Islamic stock index. As interest is prohibited in *Shariah*, there might be other explanation regarding the result issues.

Both Islamic and conventional stock market index are being monitored by Bank Negara Malaysia (BNM). Therefore, the rules and regulation as well as the transaction and business cycle are almost the same. The only different is in term of Islamic counterpart, there are certain activities are prohibited and it must be compliment with *Shariah* in order to remain as Islamic product. As for Muslim investors, most of them are eager to invest in Islamic stock. However, there exist speculators who borrowed money from conventional bank at lower interest rate and invest in Islamic stock for higher return. It is true that the investor will gain profit from the price difference but this kind of activity may affect the economic cycle. Thus, the interest rate will give effect not only to conventional stock index return but also to Islamic stock return.

At the end of year 2007 until early 2008, the financial crisis happened to give large impact on all financial market. As the crisis affect all financial market and banking system around the world, it does not give an exception to our country, Malaysia. The main index in Malaysia, KLCI dropped around 670 points within the period of 14th of January 2008 to 12th of September 2008 indicates around 45% drop in its value (Angabini and Wasiuzzaman, 2011). Based on the above results and discussion, all monetary policy variables except inflation affect both Islamic and conventional stock market index return. Therefore, the financial crisis occurs also give impact on both Islamic and conventional stock index return. However, as it is not the first experience for the country after 1997 recession, the government's reaction with monetary expansion made Malaysia as the first country in the region to successfully respond to the crisis.

5. CONCLUSIONS

This study establish that the monetary policy is a right indicator to predict both conventional and Islamic stock market return in Malaysia during period January 2005 to December 2010. However, the inflation rate is not appropriate indicator as it has no statistically significant effect on both Islamic and conventional stock market index return. In addition, the interest rate does affect both Islamic and conventional stock index return. This might be due to behavior of investor in investment transaction in order to gain higher return. To capture the effect of monetary policy variables on volatility of stock market indexes, the study employ GARCH (1,1) model.

The estimation of GARCH (1,1) model shows that there is no autocorrelation at 5% significant level. Based on ARCH and GARCH effect, the model also suggests that the volatilities in all monetary policy variables do indicate the monetary policy variance. This implies that all suggested monetary policy variables give impact on both Islamic and conventional stock market volatility.

In addition, throughout Malaysia's experience, it is also important to note that rate of inflation volatility does not affect both financial market and banking system in Malaysia. This might be due to the issues of selection of good for the CPI basket. Not only that, the weightage of each CPI component normally changed as well as structure of society and living style. The finding of the study also take into account that the government's policy response to overcome the 2008 financial crisis.

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SUKUK MARKET WEALTH AND CONSUMPTION

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Abstract

The study seeks to investigate whether wealth, in terms of sukuk issuance, affect real consumption asymmetrically in Malaysia for the period 2002-2011 based on vector error-correction (VECM) model specification. The empirical analysis uses quarterly data on consumption, labor income and sukuk interaction term. Data are sourced from Bloomberg Database and Datastream. The findings indicate that wealth, in terms of sukuk issuance, exert an important significant asymmetric wealth effect on consumer spending. Specifically, negative news reduce consumption and positive news raise consumption and the result is significant. The findings would be useful to the monetary authorities when deciding whether to react more quickly and strongly to price increases or to price declines in sukuk issuance since growth in consumption expenditure is a signal of demand side pressures on price level.

Keywords: Sukuk, Wealth Effect, Consumption, VECM, Price Level

1. INTRODUCTION

The literature on wealth effect suggests a link between wealth and consumption. The empirical research dates back to Ando and Modigliani (1963), and posits that increases in wealth may create changes in consumption beyond the effect of disposable income. Several recent estimates of the relationship between wealth and

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consumption find that a one-dollar increase in household wealth creates a permanent increase in new consumption spending (around 5-cents of new consumption spending) (Mehra, 2001). In contrast, Ludvigson and Steindel (1998) argue that any wealth effect on consumption is, at best, temporary based on the estimation of a long-run relationship between wealth and consumption.

Some literatures argue that the size of the wealth effect is over-estimated, especially after the 2008 post-crisis impact that saw a decline in the stock market. This is due to the specification techniques used to estimate the wealth effect. Moreover, since traditional specifications and estimation techniques assume that consumers are in a steady state, they do not explicitly take into account the adjustment of consumer behaviour to new conditions. Formally taking into account the adjustment process to a new equilibrium implies very different ways to specify and estimate the relationship between changes in wealth and changes in consumption.

The present paper investigates the wealth effect of aggregate sukuk issuance in Malaysia based on vector error-correction (VECM) model specification. The purpose of this paper is twofold. First, it examines the relationship among per capita consumption expenditure, labor income and aggregate sukuk issuance by examining the direction of causality. Second, it examines whether wealth in terms of sukuk issuance affect real consumption asymmetrically. The paper adds to the literature since empirical work investigating the wealth effect of sukuk in terms of consumption is relatively scarce.

The remainder of the paper is organized as follows. Following introduction, Section 2 discusses the related literature and provides a brief background on recent development of sukuk industry. Section 3 highlights the research method. Section 4 discusses the findings and the final section concludes the paper.

2. LITERATURE REVIEW

2.1 Definition of Sukuk

Sukuk is the Arabic term for Islamic securities, which in economic terms are akin to conventional bonds. The literal meaning of sukuk is certificate. Technically sukuk

refer to securities, notes, papers or certificates, with features of liquidity and tradability. Unlike conventional bonds, sukuk need to have an underlying tangible asset transaction either in ownership or in a master lease agreement. It represents ownership of underlying assets, usufructs (benefits), services, or investment. The money that a sukuk holder gets represents a share in the profit of the underlying asset. The Securities Commission Malaysia (SC) defines sukuk as *a financial document or certificate which represents the value of an asset evidencing an undivided pro rata ownership of an underlying asset*.

2.2 Development of Sukuk Industry

A capital market provides alternative funding avenue and wider investor base for corporate entities and the government. Islamic capital market consists of the debt market and the equity market. Sukuk, or Islamic bond, are the most active Islamic debt market financial instrument to date. The development of sukuk market was initiated in 1990 since the first sukuk issued by Shell MDS Pvt. Ltd., a multinational corporation operating in Malaysia. Subsequently, after the 1997 financial crisis, there was a growing importance of sukuk financing. The first international sovereign sukuk was issued by the Government of Bahrain in 2001, followed by Indonesia in 2002. Since then, there has been increasing participation in sukuk issuance from both Muslim and non-Muslim countries. Malaysia, Qatar and the United Arab Emirates (UAE) are expected to account for about two-third of 2011 issuance.

The global Islamic finance industry has grown from about USD10 billion worth of invested assets in 1975 to USD2.2 trillion today. By the end of 2010, 5.5% of the USD2.2 trillion invested in Islamic instruments was held in dedicated Islamic funds, with 31.1% in broader-based assets (mainly in Shariah-compliant bank accounts and money-market vehicles). The rest was held in other Islamic instruments, particularly sukuk, insurance packages (takaful) and equities products. Real growth in the sukuk market started in 2003 when the AAOIFI had issued a standard on investment sukuk and listed 14 different types of sukuk.

Table 1 shows the growth rate of global sukuk market for the period 2004-2009. The growth was somehow affected by the 2007 financial crisis since there is a noticeable

drop in the growth rates at the international and global market. To date, Malaysia and the United Arab Emirates (UAE) are still the two leading countries in terms of sukuk issuance. Due to the flight to safe heaven in the fixed income investment after the 2007 crisis, sovereign and quasi-sovereign types of sukuk issuance dominated the market and sukuk are mostly issued either in Malaysian ringgit or USD.

Table 1: Year on Year Growth Rates of the Sukuk Market, 2004-2009

For the Year	International Market (%)	Global Market (%)
2004	91.0	86.1
2005	71.6	69.8
2006	147.1	104.4
2007	76.1	89.2
2008	6.8	15.9
2009*	8.5	19.4
CAGR**	106.8%	88.3%

*Annualized; **Cumulative average growth rate

Source: In-house IIFM Sukuk Issuance Database

The wealth effect is an economic term refers to an increase (decrease) in spending that accompanies an increase (decrease) in perceived wealth. In general, consumption responds to changes in wealth, the so-called "wealth effect". A common assumption is that a dollar increase in wealth generates about a 5-cent increase in consumption. In other words, about 5-cents of each dollar of an increase in wealth is spent soon after it is earned. However, the literature on wealth effect of sukuk mostly investigates wealth in terms of stockholders' benefits using event study methodology. The present paper contributes to the discussion on wealth effect by looking into how consumption responds to changes in sukuk issuance.

There are two major theories explaining the long-run consumption namely the permanent income and life-cycle models. According to the life-cycle model, changes in wealth affect consumption indirectly through saving. Higher wealth lowers saving and raises consumption. On the other hand, higher stock prices lead to higher expected future income, raise permanent income, hence increase consumption (Apergis and Miller, 2005).

Traditionally, the wealth effect has been measured by estimating aggregate time-series regressions of consumption on income and various measures of financial assets,

such as stock market wealth, housing wealth and financial wealth. The estimated coefficient on wealth is described as the marginal propensity to consume (mpc) out of wealth and is interpreted as the increase in consumer spending associated with an increase in wealth. Different estimated coefficient of wealth from different types of wealth represents different characteristics of consumers. For example, stock market wealth owners may be systematically older or younger than other wealth owners or have other characteristics that lead to a different aggregate propensity to consume out of this form of wealth. The theory implies that the wealth effect should be different at different phases of life-cycle.

The literature reports mixed results on how stock market changes affect consumption. Ludvigson and Steindel (1999) show that estimates of the wealth effect are mixed and sensitive to the choice of sample period. Poterba (2000) summarizes a recent survey on the effect of stock market value on consumption. Patterson (1993) investigates the consumption and asymmetric wealth effects and finds that consumption behaves asymmetrically to wealth. Zandi (1999) posits that consumers may react more strongly to wealth contractions than to expansions. Stevans (2004) produces evidence that there is evidence of wealth effect but only when the wealth from the stock holdings rises above a critical threshold point. On the other hand, Apergis and Miller (2005) show that negative news affects consumption more than positive news. To our knowledge, there is no literature investigating the wealth effect consumption expenditure based on sukuk issuance and this paper attempts to fill this gap.

3. RESEARCH METHOD

The study employs aggregate quarterly data of sukuk issuance in Malaysia for the period 2002:Q1 to 2011:Q4 and data are sourced from the Bloomberg and Datastream. Since the variables in standard consumption function estimation namely real per capita consumption, real per capita labor income and real per capita sukuk interaction term exhibit non-stationary time-series properties, we test for unit root and cointegration properties of the data series. Data are expressed in per capita terms where the data on population is based on annual data. The interaction term between sukuk issuance per capita and the one year offered-rate KLIBOR is employed since the literature indicate that sukuk issued in Malaysia are normally linked to KLIBOR

rates. The CPI variable is included since theoretically it affects sukuk market. All data are in constant 2000 prices and are expressed in log values.

The data are tested for unit roots Augmented Dickey-Fuller (ADF) test and we found that all variables are stationary at first differences as indicated in Table 3. For the VAR lag order selection criteria, the AIC, FPE, SC, HQ and LR tests (Akaike information criterion, Final Prediction Error, Schwarz information criterion, Hannan-Quinn information criterion and sequential modified LR test statistic) all indicate three lags based on 5% significance level.

Table 2: Unit Root Statistics

	ADF statistics with intercept and trend	
Variable	Level	First Difference
Consumption (*c*)	-1.650	-6.488***
	(0.752)	(0.000)
Sukuk (*w)*	-2.150	-11.988***
	(0.503)	(0.000)
Labor Income (*y)*	-1.285	-8.505***
	(0.876)	(0.000)
Sukuk*KLIBOR (*w*)	-2.382	-12.076***
	(0.383)	(0.000)
CPI	-3.061	-4.174
	(0.132)	(0.011)**
KLIBOR	-1.533	-9.182***
	(0.799)	(0.081)

Notes: ***, **, * denotes significant at 1%, 5% and 10% level of significance, respectively. Figures in brackets are p-values. Tests include both trend and intercept. The null for ADF tests are the hypothesis of a unit root is tested against the alternative of stationarity.

Next, Johansen co-integration test is conducted to determine whether there are stable relationships between the measure of economic activities and consumption. The Trace test and Maximum Eigenvalue indicates one cointegrating vector for the period under study as indicated in Table 4. The presence of cointegration implies that the variables are tied together in the long run and their deviations from long run equilibrium path will be corrected. Since the variables are first-difference stationary and are cointegrated, VECM is the appropriate method.

Table 3: The Johansen Cointegration Tests

Null Hypothesis	Test Statistics		Critical Values (0.05)	
	Trace	Max-Eigen	Trace	Max-Eigen
$r = 0$	49.648*	39.719*	29.79*	21.13*
$r = 1$	9.928	9.921	15.49	14.26
$r = 2$	0.007	0.007	3.84	3.84

Notes: The lag order specified is 3. Effective number of observations is 36. *Both Trace test and Max-Eigenvalue test indicates 1 co-integrating equation at the 0.05 level.

In vector autoregressive (VAR) model, we use a set of p=2 endogenous variables, y = [*c*, *ind*]' where *c* and *ind* refer to the logarithm of consumption and *ind* is the specific indicator variable, respectively. We write a p-dimensional VECM as follows:

$$\Delta y_t = \sum_{i}^{k-1} \Gamma_i \Delta y_{t-i} + \Pi y_{t-1} + \mu + \varepsilon_t, \quad t = 1, \ldots T$$

where y_t is the set of $I(1)$ variables discuss above; $\varepsilon_t \sim niid(0,\sum)$; μ is a drift parameter, and Π is a (p x p) matrix of the form $\Pi = \alpha\beta'$ where α and β are both (p x r) matrices of full rank, with β containing the r cointegrating vectors and α carrying the corresponding loadings in each of the r vectors. We include quarterly dummy variable to account for seasonal variations.

4. RESULTS

The analysis uses a simple model that relates consumption, labor income and sukuk interaction term as follows:

$$c_t = a_0 + a_1 y_t + a_2 w_t + \varepsilon_t \qquad (1)$$

where *c* equals real consumption spending, *y* equals real labor income, *w* equals the interaction term of sukuk representing wealth and *e* is the error term. Since the variables are co-integrated, we run the regressions at levels and add the error-correction term (*ect)* and lagged values of certain variables to investigate the asymmetric effects as in Equation (2).

$$c_t = a_0 + a_1 y_t + a_2 w_1 + a_3 w_2 + ect_t + a_4 cpi_t + c(-1)_t + q_t + \varepsilon_t \qquad (2)$$

For the asymmetric effects, where w_1 = positive news and w_2 = negative news, $c(-1)_t$ is the lagged value of consumption and q_t is the quarterly dummy. Since the regression performed based on the per capita terms as suggested in the literature yield unsatisfactory results, we use the variables on levels. The model passes major diagnostic tests. In some cases, there are heteroskedasticity and autocorrelation problems. These are corrected using the Newey-West method. The results are presented below, where figures in bracket denote *p*-values:

$$c_t = a_0 + a_1 y_t + a_2 w_1 + a_3 w_2 + ect_t + a_4 cpi_t + c(-1)_t + q_t + \varepsilon_t$$

$$-6.44^{***} + 0.17 y_t^{*} + 0.003 w_1^{**} - 0.002 w_2 + 0.016 ect_t^{*} + 1.40 cpi_t^{***} + 0.51 c(-1)_t^{***} + q2 + q3^{**} + q4^{*} + e_t$$

-3.57 1.71 2.04 -1.19 1.91 3.75 4.62 0.32 3.03 1.97

[0.00] [0.09] [0.05] [0.24] [0.06] [0.00] [0.00] [0.75] [0.00] [0.05]

$Adj.\ R^2 = 0.97$

Wald Test = 3.31 [0.07]; *JB Test*= 0.52 [0.77]; *ARCH Test*= 0.93 [0.33]

We concentrate on the values of w_1 and w_2 and report only the significant results. The effect of positive news of sukuk wealth effects is slightly higher than the negative impact and it is significant. The negative news reduces consumption and the positive news raise consumption. Therefore, there is asymmetric wealth effect of sukuk issuance and the impact is significant based on the result of Wald test. Therefore, consumers respond more strongly to favorable news than to unfavorable news for the period under study. The result is in contrast to the findings of Apergis and Miller (2005). They find that consumers respond more strongly to unfavorable news than favorable news due to loss aversion in inter-temporal preferences. In other words, individuals suffer more when forced to reduce consumption standards due to diminishing marginal utility of wealth (Apergis and Miller, 2005). This is an

interesting area of further research to differentiate sukuk behavior from its conventional counterparts.

In addition, the study performs Granger-causality test to maintain correct orderings of the selected variables. Table 4 displays the results and indicates that labor income, sukuk and CPI all granger-cause consumption. There is a bi-directional direction between income and consumption and consumption and wealth effects in terms of sukuk issuance. In addition, income granger-causes wealth but the relationship is uni-directional. Therefore, the orderings in the VECM model is consistent with the theory.

Table 4: Granger Causality Tests within VECM Framework

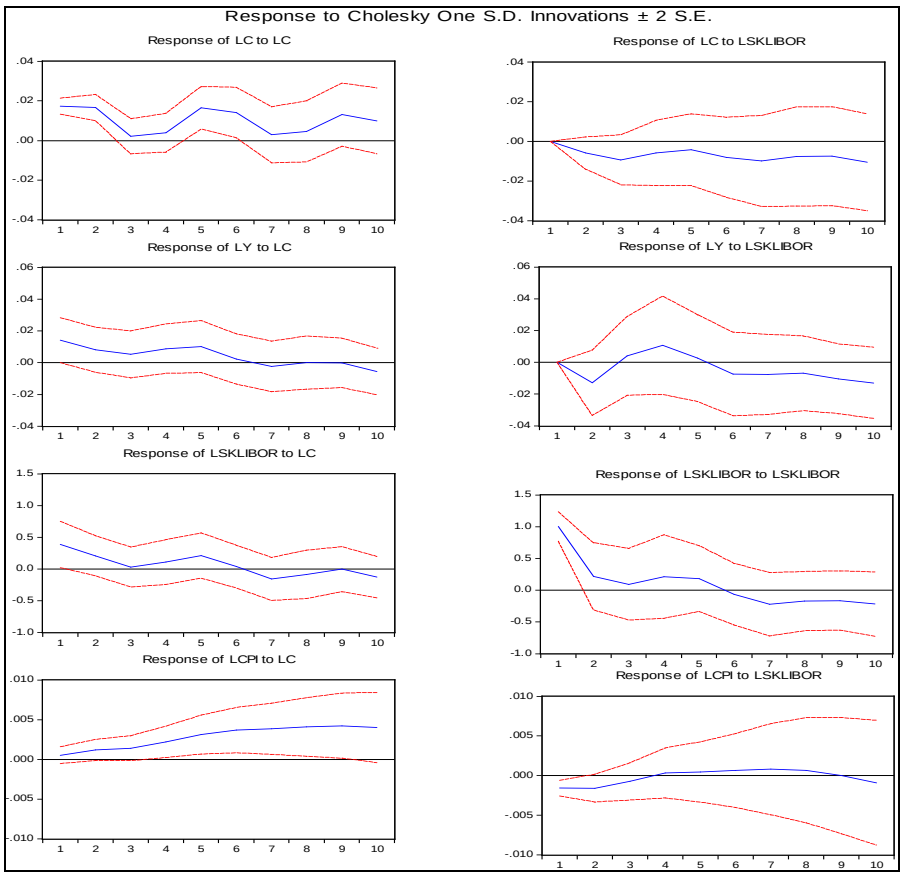
Dependent Variable	F-statistics of lagged first differenced terms			
	Δc	Δy	Δw	Δcpi
Δc	-	5.56* [0.06]	4.82* [0.08]	6.14** [0.04]
Δy	15.59*** [.0.00]	-	2.32 [0.31]	2.91 [0.23]
Δw	10.19*** [0.00]	14.84*** [0.00]	-	3.89 [0.14]
Δcpi	4.60 [0.10]	2.51 [0.28]	1.58 [0.45]	-

Notes: Figures in [.] represent p-values. ***, **, * denotes significant at 1%, 5% and 10% level, respectively.

Figure 1 shows the cumulative impulse responses functions (IRF) calculated over a 12-quarter time horizon. The IRFs indicate the direction, magnitude and persistence of other variables to the shocks in consumption and sukuk wealth. All shocks are standardized to one-percent shock; thus the vertical axis in the figures reports the approximate percentage change in *c*, *y* and *w* in response to a one-percentage shock in either sukuk issuance or consumption. The two dashed lines show two standard deviation band for the impulse responses which are calculated using Monte Carlo simulations (with 1,000 repetitions) or asymptotically.

The response of sukuk wealth to shocks in consumption is large and immediate and fluctuates over the 3-year horizon and tends to be negative and declining in the long run. Meanwhile, consumption responses with a lag to a shock in sukuk wealth and the responses are small, negative and persistence. Another interesting observation is how CPI responds to both shocks. It is increasing in the case of consumption but have a small negative impact in shorter horizon but tend to move towards equilibrium in the long run. This suggests that the impact of price increases would probably be due to the increase in consumption, not through sukuk issuance. However, the findings are in preliminary stage and should be interpreted with due caution given the small sample size.

Figure 1: Impulse Response Functions of Sukuk and Consumption



5. CONCLUSION

This paper examines asymmetric wealth effects on consumption spending in Malaysia when wealth equals sukuk issuance. The findings indicate that wealth, in terms of sukuk issuance, exert an important asymmetric effect on consumer spending whereby

positive news exert a positive slightly larger positive significant effects upon consumption than negative news. The findings would be useful to the monetary authorities when deciding whether to react more quickly and strongly to price increases or to price declines in sukuk issuance since large market fluctuations will cause consumer spending and aggregate demand to fluctuate. This is particularly important since growth in consumption expenditure is a signal of demand side pressures on price level. Future research work in this area should differentiate between permanent and transitory movements in sukuk issuance and its impact on consumption expenditure pattern.

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ESTIMATING INVESTOR LOSSES IN SUKUK DEFAULT RESTRUCTURING: A CASE STUDY ON DEFAULTED CORPORATE SUKUK IN MALAYSIA

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Abstract

The aim of the study is to estimate investor losses in case of sukuk default restructuring using government and corporate sukuk as a benchmark. The main findings suggest that the average investor losses ranging from 2.01% - 3.14% (for less than or equal to 1 year remaining tenure) to 18.15% - 18.94% (for more than 5 years remaining tenure). The findings indicate that investors will face relatively bigger losses if the defaulted sukuk have longer remaining tenure. This finding may be used by market participants as benchmark in restructuring process by providing border line of estimated recovery value in their negotiations. Further study might compare the findings with actual investor losses to check it accuracy.

Keywords: Sukuk Default; Debt Restructuring; Investor Losses; Islamic capital market

1. INTRODUCTION

Sukuk industry has emerged as one of the main components of the Islamic financial system and has increasingly become an integral subset of the international financial system. According to the Kuwait Finance House (KFH), over the years the sukuk market has grown by 10% to 15% annually to reach approximately USD170.3 billion outstanding as at end of 3rd quarter of 2011 and contributes approximately 14.3% of the global Islamic finance assets. Prospect for the sukuk markets remain bright and expected

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to see further growth in coming years indicated by greater interest from the international community and the spread of sukuk issuance around the world.

However, the recent development of increasing number of defaulting sukuk is a cause for concern. According to the Islamic Finance Information Services (IFIS), there are 33 sukuk default events in the market around the world for the period 2003-2011. The amounts of default reach USD1.93 billion and represent about 0.70% of total sukuk issued in the market for the same period. Malaysia, as the largest sukuk issuer, registered 25 default events representing more than two-third of total default events. However, the default amounts reach only USD674.72 million or represent about 0.31% of total sukuk issued by Malaysia for the same period. This amount is relatively small and may not pose significant threat to the local capital market. However, it has an impact on the overall reputation of Malaysia as the hub for global Islamic finance and negative perceptions on Shariah principles that are used as underlying structure of sukuk.

There are many factors that may contribute to sukuk default but the ultimate reason for a default is the issuer unable to meet its contractual obligations and may renege from paying the principal and the profit due. Every case of default raises important issues on how much loss suffered by investors and what proportion of the original principal they were able to recover. Understanding these issues is important for at least two reasons. First, assumption about expected losses and recovery value is one important factor considered by investors in their investment decision. It is often used by investors as a proxy of default risk in the pricing models. Second, the extent to which investors suffered losses in recent sukuk restructurings is an important input in both the legal and financial aspects on how defaulted sukuk should be restructured, and whether the current framework for doing so is appropriate or not. On one side, a restructuring that involves high investor losses may raise concerns about issuer moral hazard and its impact on the future of the sukuk market. On the other side, a restructuring that is too easy to side investors will harm the issuers and may have negative impact on the economic activities.

The study is motivated by a condition where information on how much the actual loss suffered by investors in case of restructuring defaulted sukuk is very limited. This was due to the restructuring process mostly taken place through out of court and it conducted by issuers and investors, either directly or through intermediaries. Consequently there is no accurate data about losses of investors in the event of default. Therefore, the study aims to estimate the losses of investors in the restructuring of sukuk default. Hence, the study contributes to the literature since empirical studies on sukuk default are very limited and the result may be used by the market participants as a benchmark of sukuk default restructuring in the future. The remainder of the paper is organized as follows. Section 2 discusses the related literature. Section 3 highlights the research method. Section 4 discusses the findings and the final section concludes the discussion.

2. LITERATURE REVIEW

Events of default have been make market participants aware that sukuk as a product of Islamic capital market, by design, have similarity with products in the conventional counterpart, in term of their exposure to the default risk. Since these default events are largely unprecedented, the default study is a new research area for the Islamic finance industry. Therefore, until very recently the default study in sukuk market is relatively limited as compared with one in conventional market.

A study conducted by Khnifer (2010a) is one of the early studies that discuss the sukuk default. In his paper, the author reports that there are at least 21 defaulted sukuk in last 20 months from November 2010. The issuances of these defaulted sukuk come from various industry and spread from Malaysia, Pakistan, United States and the Gulf Cooperation Council (GCC) countries. Learning from conventional market experiences, Khnifer (2010b) further proposes three approaches to restructure defaulted sukuk based on Shari'ah principles namely haircut, rescheduling and debt-for-equity swaps. The first approach is 'haircut' whereby the sukuk holders would come to agreement to make a discount on their investment in order to get early settlement. The second approach is 'rescheduling' whereby the sukuk holders may agree to reschedule the financial obligations of the issuer by extending maturity for the same, lower or usually higher

profit rate. Alternatively, the sukuk holders may agree to covert some or all of the debt in exchange for equity in the company under a 'debt-for-equity swaps' approach. The author further argues that these three approaches do not guarantee the recovery of the principle. He estimates, for example, that haircut approach will recover 70-80% of the original principle without any profits. However, the estimates are not empirically proven.

In another default study, Purwono (2012) estimates the default probability and recovery value of Ijarah sukuk. Employing *reduced-form* approach and using daily price of selected Ijarah sukuk listed in the Dubai Bond Market for the period April-May 2010, the study concluded that the estimated long-term default rate steadily increases from around 5% to more than 40% and the estimated recovery value ranges between 40 to 60 cents USD over the period of study. The model is argued to be able to capture the dynamics of credit risk in the global economy since the period of study coincidence with the period of global financial crisis especially Greece debt crisis. Meanwhile, Nursilah and Norailis (2012) posit that the average distance-to-default (dtd) is approximately 4.09 for the 29 defaulted sukuk during 1997-2011 in Malaysia. The highest dtd estimation corresponds to the biggest issue size and the lowest is shown by the smallest issue size for the sample study. Comparing the initial value of asset (V_o) at issuance and the estimated value of asset at default boundary (V_b), the relative growth of V_o to V_b is the highest for the smallest size of issuance. The results suggest that bigger size of sukuk issuance is relatively less risky and requires slow growth rate of V_0 compared to V_b. The findings are consistent with the literature in which dtd is usually positive and falls within the range of empirical investigations.

Since literature on sukuk default study is very limited, literatures from conventional bond market may be adapted in the empirical study of sukuk market. Among empirical study in conventional market, Sturzenegger and Zettelmeyer (2007 and 2008) provide so far the most rigorous study on estimating investor losses. In their paper, the authors calculate investor losses by comparing the present value of new bond with both the par value and the present value of old bond at the exit from default. Using cases of sovereign debt restructuring in nine countries over the period 1998 to 2005, the paper found average

investors losses ranging from 13% to 73% and recovery values ranging from 30% to about 75%.

3. METHODOLOGY

Data

The data on the issuance date, size, coupon, rating, and the date of maturity and default was collected from Malaysia Rating Corporation Berhad (MARC) and Rating Agency Malaysia Berhad (RAM). The data on market benchmark was collected from BondStream. Another data for the study is collected from Bank Negara Malaysia and Bursa Malaysia. The sample cover default events from 2007 until 2011 and selected base on the availability of required data.

Measuring Investor Losses

In order to estimate investor losses, this study adapts the approach developed by Sturzenegger and Zettelmeyer (2007 and 2008). In this study "investor losses" does not reflect the actual loss that investors experienced in restructuring of sukuk default. Rather, our expected loss describes the loss that is incurred if investors participate in a hypothetical situation in which they agree to restructure defaulted sukuk through a 'haircut' approach. Under this restructuring mode investors agree to make a discount on their investment in order to get early settlement. The discount is measured by comparing expected value of defaulted sukuk with market value of benchmark sukuk in the market which has similar maturity and rating.

Hence, "investor losses" are defined as the percentage difference between the market value of benchmark sukuk and the expected value of the remaining contractual payments on the defaulted sukuk discounted using the yield of the benchmark sukuk.

$$EL = 1 - \frac{Pb_{(r_b)}}{Pd_{(r_b)}} \quad (1)$$

where

EL = expected investor losses

Pb = market value of benchmark sukuk

Pd = expected value of defaulted sukuk

r_b = yield of the benchmark sukuk

In order to measure expected value of defaulted sukuk (*Pd*), this paper use formula as follow

$$Pd = \left[\frac{redemption}{\left(1+\frac{yld}{frequency}\right)^{\left(N-1+\frac{DSC}{E}\right)}}\right] + \left[\sum_{k=1}^{N} \frac{100\ X\ \frac{rate}{frequency}}{\left(1+\frac{yld}{frequency}\right)^{k-1+\frac{DSC}{E}}}\right] - \left(100\ X\ \frac{rate}{frequency}\ X\ \frac{A}{E}\right) \quad (2)$$

where:

Default date	= the date when the sukuk is declared default by credit rating agency
Maturity date	= the sukuk's maturity date
Rate	= the sukuk's annual coupon rate.
Yld	= the sukuk's annual yield i.e. yield of the benchmark sukuk (r_b)
Redemption	= the sukuk's redemption value per $100 face value.
Frequency	= the number of coupon payments per year (for annual payments = 1; for semiannual = 2; for quarterly = 4)
Basis	= the type of day count basis to use (Actual/actual = 1, Actual/360 = 2, Actual/365 = 3, European 30/360 = 4)
DSC	= number of days from default date to next coupon date.
E	= number of days in coupon period in which the default date falls.
N	= number of coupons payable between default date and redemption date.

A = number of days from beginning of coupon period to default date.

Computing expected investor losses (EL) involves a number of practical complications. The most difficult problem is in determining the sukuk which is used as benchmark. To deal with this problem, firstly we employ both corporate and government sukuk as benchmark. Corporate sukuk is used to estimate a fair value of restructuring based on current market condition. While government sukuk is used to estimate a worst loss estimation of restructuring since it often perceived as risk free investment and usually gives smaller yield than the corporate sukuk.

A second problem for determining the benchmark is the maturities of the defaulted and benchmark sukuk were not exactly same. The maturity is very important since it affect the yield of sukuk. Sukuk which have longer maturity tend to have higher yields than those have shorter maturity. To deal with this problem, our approach was to group the remaining tenor of defaulted sukuk in to seven groups from less than 1 year to more than 5 years with 1 year interval of each group. Base on this approach, the benchmark is selected from the sukuk which have similar remaining tenor. When this was not possible, for example because the remaining tenor is too long and there are no sukuk in the market with similar tenor, we used the closest available benchmark and made an adjustment using the yield curve and sukuk price index.

A third complication arose when determining which rating will be used to select the benchmark. The last rating before sukuk was declared as default by rating agency should not be used because it was usually already affected by information related with default and it often drop very fast from normal or stable rating to default status. In this case, we use initial rating when the sukuk was issued. This approach will give fair valuation for investors since they used the initial rating when make decision to invest on the sukuk. Another problem is the difference in the rating symbols and categories used by rating agencies and market data provider. To deal with this problem, the rating symbols are

synchronized based on the definition provided by each rating agency and market data provider.

Finally, the sukuk was usually issued in a series which have different maturities while the rating agency released rating or default status for the sukuk facility not for each series. This situation becomes complicated when calculating the expected value since the formula required default date should be fall before maturity date. In some cases the rating agency release default rating after maturity date of the junior series, consequently the expected market value of these series cannot be calculated. In order to avoid failure in calculation, only series that have a maturity date after the sukuk was declared as default is included in the calculation.

4. RESULTS AND DISCUSSION

Corporate Sukuk Default in Malaysia

Table 1 shows the defaulted sukuk in Malaysia for the period 2007-2011. Default status is based on the criteria of one of two credit rating agency in Malaysia namely the Rating Agency Malaysia Berhad (RAM) with D rating and the Malaysian Rating Corporation Berhad (MARC) with D_{ID} rating. Overall, there are 15 cases of default that meet the criteria of sample. There are 6 default cases in 2009 and only one case in 2010.

Table 1: Defaulted Corporate Sukuk in Malaysia (2007 - 2011)

Issuer	Sukuk Series	Rating Agency	Initial Rating	Issuance Date	Maturity Date	Default Date	Amount Issued (RM mil)	Amount Outstanding (RM mil)
ACE Polymers (M) Sdn Bhd	ACE PMERS 2 until 7 years	MARC	A_{ID}	15-Sep-2004	14-Sept-2006 until 2011	14-Sep-2007	70	65
BSA International Bhd	BSAINTNL 3 & 5 years	RAM	A2	19-Oct-2004	19-Oct-2007 and 2009	28-May-2008	150	45
Dawama Sdn Bhd Junior	DAWAMA 4 years	MARC	$A+_{IS}$	27-Apr-2009	27-Apr-2014	29-Apr-2011	20	5
	DAWAMA 5 years		A_{IS}	27-Apr-2009	27-Apr-2013	3-Oct-2011	120	80
Englotech Holding Bhd	ENGLOTECHS 4 until 7 years	MARC	A_{ID}	26-Sep-2005	26-Sep-2009 until 2012	27-Mar-2009	50	50
Evermaster Bhd	EVERMASTER 5 until 7 years	MARC	A_{ID}	30-Dec-2003	30-Dec-2008 until 2010	31-Dec-2008	50	50
Ingress Sukuk Bhd	INGRESS 5 until 7 years	MARC	$A+_{ID}$	9-Jul-2004	9-Jul-2009 until 2011	13-Jul-2009	160	145
Intelbest Corporation Sdn Bhd	INTELBEST 2 until 4 years	MARC	$A+_{ID}$	28-Feb-2005	28-Feb-2007 until 2009 28-Feb-2007 until 2009	29-Feb-2008	110	110
Malaysian International Tuna Port Sdn Bhd	MITP 5 until 10 years	MARC	$A+_{ID}$	17-May-2007	17-May-2012 until 2017	18-Nov-2009	240	240
Malaysian Merchant Marine Bhd	MMM 3, 5 & 7 years	MARC	AA_{ID}	28-Nov-2003	28-Nov-2006, 2008, 2010	2-Apr-2010	120	24
Memory Tech Sdn Bhd	MTSB 2 until 7 years	RAM	A2	28-Oct-2005	28-Oct-2007 until 2012	7-Jun-2007	320	320
Nam Fatt Corporation Bhd	NAM FATT 7 years	MARC	$A+_{ID}$	10-Feb-2006	10-Feb-2013	6-Apr-2010	250	50
Oxbridge Height Sdn Bhd	OXBRIDGE 4 until 6 years	RAM	A1	29-Apr-2005	29-Apr-2009 until 2011	6-Apr-2009	104	53
Peremba Jaya Holdings Sdn Bhd	PEREMBA 3 years	MARC	A_{ID}	8-Feb-2005	14-Jul-2008	16-Apr-2007	200	182.1
PSSB Ship Management Sdn Bhd	PSSB SHIP 1 until 7 years	MARC	AA_{ID}	15-Dec-2004	15-Dec-2005 until 2011	15-Dec-2009	35	20
Tracoma Holdings Bhd	TRACOMA 4 & 5 years	MARC	A_{ID}	28-Jan-2005	28-Jan-2009 and 2010	29-Jan-2009	100	100

There are 3 defaulted sukuk rated by RAM and another 12 was rated by MARC. The initial rating as shown in column 4 ranges from A1 to A2 (RAM) and A_{ID} to AA_{ID} (MARC) which are categorized as good rating in the investment grade.[3] Normally, sukuk or bond that categorized in the investment grade is expected have low default probability and take a long time to default. However, according to RAM's default study (2012), in overall market (Islamic and conventional) issuers rated A and AA at initial rating contribute almost 31% of total default events over period 1992 until 2011. Interestingly, the highest default events concentrate in BBB initial rating which contributes about 39% of total default events. These facts imply that investors should not solely look at initial rating to predict default probability.

[3] According to MARC investment grade consist bond or sukuk with rating from AAA to BBB, while non-investment or speculative grade consist bond or sukuk with rating from BB to D.

Almost defaulted sukuk was issued in series ranging from 2 until 10 maturity years except for the Nam Fatt Corporation Bhd in a single series of 7 years. The average time to default from the issuance date is 3.6 years. The shortest time to default is 1.6 years after issuance date - the Memory Tech Sdn Bhd's sukuk, while the longest one is 6.3 years - the Malaysian Merchant Marine Bhd's sukuk. This fact suggests that the perception that investment grade take a long time to default is not always true.

Estimated Investor Losses

In order to measure estimated investor losses, first the expected market price (*Pd*) of defaulted sukuk is calculated as in Equation 2 using yield of both government and corporate sukuk which have similar rating and remaining maturity. The expected price is then used to estimate losses as in Equation 1.

The result of estimated investor losses using government sukuk as benchmark is presented in Table 2. The smallest loss is the Oxbridge Height Sdn Berhad 4 year's sukuk series with expected lost 0.28%. It means that expected recovery value (that is 100 - *EL*) of this sukuk is 99.72%. The biggest loss is the Malaysian International Tuna Port Sdn Bhd 10 year's sukuk series with expected loss 22.80% or in other word investors of this sukuk is expected to get 77.20% recovery value of the principal. The smallest loss corresponds to the shortest remaining tenure (0.1 years) and the biggest loss is shown by the longest remaining tenure (7.5 years).

The result of estimated investor losses using corporate sukuk as benchmark is presented in Table 3. The sukuk series which have smallest and biggest loss are same as those are estimated using government sukuk. The smallest one is the Oxbridge Height Sdn Berhad 4 year's sukuk series with expected lost 0.02% and the biggest one is the Malaysian International Tuna Port Sdn Bhd 10 year's sukuk series with expected loss 23.80%. The findings as in Table 1 and Table 2 indicate that the estimated investor losses tend to increase when the remaining tenure increase.

Table 2: Estimated investor losses use government sukuk as benchmark

Issuer	Sukuk Series	Cuopon (%)	Coupon Freq/year	Remaining Tenure (years)	Government Sukuk Benchmark			
					Gov Sukuk Yield (%)	Expected Price	Gov Sukuk Price	Estimate Loss
ACE Polymers (M) Sdn Bhd	ACE PMERS 4 YRS	7.25	2	1.0	3.48	103.68	98.17	5.32%
	ACE PMERS 5 YRS	7.75	2	2.0	3.53	108.09	100.55	6.98%
	ACE PMERS 6 YRS	8.15	2	3.0	3.57	112.93	100.37	11.12%
	ACE PMERS 7 YRS	8.55	2	4.0	3.63	118.18	99.79	15.56%
BSA International Bhd	BSAINTNL 5 YRS	7.90	2	1.4	3.54	105.87	95.15	10.13%
Dawama Sdn Bhd Junior	DAWAMA 5 YRS	7.50	2	1.6	3.04	106.77	100.81	5.58%
	DAWAMA 4 YRS	8.50	2	2.6	3.33	114.62	102.48	10.59%
Englotech Holding Bhd	ENGLOTECHS 4 YRS	6.30	2	0.5	1.99	102.11	101.49	0.61%
	ENGLOTECHS 5 YRS	6.70	2	1.5	2.18	106.60	102.49	3.85%
	ENGLOTECHS 6 YRS	7.00	2	2.5	2.37	111.16	105.03	5.52%
	ENGLOTECHS 7 YRS	7.20	2	3.5	2.83	114.45	102.45	10.49%
Evermaster Bhd	EVERMASTER 6 YRS	7.50	2	1.0	2.86	104.53	97.69	6.54%
	EVERMASTER 7 YRS	7.75	2	2.0	3.02	109.10	101.25	7.20%
Ingress Sukuk Bhd	INGRESS 6 YRS	7.00	2	1.0	1.91	104.96	101.1	3.68%
	INGRESS 7 YRS	7.60	2	2.0	2.41	110.01	103.72	5.72%
Intelbest Corporation Sdn Bhd	INTELBEST 4 YRS	7.50	2	1.0	3.41	103.97	100.52	3.31%
Malaysian International	MITP 5 YRS	7.70	2	2.5	2.81	111.71	100.61	9.94%
Tuna Port Sdn Bhd	MITP 6 YRS	7.95	2	3.5	3.38	114.96	100.69	12.41%
	MITP 7 YRS	8.20	2	4.5	3.83	117.89	100.33	14.89%
	MITP 8 YRS	8.45	2	5.5	3.85	122.57	102.7	16.21%
	MITP 9 YRS	8.70	2	6.5	4.12	125.88	98.83	21.49%
	MITP 10 YRS	8.95	2	7.5	4.29	129.61	100.06	22.80%
Malaysian Merchant Marine Bhd	MMM 7 YRS	5.85	2	0.7	2.32	102.29	100.91	1.35%
Memory Tech Sdn Bhd	MTSB 2 YRS	5.95	2	0.4	3.34	100.98	97.34	3.61%
	MTSB 3 YRS	6.25	2	1.4	3.44	103.78	100.81	2.86%
	MTSB 4 YRS	6.60	2	2.4	3.49	107.07	100.19	6.43%
	MTSB 5 YRS	6.95	2	3.4	3.53	110.83	100.52	9.31%
	MTSB 6 YRS	7.35	2	4.4	3.55	115.32	104.1	9.73%
	MTSB 7 YRS	7.70	2	5.4	3.64	119.69	105.21	12.10%
Nam Fatt Corporation Bhd	NAM FATT 7 YRS	6.50	2	2.9	3.35	108.48	100.72	7.16%
Oxbridge Height Sdn Bhd	OXBRIDGE 4 YRS	7.00	2	0.1	1.88	100.32	100.04	0.28%
	OXBRIDGE 5 YRS	7.50	2	1.1	2.04	105.71	101.42	4.06%
	OXBRIDGE 6 YRS	8.00	2	2.1	2.45	111.10	104.12	6.28%
Peremba Jaya Holdings Sdn Bhd	PEREMBA 3 YRS	6.60	2	1.2	3.40	103.86	100.95	2.81%
PSSB Ship Management Sdn Bhd	PSSB SHIP 6 YRS	7.00	2	1.0	2.06	104.86	101.57	3.14%
	PSSB SHIP 7 YRS	7.25	2	2.0	2.33	109.56	103.55	5.49%
Tracoma Holdings Bhd	TRACOMA 5 YRS	7.60	2	1.0	2.47	105.02	101.21	3.63%

Table 3: Estimated investor losses use corporate sukuk as benchmark

Issuer	Sukuk Series	Cuopon (%)	Coupon Freq/year	Remaining Tenure (years)	Corporate Sukuk Benchmark			
					Corp Sukuk Yield (%)	Expected Price	Corp Sukuk Price	Estimate Loss
ACE Polymers (M) Sdn Bhd	ACE PMERS 4 YRS	7.25	2	1.0	5.46	101.72	99.54	2.15%
	ACE PMERS 5 YRS	7.75	2	2.0	6.19	102.90	99.70	3.11%
	ACE PMERS 6 YRS	8.15	2	3.0	6.36	104.82	103.14	1.61%
	ACE PMERS 7 YRS	8.55	2	4.0	6.84	105.90	100.53	5.07%
BSA International Bhd	BSAINTNL 5 YRS	7.90	2	1.4	7.35	100.70	98.61	2.08%
Dawama Sdn Bhd Junior	DAWAMA 5 YRS	7.50	2	1.6	5.21	103.40	100.91	2.40%
	DAWAMA 4 YRS	8.50	2	2.6	4.20	111.98	100.89	9.90%
Englotech Holding Bhd	ENGLOTECHS 4 YRS	6.30	2	0.5	6.10	100.10	99.58	0.51%
	ENGLOTECHS 5 YRS	6.70	2	1.5	6.78	99.89	99.37	0.52%
	ENGLOTECHS 6 YRS	7.00	2	2.5	7.10	99.77	98.96	0.82%
	ENGLOTECHS 7 YRS	7.20	2	3.5	7.38	99.45	98.67	0.79%
Evermaster Bhd	EVERMASTER 6 YRS	7.50	2	1.0	5.97	101.46	99.77	1.67%
	EVERMASTER 7 YRS	7.75	2	2.0	6.79	101.76	99.26	2.46%
Ingress Sukuk Bhd	INGRESS 6 YRS	7.00	2	1.0	8.95	98.19	97.95	0.25%
	INGRESS 7 YRS	7.60	2	2.0	8.63	98.15	97.59	0.57%
Intelbest Corporation Sdn Bhd	INTELBEST 4 YRS	7.50	2	1.0	5.78	101.64	94.19	7.33%
Malaysian International	MITP 5 YRS	7.70	2	2.5	6.07	103.72	96.76	6.71%
Tuna Port Sdn Bhd	MITP 6 YRS	7.95	2	3.5	6.50	104.47	94.34	9.70%
	MITP 7 YRS	8.20	2	4.5	7.13	104.05	89.02	14.45%
	MITP 8 YRS	8.45	2	5.5	7.37	104.80	86.35	17.61%
	MITP 9 YRS	8.70	2	6.5	7.64	105.35	83.41	20.83%
	MITP 10 YRS	8.95	2	7.5	7.90	105.86	80.46	23.99%
Malaysian Merchant Marine Bhd	MMM 7 YRS	5.85	2	0.7	3.21	101.70	101.65	0.05%
Memory Tech Sdn Bhd	MTSB 2 YRS	5.95	2	0.4	5.21	100.27	97.28	2.98%
	MTSB 3 YRS	6.25	2	1.4	5.36	101.17	93.41	7.67%
	MTSB 4 YRS	6.60	2	2.4	5.56	102.29	88.22	13.76%
	MTSB 5 YRS	6.95	2	3.4	6.12	102.50	91.22	11.00%
	MTSB 6 YRS	7.35	2	4.4	6.25	104.16	93.49	10.24%
	MTSB 7 YRS	7.70	2	5.4	6.42	105.74	91.64	13.33%
Nam Fatt Corporation Bhd	NAM FATT 7 YRS	6.50	2	2.9	6.36	100.35	95.26	5.07%
Oxbridge Height Sdn Bhd	OXBRIDGE 4 YRS	7.00	2	0.1	6.33	100.03	100.01	0.02%
	OXBRIDGE 5 YRS	7.50	2	1.1	6.80	100.70	99.53	1.16%
	OXBRIDGE 6 YRS	8.00	2	2.1	7.82	100.33	98.24	2.08%
Peremba Jaya Holdings Sdn Bhd	PEREMBA 3 YRS	6.60	2	1.2	5.40	101.42	92.64	8.65%
PSSB Ship Management Sdn Bhd	PSSB SHIP 6 YRS	7.00	2	1.0	4.24	102.67	101.26	1.38%
	PSSB SHIP 7 YRS	7.25	2	2.0	4.82	104.58	102.64	1.86%
Tracoma Holdings Bhd	TRACOMA 5 YRS	7.60	2	1.0	5.81	103.87	99.94	3.79%

To have an overall look at the findings, the estimated losses are grouped based on the remaining tenure into six categories ranging from less than or equal to 1 year until more than 5 years with 1 year interval of each group. The average losses of each group are presented in Table 4.

Table 4: Estimated average investor losses

Remaing	Benchmark		
Tenure	Government Sukuk		Corporate Sukuk
< 1 yrs	3.76%		2.26%
2 yrs	5.47%		3.05%
3 yrs	8.15%		5.71%
4 yrs	11.94%		6.64%
5 yrs	12.31%		12.34%
> 5yrs	18.15%		18.94%

Table 4 shows that that the average investor losses ranging from 2.01% - 3.14% (for less than or equal to 1 year remaining tenure) to 18.15% - 18.94% (for more than 5 years remaining tenure). This finding indicate that the average losses tend to increase when the remaining tenure increase. This finding is consistent with the theory in which sukuk with longer maturity are more risky than the shorter one, consequently they face bigger losses. The losses will get worse if seniority is applied among the sukuk series. In finance, seniority refers to the order of repayment in the event of a default or bankruptcy of the issuer in which senior sukuk must be repaid before subordinated (or junior) sukuk is repaid.

Table 5: Average annual yield

Remaing	Benchmark		
Tenure	Government Sukuk		Corporate Sukuk
< 1 yrs	2.57%		5.71%
2 yrs	2.89%		6.33%
3 yrs	3.05%		6.21%
4 yrs	3.34%		6.71%
5 yrs	3.69%		6.69%
> 5yrs	3.98%		7.33%

The average losses using corporate benchmark tend to be lower than the one using government benchmark. The finding is consistent with information in Table 5 which shows that the average yield of corporate sukuk is relatively higher than one of corporate sukuk, therefore it give lower average losses. However, the average losses of the last two groups (groups of 5 and more than 5 years remaining tenure) almost have same value with those one in government benchmark. The possible explanation of this phenomenon is that market had difficulty when evaluating corporate sukuk which have long maturity since corporate sukuk is issued mostly in short maturity (less than 5 years). Therefore, market tends to use the value of government sukuk as a benchmark when evaluating corporate sukuk with long maturity. Consequently, its expected value is closed to that of the value of government sukuk.

5. CONCLUSION

This study has two main results. First, the estimated investor losses tend to increase when the remaining tenure of defaulted sukuk increase. This finding implies that investors who hold sukuk with longer maturity face higher risk and bigger estimated losses in case of default. Second, the estimated investor losses using government sukuk as benchmark tend to be higher compared with the one using corporate sukuk. This finding represents the best and worst scenario of recovery value in restructuring of default sukuk using haircut approach. Therefore, this finding may be used by market participants as benchmark in the restructuring process by providing border line of estimated recovery value in their negotiation. Further study might compare the findings with actual investor losses to check it accuracy and conduct robustness tests to improve the accuracy of the estimation.

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EFFICIENCY EVALUATION OF ISLAMIC AND CONVENTIONAL MUTUAL FUNDS IN MALAYSIA BASED ON ASSET PORTFOLIO

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Abstract

Islamic finance emerges as a rapidly growing part of the market worldwide and gains recognition from the world (incorporating non-Muslim) in mitigating market failures. In particular, the Islamic mutual funds (MFs) market is one of the accelerated growing sectors within Islamic finance although it is still in their infancy stage of development as compared to the MF's industry (including Conventional) at large. Therefore, the objective of this research is to evaluate the efficiency of the MFs in Malaysia and make a comparison analysis between Islamic and Conventional MFs. Subsequently, efficiency in terms of four major asset portfolios of MFs namely Equity, Debt, Money Market and Asset Allocation is discoursed. In fact, efficiency implies that the financial assets yield highest return for a given level of risk or yield the lowest risk for a given level of return. Consequently, the study cannot verify any substantial relationship between efficiency and performance. Nevertheless, the proportion of over performance of mutual funds could possibly improve the efficiency and no relationship can be signified for the efficiency and the magnitude of performance. The main finding of the study is Islamic MFs have higher efficiency than Conventional MFs and Debt MFs have the highest efficiency within asset portfolios. The research is significant to understand the growth phases of Islamic and Conventional MFs and feasibly stipulates assessment in terms of strength, competitiveness and durability. Additionally, the results of the study deliver an essential insight on the notion of Efficient Market Hypothesis (EMH) and potential arbitrage practices.

Keywords: Efficiency, Mutual Fund, Islamic, Conventional

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1. INTRODUCTION

Islamic finance is now emerging as a rapidly growing part of the market worldwide (see Nathie (2008) and Lewis (2009)) and recently gaining momentum to grow into a vibrant marketplace. It is not amplifying to expect Islamic finance will become an integral segment of the worldwide market within several years to come. There are several factors of the expansion of Islamic finance: the introduction of wide-raging economic and structural reforms, the liberalization of capital movements, financial systems, privatization and the global integration of financial markets (Iqbal, 1997). One of the important components in Islamic finance is Islamic mutual fund (MF).

Mutual fund (known as unit trust) is a form of collective investments that allows investor with similar investment objectives to pool their funds and invest in a portfolio of securities and (or) other assets (Mansor and Bhatti, 2011c). Yuzi et al. (2012) divided mutual funds into four broad categories; Equity, Debt, Money Market and Asset Allocation. MFs are always associated with "professional management" that, apparently, provides the potential results from investment better than normal investors (layman) can possibly gain when they select securities and subsequently managing the portfolio. Islamic mutual fund is similar to Conventional MF but it is based on *shariah* (Islamic Law) that governs the principles of Islamic finance. In *shariah*'s context, it promotes the notions of profit sharing as well as partnership's scheme and strongly forbids any investment involving three elements that are *riba* (interest), *maysir* (gambling) and *gharar* (extreme and uncontrollable risk).

As a result, the objective of this study is to evaluate the efficiency of both Islamic and Conventional mutual funds. In addition, efficiency in terms of four major asset portfolios of MFs namely Equity, Debt, Money Market and Asset Allocation is discoursed. The purpose is to determine the current growth phase of Islamic MF as compared to Conventional MF and stipulate assessment for Islamic MF in terms of four asset portfolios regarding the strength, competitiveness and durability. Malaysia is chosen as a case study due to its significant growth in both Islamic finance and Islamic MF. Mushtak

Parker (2010) reported that Malaysia is one of the largest Islamic funds markets in the world based on the Capital Market Authority (CMA) 2010 Reports and Security Commission 2010 Reports. Mansor and Bhatti (2011c)suggested that Malaysia alone dominates more than one third of the global Islamic MFs. There are 155 Islamic MFs with a total volume of RM22.69 billion. Bursa Malaysia recorded that Malaysia has 87%, or 855 equities listed, of shariah-compliant stocks in the equity market and the market capitalization amounted RM422.24 billion, or 64.3% of the total market capitalization as of 28 November 2008 (Dewi and Ferdian, 2009). The net asset value of Islamic MFs is RM22.08 billion as at December 2009 out of the total RM191.71 billion of all mutual funds and the units in circulation are 56.85 billion units. There were 47 investment companies manage 188 Islamic MFs (both unit trust and wholesale funds) in Malaysia, as of 31 August 2011 (Security Commission, 2012).

This paper is important as it can give benefits to investors and researchers especially those specialising in mutual funds in Malaysia. The organization of this article is as follow: Section 1 is an introduction, Section 2 presents the relevant literature reviews, Section 3 describes data and methodology, Section 4 evaluates and analyses efficiency of MFs using regression analysis and Section 5 summarizes conclusions and limitations of the study.

2. LITERATURE REVIEW

2.1 Islamic Finance and Islamic Funds

Statistically, the global market of Islamic finance has been projected to be growing at a rate of 15-20% per annum. The estimates of the size of Islamic finance are as high as US$1,020 billion for 2007 and the estimates of all (including retail and corporate) global Islamic banking ranges from US$420 billion to US$500 billion (Silva, 2007). In terms of Islamic MFs, there are vast references to be signified. Islamic MFs is one of the fastest growing sectors in the Islamic financial system although it is still in its infancy stage of growth and development in comparison to the MF's industry at large. According to Abderrazak (2008), the total assets for Islamic equity funds have bounced from US$800 million in 1996 to US$3.6 billion in 2003. 29 Islamic equity funds are recorded on 1996

and the number upsurges dramatically to 232 funds on March 2009 (Mansor and Bhatti, 2011a). During late of 1990s, the global Islamic equity funds have experienced excellent growth since the total assets worldwide grew more than 25% over the period of 1997 to 2003 as they benefited from the technology boom, most of them indicating high positive returns, and outperformed their benchmarks. Elfakhani et al. (2005) claimed that the number of global Islamic funds increased from 8 funds prior to 1992 to 95 funds in 2000. The total assets as of the year 2000 are approximately US$5 billion and expected to grow by 12-15% per annum (Mansor and Bhatti, 2011b).

On the other hand, western investors are also playing a significant role in the growth of Islamic MF's products. Lewis (2009) and Nathie (2008) also confirmed the global investors' interest towards Islamic finance especially Islamic MFs has been tremendously increasing worldwide as it gains recognition in mitigating market failures. There are a number of studies proved that Islamic MFs are capable of delivering and maintaining consistent return during the bearish market (see Abdullah et al. (2007) , Elfakhani et al. (2005) and Abderrezak (2008)). Furthermore, Elfakhani et al. (2007) suggested evidence of strong performance between Islamic MFs in relation to the conventional benchmark (S&P 500 Index) and the Islamic benchmark (FTSE Islamic Indices) during the period of recession. Elfakhani et al. (2005) further discussed the ability of Islamic mutual funds to be a superior hedging investment especially against market depressions since the performance of Islamic MFs improves over times.

2.2 Mutual Fund's Performance and Efficiency

There are tremendous number of literatures in the area of mutual funds and only few concentrated on comparative analysis between Islamic and Conventional MFs. Many studies on the comparison analysis between Islamic and Conventional MF focused on the performance[4]and the most common analysis utilized is Sharpe Ratio, Treynor Ratio, Jensen Indices and Modigliani's Measure (see Yuzi et al. (2012) and Mansor and Bhatti

[4]The first models used to evaluate risk-adjusted fund performance were based on the work by Sharpe, Lintner, Treynor and Mossin on the Capital Asset Pricing Model (Otten and Bams, 2004)

(2011b)). Other analyses that can be found are Market timing and Snail Trail Methodology (see Dewi and Ferdian(2009)). However, there is no study that discourses efficiency itself for Islamic and Conventional MF. The closest analysis that explains efficiency is Snail Trail Method (see Dewi and Ferdian(2009)). However, still, it is applied in the context of MF's performances. This simple method applies a combination of risk and return of MF in four plotted quadrants. This method allows the movement of MF's performance to be continuously monitored and any related decision can be, therefore, made appropriately. Although performance and efficiency could somehow have positive or negative relation (correlation), this study aims to address efficiency as a single variable using the most basic framework as in the study of Portfolio Selection by Markowitz (1952).

Efficiency as presented by Markowitz (1952) implied that assets (financial) that yield highest return for a given level of risk or yield the lowest risk for a given level of return. This is in fact a model of portfolio selection that consequently became the foundation in modern investment. In addition, Bernstein(1992) distinguished Markowitz's model as a prominent insight in the history of modern finance and the model ultimately transformed the practice of investment management beyond recognition. Markowitz (1952) concurred that by combining different assets whose returns are not perfectly positively correlated; Markowitz (1952) seeks to reduce the total variance of the portfolio returns. Furthermore, mean variance analysis has been increasingly applied to asset allocation over the last decade and it is discovered that mean-variance analysis provided a powerful framework for asset allocation and, correspondingly, mutual funds too(Kaplan, 1998).

However, it is worth to discuss the literatures about the performances of Islamic and Conventional MF because it can give a good indication on the efficiency in general. Based on a previous research done by Muhammad and Mokhtar (n.d.), the performance of Islamic MFs was analysed comparatively using Sharpe Ratio and Treynor Ratio. Data consists of the Net Asset Value (NAV) of nine Malaysian equity MFs and the prices (values) of market portfolio that is Kuala Lumpur Shariah Index (KLSI) on weekly basis during the period of 2002 to 2006. It was found that only Public Ittikal fund achieved a

higher average return in comparison to KLSI (market portfolio). Furthermore, the results from Treynor Analysis showed that Islamic equity MFs' performance was significantly and positively correlated to the performance of the KLSI.

Dewi and Ferdian (2012) measured and compared the performance of Malaysian and Indonesian Islamic Market. Daily data from June 2006 until April 2009 were evaluated using Sharpe Ratio, Treynor ratio, Jensen Index, Snail Trail and Market Timing methods. It is found that Indonesian's asset allocation Islamic MFs seemingly outperformed (slightly) the same type of Islamic MFs in Malaysian market. The same outperformance was also showed by Indonesian's debt Islamic MFs in comparison to Malaysian's counterparts. Additionally, the performance of Islamic MFs can be monitored by means of Islamic index (e.g.: KLSI).

Merdad et al. (2010) investigated the risk return behaviour of Islamic and Conventional MFs in Saudi Arabia by using Sharpe Ratio, Trenor Ratio, Jensen Alpha and their variants. They reported that Islamic MFs underperformed relatively to Conventional MFs during the periods of "full and bullish". However, during "bearish and financial crisis" periods, Islamic MFs have tendency to outperform Conventional MFs. Further, it is concluded that Islamic MFs offer an opportunity for hedging during the period of financial crisis (or bearish) because of some prohibitions in *shariah* that, somehow, put several limitations on portfolio selection.

Elfakhani and Hassan (2005) concluded that the performance of Islamic MFs is improving with time as the fund managers are gaining more experience and understanding (sense) of the market. This study made no comparison with Conventional MFs and only tracked the performance of 46 Islamic MFs during the period of 1 January 1997 until 31 August 2002. Furthermore, this study did not find any statistical difference in term of performance of the 46 Islamic MFs in comparison to the respective index. This outcome is essentially consistent with Elfakhani et al. (2005) that also (mainly) observed a strong performance of Islamic MFs as compared to the benchmarks during the period of recession. Nevertheless, the short time frame of the study may contribute to the

biasedness of the results. Another point to highlight is the industry of Islamic MFs (or Islamic finance in general) was still in its early stage of development during the period of the study. This is indicated by insufficient experience of fund managers, poor transparency and limited diversification in portfolio funds.

A recent study by Yuzi et al. (2012) concluded that all the portfolio classes of Islamic MFs (Equity, Debt, Monet Market and Asset Allocation) were not affected by the market movements especially during the Global Financial Crisis in 2007 to 2008. This study investigated the performance of all Islamic MFs (with different asset classes) in three different periods namely pre-crisis (2001-2006), Global Financial Crisis (2007-2008) and post crisis (2009-2010). The study adopted the analysis (measurement) of Sharpe Ratio, Adjusted Sharpe Ratio, Treynor ratio and Modigliani Measure that utilized the data of daily average returns of each Islamic MFs over 10 years. Other observations highlighted by the study are Money Market Islamic MFs were the most invincible choice of investment during the period of bearish as it was least affected by the crisis and Equity and Asset Allocation Islamic MFs were preferable in terms of consistency and outperformance.

Extending the earlier work of Elfakhani et al. (2005), Elfakhani and Hassan (2007) also made an observation of the strong performance of Islamic MFs relatively to the benchmarks during the period of recession. The same data in Elfakhani and Hassan (2005) were used and, similarly, found no statistically significant risk-adjusted abnormal return associated with Islamic MFs.Besides, it was suggested that the behaviour of Islamic MFs does not differ substantially from Conventional MFs and Islamic MFs should be considered in the portfolio collection especially during the period of ‘slow” market due to the strong performance during that period. The same and consistent observation was made by Abdullah et al. (2007) concurred that Conventional MFs perform better in good economic period and worse during bad economic period as compared to Islamic MFs. The study evaluated the performance (using NAV) of the Malaysia Islamic MFs from the period of 1995 to 2001 and comparison analysis was done with the corresponding Conventional MFs. The study also highlighted the

underperformance (slightly) of both Islamic and Conventional MFs relatively to the market and poor selection as well as market timing ability for all asset portfolios of MFs.

Hence, most of the comparative studies between Islamic and Conventional MFs demonstrated that Conventional MFs have a better performance in comparison to Islamic MFs due to several reasons such as the infancy phase the market of Islamic MFs, insufficient experience of fund managers, poor transparency and limited diversification in portfolio funds. However, it is proven that Islamic MFs are a good hedging investment against market downturns because of some prohibitions in *shariah* that, somehow, put several limitations on portfolio selection and causes the performance return of Islamic MFs show only a mild correlation with the movement of the market. The information about the performances of both Islamic and Conventional MFs could be a significant indication in addressing efficiency. Possibly, the outcome of this study can ascertain the relationship between efficiency and performance of Islamic and Conventional MFs and in the context of asset portfolios namely Equity, Debt, Money Market and Asset Allocation.

3. DATA & METHODOLOGY

3.1 The Data

The study used daily average returns (NAV) from 1 January 2000 to 31 December 2010. These NAVs for all Islamic MFs in Malaysia were obtained from the Bloomberg database. The data period has been chosen because the availability of the data and the maturity of the industry of Islamic and Conventional MFs during that period. The sample data consists of 546 of Conventional MFs and 197of Islamic MFs as at 31 December 2010. They are categorized according to the asset portfolios that are Equity, Debt, Money Market and Asset Allocation.

3.2 Methodology

The average daily returns of each MF are calculated as below:

$$R_{it} = \frac{NAV_{it} - NAV_{it-1}}{NAV_{it-1}}$$

Where R_{it} is the daily return of MF i at time t and NAV_{it} is the Net Asset Value of MF i at time t. Use the data of MF's daily return to calculate the expected return and variance. It is convenient to use the built-in function in Microsoft Excel or SPSS to obtain the mean and standard deviation of the data for each MF. Both programs also include a function for regression analysis.

There are two parts of comparison analysis on efficiency of MFs. First, the efficiency between all Islamic MFs and Conventional MFs is evaluated. Second, the efficiency of each asset portfolios (Equity, Debt, Money Market and Asset Allocation) for both Islamic and Conventional MFs is then measured. In order to do the efficiency study, the study employs regression analysis in which a regression line is formed based on the respective data in terms of returns and standard deviations of each MF involved. The efficiency can be presented by the gradient of the regression line and the intersection of y-axis.

For the first part of comparison analysis, two regression lines are obtained from the data set of respective returns and standard deviation of all Islamic and Conventional MFs. Therefore, there should be a line representing Islamic MFs and another line representing Conventional MFs. For each line, all the data of returns and standard deviations of each MF belong in the class (whether Islamic or Conventional) are used. For the second part of comparison analysis, the study widens the scope of the comparison analysis by dividing MFs into four different groups that are Equity, Debt, Money Market and Asset Allocation. Therefore, there are four different lines for each Islamic and Conventional MF.

4. ANALYSIS AND FINDINGS

4.1 Efficiency of Islamic and Conventional Mutual Funds

Figure 1: Efficiency of Conventional Mutual Funds

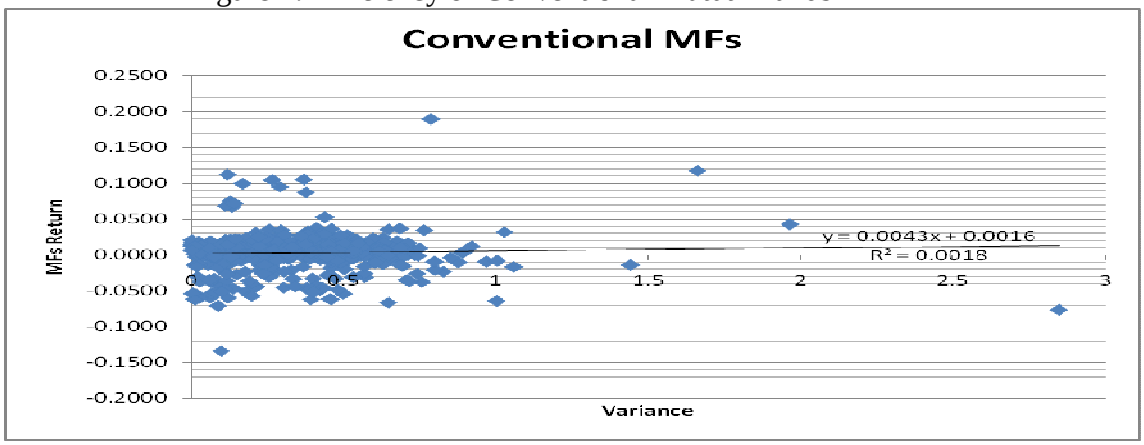


Figure 2: Efficiency of Islamic Mutual Funds

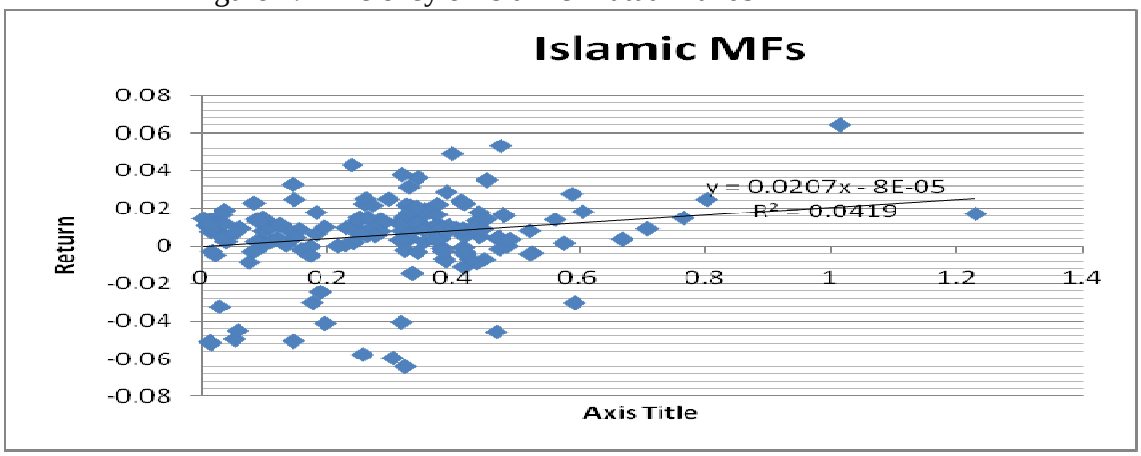


Figure 1 and Figure 2 illustrate the scatter plots of both Islamic and Conventional MFs. It is obvious that the number of Conventional MFs is more the number of Islamic MFs and this is due to the infancy phase of Islamic MFs' industry. Furthermore, it is apparent that Conventional MFs have a greater variability in terms of returns and standard deviation as they have both maximum and minimum values of returns as well as standard deviation. The efficiency for both Islamic and Conventional MFs in term of their respective regression lines is summarized in Table 1 next page.

Table 1: Summary of Efficiency for Islamic and Conventional MFs

Mutual Funds	*Gradient*	Intersection of *Y-Axis*	R^2
Conventional	0.0043	0.0016	0.0018
Islamic	0.0207	0.00008	0.0419

The gradient of the regression line for Islamic MFs is higher than Conventional MFs that indicates Islamic MFs are more efficient than Conventional MFs. It is surprising because Conventional MFs are more established than Islamic MFs and the number of Conventional MFs is far higher than Islamic MFs. Furthermore, almost all literature reviews concluded that Conventional MFs have a higher performance than Islamic MFs. From the regression analysis, a high performance of MFs does not imply (guarantee) a high efficiency. This result is considerably reliable since the analysis considers all MFs in Malaysia as at 31 December 2010. Additionally, the data is noticeably recent (until the end of 2010) and the period of the study is extensivethat coversfrom 2000 to 2010 (11 years).

Even though the market of Islamic MFs is still in an infancy growth, it displays its strength and durability in term of efficiency. This probably arises from the *shariah* principles that Islamic MFs are adhered to. The principles prohibit MFs to invest in any set of investment that are vulnerable to non-*shariah* elements such as *riba* (interest), *maysir* (gambling) and *gharar* (extreme and uncontrollable risk). In addition, other factor that contributes to the higher efficiency of Islamic MFs is the proportion of underperformance(negative returns) in Conventional MFs is higher than Islamic MFs. This can be seen from Figure 1 and Figure 2. In Figure 1, there is more Conventional MFs fall in the region of negative return than positive return. In contrast, in Figure 2, more Islamic MFs are in the region of positive return than negative return. Therefore, the proportion of positive performance MFs can, possibly, affect the efficiency. There are reasons contributing to the difference of the proportions for Conventional and Islamic MFs. One of them is due to the so-called MF “performance jinx” (Dow, 2007). It is believed that after a period of positive (above-average) performance, a MF will probably return to normalcy (mean reversion). After an influx of more money, the MF’s performance might be even less encouraging than normal. Therefore, the formerly

successful MFs have a higher likelihood to underperform. The reason of the underperformance is the exacerbation of "market impact costs[5]" that are associated with the increasing (and larger) amount of money under management of MFs. This is actually the scenario that has been happening to Conventional MFs in Malaysia as they have a lengthier period since establishment in comparison to Islamic MFs. Given the current phase of MFs in Malaysia, Islamic MFs has a competitive advantage over Conventional MFs in term of the superiority in the efficiency.

Supposedly, the regression lines that are established represent Capital Market Line (CML). However, in reality, the value of the intersection of y-axis should be the same as it represents the risk-free rate prevailing in the market and, theoretically, there is only one risk-free rate in the market. The fact that the regression analysis provides two different values of the intersection of y-axis indicates that the market of MFs in Malaysia is vulnerable to any arbitrage practices in the market and violates the notion of Efficient Market Hypothesis (EMH)[6]. Nevertheless, this study does not signify the relationship (correlation) of the efficiency and performance, although it is found that the proportion of positive performance MFs might affect the efficiency, and, we should be careful with the value of R^2 since Conventional MFs' R-squared is significantly lower than Islamic MFs. This significant difference could elevate a potential disadvantage on the observation and could lead to a misleading conclusion. The result could be different if the study divides MFs based on different periods namely the period of bearish, bullish and crisis. This, again, could be a subject for future study.

[5]It is concession in price that is subjected to all institutional investors upon buying and selling securities by virtue of the large sizes of the position traded. Also, the magnitudes of the concession vary with the liquidity of the securities traded that is related to the market capitalization.

[6] Formulated Eugene Fama in 1970, it suggests at any given time, prices fully reflect all available information in the market. Therefore, according to EMH, no investor has an advantage in making prediction since no one has access to the information that is not already available to others. Therefore, there is no arbitrage opportunity in the market agreeing with EMH.

4.2 Efficiency of Islamic and Conventional Mutual Funds Based on Asset Portfolio

Now, the study widens the scope of the comparison analysis by dividing MFs into four different groups (asset portfolios) that are Equity, Debt, Money Market and Asset Allocation. The efficiency for both Islamic and Conventional MFs in term of asset portfolios namely is summarized in Table 2 below.

Table 2: Summary of Efficiency for Islamic and Conventional MFs based on Asset Portfolio

Asset Portfolio	**ISLAMIC**			**CONVENTIONAL**		
	Gradient	*Intersection of Y-Axis*	R^2	*Gradient*	*Intersection of Y-Axis*	R^2
Equity	0.0346	-0.071	0.06528	-0.0095	0.0082	0.00988
Debt	0.0536	-0.017	0.10835	0.0573	-0.0132	0.05488
Money Market	-0.0022	0.0026	0.00009	-0.0511	0.0024	0.02647
Asset Allocation	0.0011	0.006	0.000035	-0.047	0.0287	0.0905

Based on Yuzi et al. (2012), Equity and Asset Allocation have the higher performance and consistency relatively to other asset portfolios. However, for both Islamic and Conventional MFs, the asset portfolio that has the highest efficiency (reflecting the gradient) is Debt, followed by Equity, Asset Allocation and Money Market. Again, efficiency is seemingly inconsistent with performance. Furthermore, the results from Table 2 are consistent with the previous analysis in which Islamic MFs have a higher efficiency than Conventional MFs. Based on Table 2, the gradient of all asset portfolios for Islamic MFs are higher than Conventional MFs, excluding Debt. However, the difference of gradient between Islamic and Conventional Debt MFs is negligible (small). Moreover, Conventional Debt MFs have the highest efficiency as at 0.0573 and Conventional Money Market MFs have the lowest efficiency as at -0.0511. Also, The efficiency for Asset Allocation for both Islamic and Conventional MFs is fairly low. This may suggest that (over) diversification of MFs (as in Asset Allocation) does not

necessarily lead to an efficient outcome. The best strategy for the investors looking only for efficiency is to invest in Debt MFs. However, it is vital to note that efficiency does not necessarily come with performance. Higher efficiency implies that it is a higher chance that investors do pick efficient MFs if they choose to invest only in Debt MFs. This finding is important for the investors searching for an efficient MF's class and assist the new investors in MFs. Again, the difference in the intersection of y-axis in all asset portfolios for both Islamic and Conventional MFs confirms the violation of Efficient Market Hypothesis and the existence of arbitrage opportunity.

5. CONCLUSION

This study aims to investigate the efficiency of Islamic and Conventional MFs using all data of returns and standard deviations as at 31 December 2010. The outcomes of the study are substantial as it conveys a different insight on the efficiency of a different class of MFs namely Islamic MFs and Conventional MFs. Also, the study broadens the scope of the analysis by dividing MFs into four different groups (asset portfolios) that are Equity, Debt, Money Market and Asset Allocation. Almost all reviews that have been studied proved that Conventional MFs have a better performance than Islamic MFs and one suggested that Equity and Asset Allocation have higher performance relatively to other asset portfolios. Although, initially, efficiency seems to have a positive relation with performance, the results of the study proved otherwise. However, there is no conclusion can be drawn out about the relationship (in term of correlation) between efficiency and the magnitude of performance. This would be a subject for future research. On the other hand, the proportion of positive performance's MFs can, seemingly, have an effect to the efficiency.

Conclusively, the study reveals that Islamic MFs have a greater superiority in efficiency than Conventional MFs as it is shown by different values of gradient. Furthermore, for asset portfolios, the ascending order of efficiency for both Islamic and Conventional MFs is Money Market, Asset Allocation, Equity and Debt. More efficiency in Islamic MFs means that there is a greater chance that the investors do not pick inefficient MFs if they choose to invest in Islamic MFs as compared to Conventional MFs. The same scenario

applies to Debt MFs. Moreover, different intersection of y-values for both Islamic and Conventional MFs indicate that arbitrage opportunity exists in the Malaysian market of MFs and this violates the Efficient Market Hypothesis. Lastly, this analysis should be extended to different periods (bearish, bullish, crisis) to comprehensively study and analyse the efficiency of MFs.

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SURVEYING PERFORMANCE EFFECTS OF ELEMENTS INTELLECTUAL CAPITAL ON BANKING INDUSTRY PERFORMANCE

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Abstract

Organizational performance management is changed to one of the important and attractive subject in recent two decades. Most of the scientists and specialists of management field believe that workers are main base of improving performance and beneficiary and should include human power as main base of improving performance, beneficiary and fund. Human power with high quality is important competitive advantage and scarcer source in Today's knowledge-based economy. This research is surveying the relationship of intellectual fund and performance of the banking industry. The results are showing that intellectual, human, customer and Structural power have meaningful relationship in separated surveying from each other. Whereas have only Structural fund and human relationship with meaningful performance.

Keywords: intellectual capital, human, customer and Structural powers

1. Introduction:

Intellectual power is made by scientific field that is proposed in 1991 for the first time and is included two parts of economic values of company's intangible assets as organizational(structural) and human power. Intellectual power includes total fund or company's asset that are based on scientific that company is accounted as possession. So, intellectual find can include scientific that is converted to intellectual possession or intellectual power of company and also be final result of transmission process (Ali .M, and Ali A, 2008).

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Economy based on industry in Twentieth Century. Each company or country that has more Physical, financial and tangible assets was producing more Wealth in this century. But economy bases on scientific in century 21.for example (Seetharaman,et al,2002) are Expressing quote on one of American economists that the ratio of intangible to tangible possessions is 30 to 70 in 1925.but the ratio changed to 63 to 70 in 1990. Stewart T. A (1997) was considering as the most important of organization possession. So we are expecting that companies that have more human and intellectual power, have higher financial performance. Intellectual finds are more than physical and tangible possession. Nowadays, intellectual power stock can have important role in making added Value and GDP as producing scientific and information and also as the result of making Wealth. Because of this, companies' financial performance can be affected intellectual possession and human fund in the Level of economic institutions.

2. Reviewing on theoretical Basics and background research

General scientific is based on this basis during the past two centuries that only two factors of work and fund power play a role in producing. Whereas asset scientific and information are known as producer of wealth and economic value. In addition, improving new technologies have transmitted wide part of physical activity in making value to Dimensions of knowledge-based in century 20.technolog,information and scientific are new key factors in Production success and service delivery(Srivihok A, 2008). Today, intellectual fund like Knowledge, experience, personal skills, ability and good relations are important source of competitive advantage and key factor of Company profitability. Two important factors that caused improving performance quality in Past two decades are globalization and increasing technology changes. Intellectual fund and intangible asset are important factors of success in this field.

Traditional thinking of economy that based on measuring of sources and financial tangible asset is giving its priority to value-maker of intangible asset. In the middle of century 20, financial economists tried to attract company to new working approach. This

approach based on this thinking that each organization has ability, scores an do the unique non-financial sources from other organization that is Source creation of value and wealth. So, all of sources and organizational capacity and external balance sheet assets have to identify and measure. Intellectual fund are all of asset that weren't in company's Balance sheet and are including intangible asset like Trademarks, patents and the benefits and superiority of human, structural and environmental communication that aren't reflect as accounting methods in financial statement. Rising intangible asset of companies is supporting completion power and Sustainable Development (Seetharaman A et al,2002). Bontis (1998) divided Components of intellectual fund to three human fund groups as human, structural and social.

Intellectual fund is combination of intangible asset; human asset and substructure that make company enable to do its task in Brocking's opinion (Brooking A, 1997). They believe human fund of organization includes skillfulness, Expertise; problem-solving abilities and leadership styles. Intellectual fund includes scientific, intellectual and experience asset that can affect in making wealth in Stewart's opinion. Structural fund, information technology is registering and beneficiary right from business brands in his opinion. Workers make intellectual fund by Competencies, attitudes, intellectual skills and experience in Ross and his Colleague (Roos J. et al 1997). Investment structure for all non-human resources and existence scientific of organization include Databases and data sources, organizational charts, organization and procedures, guidelines and regulations, the content and processes, organizational strategies and operational plans.

Chen J et al (2004) believe structural fund of supporting part is for improving organizational performance. Therefore, structural fund is function of human fund that are in interaction with them and relation fund (relationship with customers) is marketing, increasing market Contribution and Customer loyalty in their opinion. Relation fund(social) is all of relations that company has with customers, competitors, suppliers of materials and goods, trade associations or government (Bontis. N,1998).human fund is more important between Components of intellectual fund (Bontis et al 2000).Because human fund is innovation source and restructuring of Strategic firms that is gaining be

improving human skills. Human fund is collection of science, ability and worker's experience of company in Smith's opinion (1998). But, structural fund is abilities and existence science of company that is controlled by company and remained in company after exiting workers.

Intellectual fund is called Non-tradable in Accounting of Intangible asset (Smith .P.A.1998). Kaplan and Norton (1996) set intangible asset consist of human fund, information fund and organizational fund. Intangible asset cannot be tradable in market. Monitoring and controlling the existence of asset are not accessible. These assets do not have limited age and their Depreciation do not calculated.

Two views exist about management of intellectual fund in financial literature: In first view, organizational substructure, learning, communication and worker's abilities amplifying to improve organizational science of company performance. This view is famous as scientific method. Supporter of this method as Linkpen (1998) and Zak(1999) believe if any company have better intellectual fund in working field, have competitive advantage. In second view intellectual fund is setting type of measured economic asset. This view emphasizes on giving profit by intellectual fund and is famous as economic fund method.

A lot of events are showing there is a positive relation between intellectual fund and companies' performance. Bontis ,N.(1998) and Bontis N.et al.(2000) in Malaysia showed that there is positive corporation between intellectual, structural and customer fund. Human fund effects on company's performance except business type. Structural fund has positive relation with financial performance. Importance of intellectual fund doesn't depend on market's value and companies' share cost as tangible asset. But also depends on intangible asset as intellectual fund. For example Lev B (2001) showed 80% of market's value that effect on market's value in intangible asset. Kujansivu P and Lönnqvist A (2006) surveyed intellectual fund for 11 biggest businesses in Finland. Results showed that عام المنفعه companies used their intellectual fund. Chen Goh P. (2005) measured intellectual fund in Malaysia's banks. This research showed that as Hong Kong

banks have less physical fund ratio to the bank, but because it has the most factor fund, identified as inner bank with high performance. Appuhami R.(2007)surveyed the effects of added value factor on share cost of Thailand EXCHANGE. There is meaningful relation between companies' intellectual fund with increasing share cost. Chin Chen .M et al (2005) surveyed relation of intellectual fund and share market value and financial performance of Thailand's exchange companies.

They used added value model for Palic intellectual funs (Pulic Aet al.2000) as measuring scale of intellectual fund and showed with executing Regressive model. Higher intellectual fund of companies cause to improve financial performance and increasing market's value of companies share.

Pew Tan et al.(2007) surveyed the relation of intellectual fund and financial performance of Singapore exchange in three bases of financial index (profit of each share, Revenue rate of share right and anniversary revenue rate).Results showed that there is a positive relation between intellectual fund and financial performance index and there is meaningful difference between intellectual fund factors in different business. Roos J. et al (1997) show that the performance factor of added value in intellectual fund effect on profits of banking 61.3% in Istanbul exchange.
Kamath G., Bharathi R. (2008) showed that human fund effect on profitability, beneficiary and pharmacy companies' value in India. Chen Jet al .(2004) showed that there is a relation between intellectual fund objects and these objects effect on performance of companies' working. Bontis N, et .al (2000) proved with the multi-changing regression that there is a relation between intellectual fund and market's value of electronic company in America. Methods and different models of measuring intellectual find surveyed by Anvari et .al(2005).

Another research that was performed by Anvari and Rostami showed that intellectual fund has high correlation with portfolio market value. Hamid R. Y(2005) surveyed the relation between intellectual fund and performance of Mellat Bank in Tehran. His results showed that intellectual fund doesn't have any effect on branches performance of Mellat

Bank. Qhelich B.et al (2007) showed that human and structural fund have positive effect on improving competitive advantage of two cars company in Iranian market.

But it wasn't seen as this effect in relation fund. The research's results showed that intellectual fund objects of these two companies include: human fund, structural fund and relation fund. Mdhvshy M et al (2009) showed that there is positive and meaningful relation between intellectual fund, financial revenue, intellectual fund and next financial revenue of enterprise companies in Tehran exchange. lot of articles are found in researching literature about implicit, nature, consisting objects ,measuring methods and reporting of intellectual fund and its relation with performance. Huang C, Wang M.C (2008) surveyed effects of economic added value method and intellectual method on companies' market value

Ax .C and Marlon .J (2008) surveyed relation of anniversary reporting in intellectual fund and management methods of intellectual fund.. Khavandkar et .al(2008) studied relation of intellectual fund and performance of scientific companies with average size. Also, tentative data showed that specified floors of intellectual fund has positive effect on performance of company. Bontis N, et .al (2000) surveyed the relation of intellectual fund and companies performance of Taiwan engineering. Results showed that there is positive correlation between three objects of intellectual fund and financial performance. Highest correlation was for human fund and then related to customer fund (Chen Goh P.(2005). Bose S, Thomas K (2007) surveyed the relation of performance and intellectual fund by using balanced evaluation card and they result that best method of evaluation is balanced evaluation card.

Tovestiga and Tulugurova (2007) surveyed the relation of intellectual fund and performance in Russia. Research's finings shows that intellectual fund especially structural and human fund determined as first scale (Kamath and Bharathi 2008). Researches were performed about intellectual fund in Iran. For example Anvari A.et al (2005) surveyed the relation between intellectual fund and portfolio market value of exchange companies in Tehran by using 5 different and simple ways [1]. Qlych B. Lee

(2005) determined the role of social and mental fund in defining competitive advantage in Iran Khodro and Pars Khodro companies and then take this result that there is a meaningful and positive relation between social and mental fund .in other words, intellectual fund is increasing by social fund .also the effect of social fund by using intellectual fund is more than effect of social fund ratio to competitive advantage.

Research hypothesizes

Research hypothesizes is designed as following with attention to literature:

Main hypothesizes

There is meaningful relation between intellectual fund and performance of banking business. As, intellectual fund is dividing to three parts of human fund, customer fund and structural fund. Main hypothesis is divided to three secondary hypothesis:

1) There is meaningful relation between human fund and performance of banking business.

2) There is meaningful relation between customer fund and performance of banking business.

3) There is meaningful relation between structural fund and performance of banking business.

3. Researching method

This research is practical as descriptive type and its goal. Measuring tools of questionnaire is designed in Lickert scale. In this research Croonbakh alpha is used for perpetuity (questionnaire perpetuity by using Croonbakh alpha 83.6 %).They use statistics methods like regression to examine hypothesizes. Simple line regression model is designed as following:

$$Yi = \beta 0 + \beta 1\ Xi + \varepsilon\ i \quad i=1, 2, 3,\ldots, n$$

Dependent variant (performance): Yi

Independent variant (human, customer and structural fund):Xi

Independent variant factor:β1, β 0

Accident error: εi

(x,y) observation peer :n

$$Yi = \beta 0 + \beta 1\ Xi1 + \beta 2\ Xi2 + \ldots + \beta\ p\text{-}1\ X\ i,p\text{-}1 + \varepsilon\ i$$

Dependent variant: performance Yi

X i,p- و1 ... ،Xi1: Dependent variant(human, customer and structural fund)

E: accident error.

Dependent variant of this research is performance and independent variant are human, customer and structural fund.

So, all of the regression model with dependent and independent variant are set and their model factor are calculated and the model that has highest F factor, selected. In next step, all of possible models are set with two variants and R2 is calculated and the model is selected that has biggest R2.Also, they use Pearson correlation to survey relation between intellectual fund and performance.

Statistics Society and models

Common schema of statistics society for this research are managers that work in bank. Because the personnel should be specialist to answer the questions, center branches manager organize models. Modeling method performed accidently.

4. Research findings

Hypothesizes H1 is designed as following:

H1=There is meaningful relation between human fund and performance.

H1=There is meaningful relation between human fund and performance.

H1=There is meaningful relation between structural fund and performance.

H1=There is meaningful relation between intellectual fund and performance.

Results of hypothesizes examination is as following by using simple regression method.

Correlation Pearson	Level of sig	T	Beta1	Standard error	Beta0	Accounting Variables
	0.123	1.932		0/693	1.186	Fixed amount
0/459	0/003	5/287	0/461	0/164	1.136	human fund
	0/167	1/180		0/593	0/854	Fixed amount
0/573	0/005	6/784	0/560	0/098	1.154	customer fund
	0/247	0/673		0/467	0/348	Fixed amount
0/596	0/008	8/835	0/504	0/112	1.540	structural fund
	0/379	-0/492		0/635	-0/328	Fixed amount
	0/000	8/466	0/583	0/149	1.752	intellectual fund

The level of significance for the intercept (0/000) of less than 0.05and the slope of line (0.130, 0.212 ،0.381)is more than 0.05. So zero for the width of the origin of the failed bonds slope of the line has been refused. According to the figures contained in the image (1) the following regression equation was written: Simultaneous effect of independent variant (human, customer and structural fund) is surveyed about independent variant.

Hypothesis H0 and H1 is designed as following:

H0: $\beta 1 = \beta 2 = \beta 3 = 0$

H1=At least one of them is opposite of zero :

H0=none of three variants effect on performance

H1=At least one of three variants effect on performance

Level of sig	T	Beta1	Standard error	Beta0	Accounting Variables
0.481	-0.427		0.643	-0.349	Fixed amount
0.033	1.687	0.198	0.176	0.345	Human capital
0.503	0.461	0.048	0.198	0.116	Customer capital
0.000	3.541	0.486	0.989	1.038	Structural capital

Calculation results of multi-regression are seeing to survey the simultaneous effect of image. Because meaningful level for human fund(0.033),for structural fund(0.000) less than 0.05 and for customer fund(0.503) more than 0.05,the supposition of zero is confirming for customer fund except human and structural fund. In other words, there is meaningful relation between human fund and performance and structural fund and performance. Whereas there is not meaningful relation between customer fund and

performance. It is sounded that the reason of ignoring this hypothesis is gathering managers' attitudes. But if it surveyed from customer's view, maybe the hypothesis confirm. With attention to image 2, the regression equation set as following:

Structural fund 1.038 + human fund 0.033 = performance.

They use to examine independent variants simultaneously on base of bank type and omitting inner correlation of variants.

Level of sig	T	BETA 1	Standard Error	BETA 0	Variables	Type of company
0/000	2/265		0/654	2/087	Fixed amount	Private step1
0/019	4/652	0/438	0/098	1/002	Structural capital	
0/260	0/720	0/072	1/008	0/659	Fixed amount	Private step2
0/009	1/389	0/250	0/182	0/481	Structural capital	
0/10		0/281	0/180	0/582	Human capital	
0/206	-0/095		0/653	-/804	Fixed amount	Government
0/000	7/672	0/689	0/107	1/208	Structural capital	

According to the information contained in the image (3) and significant levels of each of the variables, equations the final form of the following were written:

Private company performance =0.481 structural capital

Government company performance=1.208 structural capital

Notably, 90% confidence level of human capital in relation to performance.

5. Conclusion

Intellectual fund is made by science field. Human factor has main role in process of management science and scientific field and is the most important organization's advantage and rarest source in scientific economy. Goal of this research is surveying the relation of intellectual fund and performance of banking business from managers'

attitude. So, we can announce on the base of statistics examinations results that when human fund variant, customer fund and structural fund are surveying, they have positive relation with performance of company. But only human and structural fund are effective on performance in surveying the effects of three variants on performance.

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CRAFTING STRATEGYTOWARDS THE SHARIAH COMPLIANT STANDARD: A CONCEPTUAL FRAMEWORK

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Abstract

A standard is an agreed, repeatable way of doing things. Islam provides guidelines for a noble standard to be applied in a daily life notwithstanding guidance for business organizations. Malaysian Standard (MS) 1900:2005 is established as a standard which specifies the requirements for a shariah compliant Quality Management System. The aim of the standard is to ensure that organizations are managed in accordance with universally accepted values such as justice, honesty, truthfulness, sincerity, timeliness and discipline, and that the halal and non-halal aspects of all processes necessary for the delivery of services and products are identified and communicated within the organization and effectively implemented. In 2008 only five companies obtained this accreditation and another 10 received it in 2011. Currently, there are 18 organizations have received the MS1900:2005 from SIRIM Berhad. The increasing numbers show the significance and vigilance of utilizing Islamic principles in the business organizations. A study will be sought to understand of why and how business organizations crafting strategy towards achieving the MS1900:2005 and business growth. For the purpose of this paper, a conceptual framework for this study will be presented.

Keywords: quality management system, shariah compliant standard, strategy, case study, business growth

1.0 Background of the Research

One of the important factors in business to sustain in the market is to maintain and manage the quality of the product/service provided. In order to do this, business operators will be sought for an accreditation from the standard bodies (for example in Malaysia, the body who governs the accreditation of standards is SIRIM Berhad). This is to ensure that their business operation is managed appropriately with an international standard quality. Many scholars have investigated topics on quality management activities such as Total Quality Management (TQM), Quality Control and Quality Assurance (for example, see Easton & Jarrell, 1998; Kannan& Tan, 2005;

Powell, 1995; Robin & Kehoe, 1994; Samson &Terziovski, 1999). Nevertheless, there is no such study which covers this topic from the Islamic perspective. This paper will therefore discuss on the MS1900:2005, a Quality Management System which is established in Malaysia to specify the requirements for a shariah compliant. On the other hand, the number of current recipients of MS1900:2005 is still small. Thus, this study will be sought to understand of why and how business organizations crafting strategy towards achieving the MS1900:2005 and business growth. Accordingly, this paper presents a conceptual framework for the study to be carried out.

1.1 Quality Management System

The development of quality management system has internationally established for business improvement since 1980's although the origins can be traced back to 1949, when the Japanese formed a committee to improve their productivity and quality of life (Powell, 1995). Organizations have sought TQM to refine their business performance (Robin & Kehoe, 1994; Kannan & Tan, 2005). As noted by Robin and Kehoe (1994), the quality improvement activities, particularly TQM have beneficial effects on business performance. This is supported by an empirical investigation of TQM effects on corporate performance by Easton and Jarrell (1998). The findings indicated that performance, measured by both accounting variables and stock returns, was improved for the firms who adopted TQM. In addition, a study was conducted in five Danish libraries and it was found that an integrated measurement and management system have improved the customers' satisfaction and loyalty (Martensen & Gronholdt, 2003). TQM has also been practiced in SMEs (Ghobadian & Gallear, 1996) and reviewed as a competitive advantage of a company (Powell, 1995).

1.2 MS1900:2005

Quality management system has been established in Malaysia as one of the Government's agenda to provide a respectable public service. Along the way, many programs have been introduced such as Total Quality Management (TQM), Quality Control Circle (QCC), Quality Assurance Unit, Strategic Management and Customer Charter. Since 1996, ISO 9000 has established in public service in Malaysia (Siddiquee, 2006).

Malaysia also practices ISO 9001 which covers the public and private service introduced by the International Organization Standardization (ISO Geneva). As a Muslim-majority country, Malaysia is heading further by introducing and implementing the MS1900:2005, a Quality Management System from shariah perspective (Che Pa et al., 2010). This standard was developed based on ISO 9001, an international practice standard. This standard requires organization to have a comprehensive quality management system in order to accommodate the customer needs, to fulfill the requirement of a quality product/service, to enhance the effectiveness and productivity as well as to reduce the operational costs. These requirements are value added from the ISO 9001 and are aligned to the shariah perspectives.The objectives of MS1900:2005 are (Departments of Standard Malaysia, 2005):-

i- To implant the shariah in quality management system with emphasis on management through value.

ii- To improve the effectiveness and efficiency through noble universal values in all levels of organization.

iii- To upsurge the practice of shariah compliance and increase the confidence level among the Muslims and stakeholders.

The value of MS 1900:2005 is universal and although its compliance is from the Islamic perspective its universal value can be accepted by all including the non-Muslims like improving work quality and performance, proper and timely delivery. All of these are not in conflict with universal values and general features of the other religions (Bernama, 2008).

The introduction of this shariah standard has opened the eyes of business operators of getting theaccreditation. In 2008, there were only five companies who received MS1900:2005. They are Natural Wellness SdnBhd, Century Total Logistic SdnBhd, Takaful Ikhlas, PNB Darby Park and Pusat Zakat Melaka (Bernama, 2008). In 2011, another 10 organisations received this standard. They are Syarikat PNB Ilham Resort, UniversitiSains Islam Malaysia (Jabatan Pembangunan danPengurusanFasiliti), UniversitiTenagaNasionalSdnBhd (UNITEN), Penang Port SdnBhd ,JabatanKehakimanSyariah Perak, KolejKomunitiGerik, SindoraBerhad, TabungBaitulmal Sarawak, JabatanWakaf, Zakat dan Haji and KFC Manufacturing

SdnBhd (Group Logistic Division). Currently, there are 18 organizations in Malaysia who have received the MS1900:2005 from SIRIM Berhad (Utusan Malaysia, 2012).

1.3 Research Question

As mentioned above, one of the objectives of MS1900:2005 is to upsurge the practice of shariah compliance andincrease the confidence level among the Muslims and stakeholders. Currently, the number of organizations who have received this standard is still small and the reasons are still doubtful despite the large number of business establishments in Malaysia. Therefore, the research question for this study is:-

> ***Why and how business organizations crafting strategy towards achieving the MS1900:2005 and business growth?***

A conceptual framework for the study is proposed below (see Diagram 1).

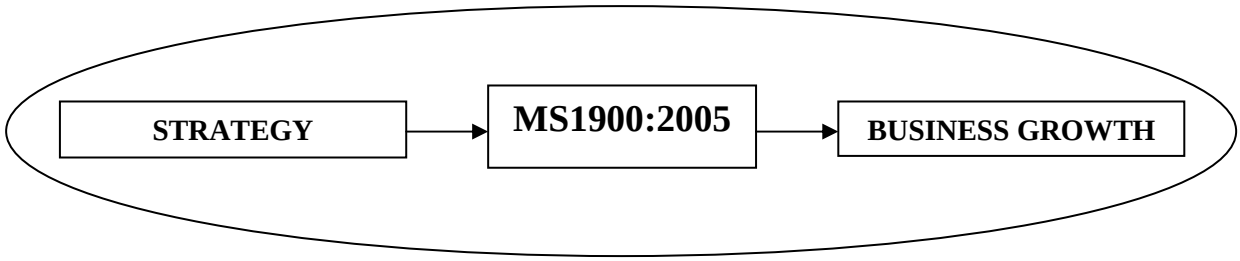


Diagram 1: Conceptual framework for this study

2.0 METHODOLOGY

As suggested by Yin (2009), this study will be utilizing upon a case study method in order to study in-depth about the research question. Primary data will be sought through semi-structured interviews with the officer from the standard body of SIRIM Berhad, the current recipient of the standard and also with a company who is in the process of gaining the MS1900:2005. Besides that, secondary data such as company documents, newspapers and articles will be sought to support the input from the interviewees. For data analysis, the research will be using the five-phased cycle, namely: (1) compiling, (2) disassembling, (3) reassembling (and arraying), (4)

interpreting, and (5) concluding (Yin, 2011).Case study will provide lessons which learnt from the interviewee's unique experiences (Yin, 2009).

3.0 CONTRIBUTION TO KNOWLEDGE

First, this study will contribute to the knowledge through understanding of why and how business organizations crafting strategy towards achieving the MS1900:2005. As clearly stated at the research background, the quality management system from an Islamic perspective is a new field to be explored. Since the establishment of MS1900:2005, there is only 11 organizations who have received this standard. There might be reasons of why this standard is not popular among the Muslim companies in Malaysia albeit the objectives of the standard will create another competitive advantage for them.

Second, this study will understand of how business organizations crafting strategy towards achieving business growth. Strategies that have been deployed might be useful tactics to nascent business organizations to achieve business growth through implementing MS1900:2005. Therefore, it is hoped that the findings will assist many other business organization towards achieving the MS1900:2005 as well as stimulating their business growth.

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CORPORATE ENTREPRENEURSHIP AS DETERMINANT OF LARGE FIRM PERFORMANCE: EVIDENCE FROM MALAYSIA

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Abstract

This study aims to investigate the influences of corporate entrepreneurship activities and behaviour on large firm performance. Corporate entrepreneurship is a term used to describe entrepreneurial activities and behaviour inside established and large firms for gaining corporate entrepreneurship advantages namely new venture creation, innovation and renewal efforts. Behavioural model approach, incorporating both tangible and intangible resources that can be deployed to achieve corporate entrepreneurship advantages is utilised. Entrepreneurial orientation dimension includes innovativeness, proactiveness, risk taking and corporate venturing dimension are chosen as a construct for corporate entrepreneurship while firm performance conceptualised as sales growth and return on investment (ROI) are used as proxy of financial performance. The environmental uncertainty factors are tested for moderating effects between the relationship of corporate entrepreneurship and firm performance. Public listed companies registered in main market, Bursa Malaysia are identified as the sample of the study (N= 74), with 24.7% response rates. Employing multivariate and hierarchal regression analysis the results showed that, there is significant relationship between corporate entrepreneurship and firm performance for both sales growth and ROI models, except proactiveness is found to be positive but weak relationship to ROI. All variables tested are positively related to the firm performance, except risk taking is negatively related to performance. Interestingly, the environmental uncertainty factor significantly moderates the relationship between corporate entrepreneurship and firm performance. The findings shed light on the extend to which Malaysian big firms have to behave entrepreneurially in creating new values by means of innovation, proactiveness and venturing for performance. In this way, it elucidates the significance of corporate entrepreneurship practices and how it can be stimulated in policy development for big firms in Malaysia.

Keywords: Corporate entrepreneurship, environmental uncertainty, firm performance.

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1.0 INTRODUCTION

The large firm in Malaysia is defined as firms with have full-time employees more than 150 or with annual sales turnover exceeding RM25 million for the manufacturing, manufacturing-related services and agro-based industries (SMIDEC, 2005). Other industries such as services, primary agriculture and Information and Communication Technology (ICT) must have more than 50 employees or with annual sales exceeding RM5 million. These large firms can be considered as an engine for the nation economic growth due to its vast contribution in economic growth namely, national earning export, employment opportunity, contribution to gross domestic product (GDP) and government tax revenue among others. For example, in 2006, the large firms contributed 68% of gross domestic product and 81% of total exports (Secretariat to National SME Development Council, 2007). Until year 2011, tax revenue was still the major source for federal government revenue, whereby the companies were the main contributor to the direct taxes income which is 46.5%. Compare to small firms, the larger firm pays huge amount of taxes. Looking into these contributions, it is relevant to identify success factors of large firms especially the public listed companies (PLCs).

However, the performance of the PLCs has been a major concern due to changing environment and fierce competitions locally and globally. The survival rates of the public listed firms are declining (Fama and French, 2004). Besides, they are suffering from low level of profitability and often with negative profitability when they go public (Demer and Joos, 2007). They also failed to present a quality, balanced and meaningful strategy (Raja Suzana and Rahim, 2008) for survival and growth. According to Bursa Malaysia, as on August 2010, the amount of PLCs categorized under P17 classification has increased to 34 companies. The Bursa Malaysia termed P17 as those companies facing financial distress whereby the loan amount is higher than the value of their assets. They could be exposed to bankruptcy. Failure of PLCs might be a threat to public business confidence as they hold public investment in their organisations.

Drucker (1999) the management guru, claimed that large organization will not survive without acquiring corporate entrepreneurship in their organisations. One of the main

factors why big firms must behave entrepreneurially to survive is due to fast changing business environments. This has been confirmed by previous studies that corporate entrepreneurship is a key ingredient to firm's growth and profitability (References at least two or more). Despite being cited as a source of high firm performance, there are minimal empirical studies on the effect of corporate entrepreneurship on firm performance within large firm settings (Moreno and Cassilass, 2008).

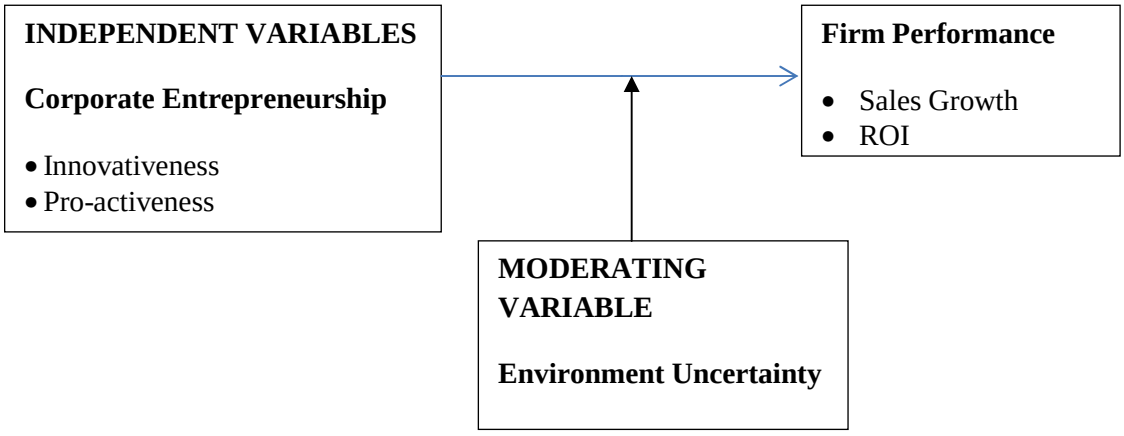
The large firm fundamentally faced different challenges as compared to small and medium enterprises. Small firms are known as the 'gazelles' the fast-growth young entrepreneurial companies that are flexible and robust in their strategies to exploit opportunities for profits (Barringer and Ireland, 2008). On the other hand, large firm have difficulty to act entrepreneurially because of its size, bureaucracy, complex processes and hierarchy. Large firm usually have tight procedures and formal management controls of its operations (Burns and Stalker, 1961). Their ability to immediate response with the changing business environments is slow and sluggish as compared to small firms. In order to achieve superior performance and stay competitive, the large firm must opt for corporate entrepreneurship (Kuratko, 2007) to avoid stagnant growth and extinction. Does corporate entrepreneurship influences large firm performance? What are the factors of corporate entrepreneurship that would explain performance? These are the main questions this study aims to investigate.

2.0 LITERATURE REVIEW, THEORETICAL FRAMEWORK AND HYPOTHESIS

The aim of this research is to investigate the influences of corporate entrepreneurship on large firm performance. The environmental uncertainty factor is tested for its moderating effects to the relationship between corporate entrepreneurship and firm performance. Figure 1: The Theoretical Framework; illustrates the constructs that will be used throughout the study. The construct for corporate entrepreneurship developed by Covin and Slevin (1989) is picked as independent variables namely innovativeness, proactiveness and risk taking. While corporate venturing includes

activities of creating, adding to, or investing in new business either internally or externally developed by Morris et al. (2008) is also chosen in the construct. These four dimensions are reflective to corporate entrepreneurship measures and would capture the entrepreneurial activities of the large firms. For moderating factor, the hostility and dynamism of the environment are used as a proxy to environment uncertainty. It is recommended by the scholars that, both financial and growth measures have to be used as performance indicators in entrepreneurship research (Wiklund, 1999). This study used actual sales growth and return on investment (ROI) as measures for firm performance.

Figure 1 – Theoretical Framework



Hypothesis Development

Corporate entrepreneurship and Firm Performance

According to the resource-based theory of the firm, in achieving superior performance and stay competitive in the industry, the firm needs to acquire a set of resources that are valuable, difficult to imitate and rare to be found (Barney, 1991). These resources are inclusive both tangible and intangible in nature. However, corporate entrepreneurship is recognized as one of the intangible resources of the firm (Shepherd and Wiklund, 2005). Theoretically, the four dimensions of corporate entrepreneurship, namely, innovativeness, proactiveness, risk taking, and corporate venturing would lead to high growth and profitability of the firm. This will ultimately outperformed competitors and would be a competitive edge of superior firms.

Innovativeness is the propensity of the firms to support new ideas, novelty, experimentation, and creative process (Lumpkin and Dess, 1996). The innovativeness is not only limited to the introduction of new product or services but it might be the introduction of new method of production, the identification of new sources of supply materials and new organizational structure or administrative system (Damanpour and Wischnevsky, 2006; Schumpeter, 1939). Therefore, innovative firms are continuously introducing newness that is previously unknown to the market or new to the organization. This innovative behaviour ensures the firm to capture the market demands and outperform the competitors.

Proactiveness represents the first mover advantage by anticipating and acting on future wants and needs (Lumpkin and Dess, 1996). Besides, proactive firms benefit from on emerging opportunities by aiming for premium market segments and 'skim' the market in advance of opponents (Zahra and Covin, 1995). With this futuristic point of view, the proactive firms have power over the distribution channels as well as launch brand recognition (Wiklund and Shepherd, 2003).

Risk-taking behaviour related to the firms' ability to commit huge amount of resources to projects, investing in inexperienced technologies or bringing new products to the market with the objective of obtaining high returns whereby the outcome is unknown and the cost of failure maybe high (Miller and Friesen,1978; Wiklund and Shepherd, 2003). This risk-taking behaviour shows that the entrepreneurial firms put more effort and willing to do courageous action to seize opportunities. Risky strategies will leads to performance variation and perhaps more profitable in the long term (McGrath, 2001).

Corporate venturing is referring to the entrepreneurial efforts of the established firm to invest and/or adding new businesses (Sharma and Chrisman, 1999; Morris et al., 2008). The corporate venturing can be implemented through the launching of branches, sponsored new venture or corporate venture capital, alliances, joint venture and acquisition. Superior corporate performance can be achieved through corporate venturing because it is the most productive tools when practiced in strategic manner (Covin and Miles, 2007). Generally, the firms frequently use corporate venturing to gain access to ideas, discoveries, technologies, innovations, business practices, and

enhance business growth and profitability (Narayanan, Yang and Zahra, 2009). The previous research shows that, corporate venturing activities generate economic benefits for the parent's corporation and improves its financial performance (Antoncic and Hisrich, 2001). Corporate venturing is also often used as a strategy for declining businesses in transforming their corporation into new core businesses with better opportunities for growth and survival (Donahoe, Schefter and Harding, 2001). In this situation, Nokia is the best example whereby they transformed their core business from manufacturing to telecommunications. Together, all these four dimensions of corporate entrepreneurship would contribute a great deal to the firm performance. Thus, the study hypothesizes that;

H1: There is a significant relationship between corporate entrepreneurship and firm performance.

The Moderating Effect of Environmental Uncertainty on Corporate Entrepreneurship and Firm Performance Relationship

Previous researchers conclude that, the superior firm performance can be achieved when the key variables are correctly aligned and fit (Naman and Slevin, 1993). As mentioned in contingency theory, the optimal performance can be obtained when the key variables such as environmental, industry conditions, organizational structure, and strategy (Lawrence and Lorsch, 1967; Child, Chung, et al., 2003) are aligned. Based on this argument, this study included the environment factors as a moderating variable to be clearer about the underlying factors of firm performance. It is found that the environmental factors can have a strong effect on corporate entrepreneurship and firm performance relationship (Zahra and Covin, 1995). It is widely used as the bases to align business strategy in coping with the current business conditions. Thus, it is vital to investigate the role of environmental factors on corporate entrepreneurship and firm performance relationship. The environmental dimensions that often used as moderators of corporate entrepreneurship and firm performance are dynamism and hostility (Lumpkin and Dess, 2001; Moreno and Cassilass, 2008).

The hostility is the degree of threat to the firm characterize by unsafe industry setting, intense competition, and lack of business opportunities (Covin and Slevin, 1989). On

the other hand the dynamism characterized by the rate of change and innovation in the industry and also the unpredictable actions by competitors and customers (Burns and Stalker, 1961; Miller, 1983). During dynamic environment the customers demand and action from competitors are unpredictable as well as creating high rates of change in market trends and industry innovation (Miller, 1983).

The research on the effect of the dynamic environment on innovative practices within an organization has been quite dramatic. Most of the findings show that in dynamic environments, the firms are more likely to participate in new product innovation activities than firms operating in stable environments (Miller, 1983; Miller, 1988; Zahra, 1993). The consequences of the firm's failure to respond to dynamic environment are a loss in market share and sales, therefore, to be competed out of the business (Miller, 1988). By pursuing new radical technologies and pioneering activities as a way to respond to dynamic environment setting, the firm will have an advantage over its competitors (Zahra and Bogner, 2000; Zahra, 1996).

The proactive behavior is also crucial in dynamic environment as the ability of the firm to capitalize on market opportunities ahead of its competitors and to capture the fast changing customer's demands is heavily depending on firm's proactiveness behavior. Lumpkin and Dess (2001) argue the importance of a proactive behavior presence in dynamic environments. They found that, as environmental conditions are consistently and rapidly changing and fewer opportunities in the market, the proactiveness behavior would enable the firm to better capitalize on the opportunities. Therefore, by being proactive in dynamic environment, the sales growth and profitability of the firm will be higher (Lumpkin and Dess, 2001). The proactive firm will have competitive advantage and the ability to adapt faster with the dynamic environment.

The empirical support of the risk-taking behavior in dynamic environment, show that a greater level of risk-taking in decision making. Rapid changing environment require an organization to make decision and faster action to be more effective and succeed. (Khandwalla, 1977). Therefore, the firm should avoid passive behavior and increase decision-making speed in responding to environmental change. If the firm unable to

adopt risky behavior in dynamic environments, they will lose the market share, and falling behind competitors (Covin and Slevin, 1991;Miller, 1983).

The dynamic environments trigger the effort of the firm to venture into new business to respond with the challenges and change in the business environment. In dynamic environment setting the condition of an industry is instable and continuously changes. The social, political, technological, and economic changes bring new ideas for the firms to venture into new markets and broadening the firm's niche (Zahra, 1991). The change in the environment creates more opportunities that enable the firm to pursue new innovative ventures to benefit from these environment characteristics. Thus, in order to pursue into venture, the firm will employed newer technologies and innovative marketing practices (Oster, 1990). In addition, the firm diversifying its business to cope with the intensify environment and to avoid failure. Therefore, venturing into new business helps the firm to respond the intense competition and taking the opportunities to growth.

The large and established firm is having difficulties to survive and flourish in hostile environments (Hall, 1980). Thus, the entrepreneurial efforts must be increased during this uncertainty and high rate of change in the markets and this situation needs more innovations (Miller, 1983). The firm's innovativeness is needed in order to create more new products or services to tailor with the dynamic environments where customer preferences, product-service technologies, and competitive postures often change unpredictably (Miller, 1983).

The firm is more proactive during hostile environments because there are limited businesses opportunities during turbulence time. The proactiveness behavior ensure the firm to have strong tendency to be ahead of other rivals in introducing new products or services, administrative techniques, operating methods or new technologies (Miller and Friesen, 1983; Covin and Slevin, 1986, 1989; Covin and Covin, 1990; Lumpkin and Dess; 2001; and Lumpkin and Dess, 1996). Thus, only proactive and innovative firms will survive and prosper in hostile environments. The proactive behavior enables the firms to grasp whatever opportunities available in the market because such behavior takes very competitive actions towards its competitors.

The survival of the firm is decreasing in hostile environment due to the increased in competition, and depressing demands (Miller and Friesen, 1984). Thus, the firms are encouraged to venture into additional business to avoid major lose in firm's primary business. The firm can opt for internal venture or external joint venture (Keats and Hitts, 1988). The example of the firm that having successfully diversified during hostile environment is the H.J. Heinz Company. They are well-known for its ketchup business and baby foods. In hostile environments, where the decreasing of the demand due to the increase of the health awareness and slowing in birth rates, this company acquired other companies such as the pet food companies and other companies that related to health and wellness to strengthen its position in the USA and overseas operation. With these acquisitions, the company continuously captured the customer demands and succeeds in expanding their business and increased the firm profitability (Zahra, 1991). For these phenomena this study proposed a hypothesis that:

H2: Environmental uncertainty moderates the relationship between corporate entrepreneurship and firm performance.

3.0 METHODOLOGY

Sample and Data Collection

The population of this study was the PLCs in Malaysia. As at June 2011, there are 854 firms listed in main market, Bursa Malaysia. According to table of population and sample by Sekaran & Bougie (2010), the appropriate sample size for such population is 234 respondents. Thus, 300 questionnaires were mailed and asked them to respond within 3 weeks. The PLCs were chosen because corporate entrepreneurship is associated with the large and established firm. The questionnaires addressed to top or senior management team of the company with designation of senior manager, chief executive officer, vice president, president and executive director. The top management team were chosen because they are the most knowledgeable individuals in the firm which includes involvement in decision-making, well known about the policy, strategy, and perception of external business conditions (Weaver,Dickson, Gibson and Turner, 2002; Zahra, 1993). Besides, top management level is more likely

to participate in the survey (Zahra, 1993). The data were analysed using SPSS software package to test the relationship between variables.

Measurement

The instrument for independent variables were adapted and modified from previous researches. Entrepreneurial orientation measurement was adapted from Khandwalla (1977), Miller and Friesen (1982), which is commonly used in prior research due to its high reliability and validity. Corporate venturing instrument was adopted from Zahra (1991). The instrument for environment hostility and dynamism was drawn from Miller and Friesen (1982) and further revised by Covin and Slevin (1989), Zahra (1991, 1993). All measurements were asses using 7-point scale, ranging from 1 (strongly disagree) to 7 (strongly agree).

The dependent variable which was the firm performance was used actual data drawn from *datastream* 5.1 and annual reports. Two performance indicators were used to represent growth and profitability of the firm, the sales growth and the return on investment (ROI). The sales growth was measure using relative measures and absolute measure for ROI for five years period (2006-2010). The five years period was the most widely used number of years to measure the performance of the firm (Delmar, 2006).

Results

A total of 74 questionnaires were received, which is 24.7% response rate. Of the 74 respondents, 45 (61.6%) were male and 28 (38.4%) were female. The responses were largely males due to the fact that, majority of the senior management team was predominance by male. Almost half of the respondents were 41 to 50 years old (47.9%). 71 (97.3%) of the firm responded were Malaysian owned company. Additionally, 69 (93.2%) of the businesses has incorporated in Malaysia for more than 10 years and 55 (74%) of the firms were consisted of more than 300 employees. Cronbach's alpha value utilized to measure the questionnaire accuracy. The closer the Alpha value to 1.00 the greater the internal consistency of the items. In general, all the

variables have more than 0.80 Alpha values. Thus, it is considered as a good reliability of data.

Hypothesis Testing and Evaluation of Findings

Generally there are two sets of hypotheses; the first set is to test the direct relationship between corporate entrepreneurship and firm performance. The second set of the hypothesis investigates the impact of the environment uncertainty in the relationship between corporate entrepreneurship and firm performance.

Multiple Regressions Results

In this study, the multiple regression analysis was used to examine the relationship between each the variables of corporate entrepreneurship such as innovativeness, proactiveness, risk taking and corporate venturing with firm performance (sales growth and ROI). The Table 1 and 2 shows the multiple regression result for the Hypothesis 1a and 1b.

Table 1: Multiple Regression analysis of corporate entrepreneurship and firm performance (Sales Growth)

Model 1	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	β	Std. Error	Beta		
(Constant)	2.094	0.565		3.705	0
Innovativeness	0.312	0.139	0.266	2.242	0.028
Proactiveness	0.317	0.130	0.311	2.44	0.017
Risk Taking	-0.340	0.114	-0.291	-2.987	0.004
Corporate Venturing	0.299	0.087	0.357	3.416	0.001
R Square = .518	Adjusted R Square = .490		F = 18.260		Sig (F) = .000a

As illustrated in Table 1, the F value of 18.260 is significant at the 0.01 level. All of the corporate entrepreneurship dimensions utilized in this study have significant relationship with sales growth. However, only 51.8% of the variance in firm performance (sales growth) explained by corporate entrepreneurship. Thus, hypothesis 1a was supported.

Table 2: Multiple Regression analysis of corporate entrepreneurship and firm performance (ROI)

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	β	Std. Error	Beta		
(Constant)	3.168	0.421		7.526	0.000
Innovativeness	0.505	0.104	0.592	4.877	0.000
Proactiveness	0.030	0.097	0.041	0.311	0.757
Risk Taking	-0.205	0.085	-0.241	-2.417	0.018
Corporate Venturing	0.126	0.065	0.207	1.942	0.056
R Square = 0.495	Adjusted R Square = 0.466		F=16.679		Sig (F) =.000a

variance in firm performance (ROI) explained by innovativeness, proactiveness, risk taking and corporate venturing. Thus, hypothesis 1b was supported.

Hierarchical Regression Results

The hierarchical regression analysis was used to test the effect of the environment uncertainty on the corporate entrepreneurship and firm performance relationship. The following Table 3 and 4 illustrates the results of the test.

Table 3: Hierarchical Regression analysis of corporate entrepreneurship, environmental uncertainty and firm performance (Sales Growth)

Model 2	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	β	Std. Error	Beta		
(Constant)	2.716	0.541		5.018	0.000
Innovativeness	0.579	0.145	0.493	3.99	0.000
Proactiveness	0.219	0.121	0.215	1.809	0.075
Risk Taking	-0.194	0.111	-0.166	-1.752	0.084
Corporate Venturing	0.306	0.080	0.365	3.831	0.000
Uncertainty	-0.51	0.134	-0.378	-3.813	0.000
R Square = 0.604	Adjusted R Square = 0.574		F = 20.423		Sig (F) =000b

H2a: The environment uncertainty moderates the relationship between corporate entrepreneurship and firm performance (Sales Growth).

The Table 3 shows that environment uncertainty has moderating effect on all dimensions in corporate entrepreneurship and firm performance (sales growth) relationship. The R square was increased to 60.4% when the environment uncertainty included in the analysis. The model is fit when the R square is 0.6 and above. Therefore, hypothesis 2a was supported.

Table 4: Hierarchical Regression analysis of corporate entrepreneurship, Environmental Uncertainty and firm performance (ROI)

Model 2	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	β	Std. Error	Beta		
(Constant)	3.163	0.441		7.164	0.000
Innovativeness	0.521	0.102	0.609	5.108	0.000
Risk Taking	-0.195	0.082	-0.23	-2.386	0.020
Corporate Venturing	0.132	0.063	0.217	2.103	0.039
Uncertainty	0.002	0.107	0.002	0.016	0.987
R Square = 0.495	Adjusted R Square = 0.495		F = 16.632		Sig (F) =000b

relationship between corporate entrepreneurship and firm performance (ROI). Thus, hypothesis 2b was supported.

4.0 CONCLUSION AND LIMITATIONS

The aim of this study is to investigate the relationship between corporate entrepreneurship and firm performance among the large firm in Malaysia. In addition, the moderating effect of the environment uncertainty to this relationship has been included. Four dimensions of corporate entrepreneurship namely the innovativeness, proactiveness, risk taking and corporate venturing were used in this study. Both sales growth and return on investment has used as a proxy of firm performance.

Consistent with the previous research findings the corporate entrepreneurship practices in large firm have significantly affected the firm performance of the large firm. The large firm especially the public listed companies are important for economic development, therefore, examination of their performance is a worthwhile scholarly endeavour. All four dimensions; innovativeness, proactiveness, risk taking and

corporate venturing of the firm have increased the sales growth of the firm. This finding is similar with the previous researches that describe corporate entrepreneurship as a useful tool to achieve superior performance (Wiklund and Shepherd, 2005; Wiklund and Shepherd, 2003; Zahra and Covin, 1995). The highest contribution to the firm performance is the proactiveness (β=0.317) and followed closely by innovativeness (β=0.312) of the large firm.

However, not all corporate entrepreneurship dimensions have significant relationship with the return on investment of the firm. The proactiveness behaviour has no significant relationship with the profitability of the firm. The reason for this may be due to the fact that proactive behaviour is always "undo-the-competitor" by lowering the price even if it is below the production cost. This is to ensure that, the firm have the privilege to be ahead of other competitors. The innovativeness dimensions has the major contribution in explaining the ROI of the firm (β=0.505).

In explaining the firm performance, the findings of this research show that, the configurationally approach will complete our understanding on the corporate entrepreneurship and firm performance relationship. It is found that, the environment uncertainty moderates the relationship between corporate entrepreneurship and firm performance. During uncertainty, the corporate entrepreneurship effort will increase and therefore the performance of the firm also will increase. The hierarchical regression analysis show that adjusted explained variance reaches between 49% and 57.4% of the total variation in performance. Thus, this was encouraging result.

This research, as all researches, has limitations. The limitation of this study is, due to the poor response rate, the respondents were considered small and the result may not generalize the population. The data should be further collected in order to increase the sample size.

The result of this study has important implications for the large firm management team. In order to achieve superior performance, they should practise and encourage innovativeness, proactive behaviour, willing to take risk and to venture into new or existing industries. During uncertain business environment, the firm must be able to

align their strategy to cope with the intense competition during the hardship. The findings of this study can be generalized to some extent, despite the limitation of the sample size.

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TYPES OF LARGE SHAREHOLDER AND DIVIDEND POLICY OF MALAYSIAN COMPANIES

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Abstract

This paper analyses the influence of large shareholder's identity on dividend policy of Malaysian companies. The period under review is over the period from 2002 to 2006. Two types of decisions related to dividend policy is considered in this paper, (1) whether or not companies pay dividends and (2) how much earnings are payout as dividends. Regression analysis shows that the identity of large shareholder has no association with dividend policy. However, the greater the largest shareholding, independent of identity, the more likely companies is to pay dividends and have a higher dividend payout. This study enriches the dividend policy literature by providing evidence from an Asian country.

Keywords: Large shareholders, identity, ownership structure, dividend policy, Malaysia

1.0 Introduction

Many publicly listed companies in countries besides the United States (U.S.) and the United Kingdom (U.K.) are found to have high ownership concentration. Furthermore, a single large shareholder or shareholder group predominantly control these companies (Claessens, Djankov, Fan, & Lang, 2002; Faccio & Lang, 2002; La Porta, Lopez-De-Silanes, & Shleifer, 1999). Although most companies in Europe are controlled by large shareholders, their identities and typical characteristics differ markedly from those of large shareholders in Asian economies. For example, companies in Germany, France and Italy are said to be bank dominated (Rajan & Zingales, 1995), but in contrast, the majority of companies in Asian countries such as Malaysia and Thailand are dominated by family groups who are in effect the controlling shareholders (Claessens et al., 2000).

Prior studies have found that one type of company decision that commonly affected by ownership structure is dividend policy (e.g. Kouki & Guizana, 2009; Mancinelli &

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Ozkan, 2006; Short, Zhang, & Keasey, 2002). The objective of this paper, therefore, is to investigate the influence of the identity of large shareholder on the dividend policy of Malaysian companies. Malaysian companies' ownership structure adds to the appealing aspect of the examination of this issue. Firstly, corporate ownership structure is concentrated and large shareholders are in control of a large proportion of listed companies (Tam & Tan, 2007; Truong & Heaney, 2007). Secondly, the large shareholder of listed companies in Malaysia can be grouped into three main types: a family, the Government or an institutional shareholder. The conclusions reached by the European studies may not be applicable to the Asian context, and thus, may not serve as a prototype of the blockholder-based system.

2.0 Literature Review

Prior literature has indicated that large shareholders have a dual influence on companies. Large shareholders are noted to have strong motivation and could act as monitor in ensuring the company's value is maximized, while based on agency perspectives, they may enjoy private benefits of control and thus, embroil in expropriation of the corporate wealth (Bolton & von Thadden, 1998; Shleifer & Vishny, 1986, 1997). One mechanism to alleviate agency problems is dividends (Easterbrook, 1984; Jensen, 1986; Rozeff, 1982). Based on agency theory, ineffective companies' governance system might influence managers to expropriate corporate funds. Distribution of a company's earnings equally to all shareholders in the form of dividends could reduce corporate funds from managers' hands, and thus, dividend policy could become a corporate governance device to mitigate agency conflicts.

Types of large shareholder, such as a family group, an institutional shareholder and the Government have been discussed in the literature in which could influence the dividend decisions (Gugler and Yurtoglu, 2003). The shareholder's impact on the dividend policy may depend on the nature of agency conflicts associated with certain types of largest shareholder or the efficient monitoring function of the shareholder. Several studies have empirically examined the relationship between family ownership and dividend policy. Gugler (2003) states that the conflicts of interest and information asymmetry in family-owned companies are low due to there being no separation between large family shareholders and managers. The management of

family-owned companies is mostly comprised of the family members. Therefore, large family shareholders have more motivation to monitor the company directly, and this limits the monitoring function of dividend payments. This is consistent with a negative relationship between family-owned companies and dividends. Truong and Heaney (2007) also find that dividend payout ratios are lower when the largest shareholder is an insider, which includes employees, individuals and families. They explain that insiders may enforce low dividend policy on the company to increase the company's cash flow.

Evidence shows that the posts of the Chief Executive Officer (CEO), Board Chairman or Vice-Chairman of 85 percent of Malaysian companies are held by a member of a controlling family (Claessens, Djankov, Fan, & Lang, 1999). Renneboog and Trojanowski (2007) also find a significant negative relationship between dividend payout and the voting power of executive directors. High retention of companies' earnings may give executive directors the private benefit of enjoying free cash flow (Jensen, 1986). Overall, smaller payout can be expected in family-owned companies as this type of company is associated with lower agency conflicts (Gugler, 2003). In addition, as most managers are part of the family group, payouts are not needed as a monitoring tool because greater insider ownership helps mitigate agency problems. Therefore, the study proposes the following hypothesis:

$H_{1:}$ Dividend policy is negatively related to the existence of a family group as the large shareholder.

The efficient monitoring hypothesis proposed by Pound (1988) views institutional shareholders as having a greater incentive to monitor the management of companies. Institutional shareholders can also indirectly monitor companies by using their size to influence or place constraints on managerial decisions (Jennings, 2005). Based on the role of large institutional investors as a monitoring device, high dividend payments are therefore not needed to mitigate agency problems. Zeckhauser and Pound (1990) have suggested that institutional shareholders and dividend payments work as substitutes for monitoring of a company. Considering that an institutional shareholder is an efficient monitor and a substitute monitoring instrument to payouts, lower payout can be expected in institution-owned companies. However, it is possible that

an institutional shareholder may also influence companies towards higher dividend payout. One explanation is that, as large shareholders with strong monitoring skills, institutional investors would encourage companies to pay higher payout to avoid being expropriated (Renneboog & Szilagyi, 2006). Alternatively, the institutional shareholder may prefer that companies be subjected to the scrutiny of capital market monitoring as suggested by Easterbrook (1984). Institutional shareholders may think that their role in monitoring a company is not sufficient or it is too costly, and consequently prefers the company to be monitored by external capital markets (Farinha, 2003). Furthermore, institutional shareholders may need consistent cash flow on an ongoing basis, thus the expectancy arises that companies will pay higher payouts. Institutional shareholders need income return on investments to fund activities or liabilities, as institutional shareholders may not depend solely on capital gains (Short et al., 2002).

Empirical evidence on the influence of an institutional shareholder on dividend policy has, however, yielded mixed results. Moh'd et al. (1995) contend that there is a positive relationship between institutional ownership and dividend payouts in US companies. The high payouts attract large shareholders, which are perceived to have strong monitoring skills (Moh'd et al., 1995). Short et al. (2002) also provide evidence of a positive relationship between dividend policy and institutional shareholdings. Renneboog and Szilagyi (2006) evaluate companies as trying to please institutional investors' preferences, because dividends increase when they are present. Other studies find no association between institutional ownership and dividend payments. In contrast, Renneboog and Trojanowski (2007) find that dividend payments are negatively associated with the existence of institutional investors. Although institutional investors have tax advantages on dividends, Renneboog and Trojanowski (2007) suggest that they recognize the costs associated with high dividend payments, thus, they are willing to receive lower dividend payouts. Based on the efficient monitoring hypothesis (Pound, 1988), the following hypothesis, is, therefore, tested:

$H_{2:}$ Dividend policy is negatively related to the existence of an institutional shareholder as the large shareholder.

In analysing the association between dividend policy and Government ownership, Gul (1999) suggests that Government ownership is a form of, or is similar to, institutional ownership. The Government could operate as a domestic institutional investor in a country's capital market and monitor companies in which it invests. Against this background, the Government can substitute for dividend payouts as a monitoring device. Thus, lower payouts can be expected in Government-owned companies. Very little empirical research, in fact, has been conducted on the impact of Government ownership on payout policy, although studies report that Governments own and control a substantial percentage of publicly listed companies in many countries around the world. An empirical study by Gugler (2003) shows that Government ownership is positively associated with payout policy. The author indicates this is due to double principal-agent problems. This conclusion also supports the agency cost explanation regarding dividends, where payouts are used to mitigate severe agency conflicts in Government-owned companies. Gul (1999) states that there is a positive link between Government ownership and payout policy. However, instead of attributing this scenario to agency conflict in Government-owned companies, Gul views that, in having the Government as a shareholder, companies would experience fewer problems in obtaining funds and, thus, are better able to provide larger payouts. Gugler and Yurtoglu (2003) conclude that dividend payments are positively associated with the voting rights of the Government's shareholding. The study, therefore, explores whether the findings by Gugler (2003) and Gugler and Yurtoglu (2003) are tenable for Malaysian listed companies. Based on the double principal-agent problems, the next hypothesis is:

$H_{3:}$ Dividend policy is positively related to the existence of the Government as the large shareholder.

3.0 Methodology

This study extends the data from Nathasa Mazna (2010), which focuses on non-financial public listed companies (PLCs) of Bursa Malaysia (Malaysian Stock Exchange) that consistently listed over the period of 2002 to 2006. Due to the extent of data required in this study, particularly relating to ownership data, a systematic random sampling of one for every two companies in the population is applied. This

study excludes financial, trusts and closed-end funds companies due to the regulatory framework that specifically apply to them. The final sample contains 245 companies, which covers 1,225 firms-years observations. The ownership data of the sample companies are collected from the respective annual reports. This study focusses on the largest shareholding, as the largest shareholder of a company is a unique type of shareholder. This due to their holding can be associated with benefits and costs, and especially underinvestment costs (Claessens et al., 2002; Truong & Heaney, 2007). The largest shareholder is defined as the largest shareholder who owns directly and indirectly the equity of the company. The information relating to ownership is generally provided in the analysis of shareholdings section in an annual report. This study carefully collects the relevant information of each company in annual reports, especially in identifying the indirect holdings of the largest shareholder.

The largest shareholder is classified into four mutually exclusive categories: (1) individual/family, (2) Government, (3) institutional investors and (4) foreigner. Consistent with prior studies, this study does not differentiate between family members. The family group is considered as a unit of analysis, assuming that they vote as a coalition. People with the same surname and people that have the same father's name are assumed to belong in the same family. In Malaysia, the Muslims' name will include their father's name after the word 'Bin' which mean 'the son of' or 'Binti' which can be translated into 'the daughter of'. The largest shareholder is categorized as the Government if it can be grouped into one of the three bodies, namely the Federal Government, the State agencies, and the Federal Government-Linked agencies/Government-Linked Investment Companies (GLICs). However, Government-Linked institutional shareholders are classified as an institutional investor, due to its principal activities and characteristics. Besides that, insurance companies, pension funds, professional fund managers and licensed banking institutions are also categorized as institutional shareholder. A company with the largest shareholder is a foreign company or foreign individual, is classified as foreigners. There are companies that the largest shareholder is a private company. The ultimate owner of the private company is scrutinized until the shareholder is able to be grouped into one of the above category. The main source for financial data is OSIRIS database.

The study focuses on the influence of large shareholder's identity on two types of decisions related to dividend policy: (i) *whether or not* companies pay dividends, and (ii) *how much* of corporate funds are distributed in the form of dividends. The following random-effects Logit regression equation is used to examine the first type of decision i.e. the likelihood that a company distributes earnings in the form of dividends.

$$\Pr(\text{PAYER}_{it}=1)=\text{LOGIT}\left[\alpha+a_1\text{LARGEST}_{it}+\sum_{k=1}^{3}a_k\text{TYPE}_{kit}+\sum_{l=1}^{5}a_l\text{CONTROL}_{lit}+\sum_{m=1}^{4}a_m\text{TIME}_{mit}+\sum_{n=1}^{8}a_n\text{INDUSTRY}_{nit}+\mu_{it}\right]$$

(Equation 1)

Where:

μ_{it}	:	the unobserved error component
PAYER_{it}	:	dummy variable equal to 1 if the ompany pays cash dividends and 0 if otherwise
LARGEST		largest shareholder equity holding
TYPE_{kit}	:	set of variables either FAMILY, GOVERNMENT or INSTITUTIONAL for k=1,2 or 3 respectively
CONTROL_{mit}	:	set of control variables: profitability (ROA), firm size (SIZE), investment opportunities (INV), debt level (DEBT) and risk level (RISK)
TIME_{nit}	:	set of year dummies that, respectively, take a value of 1 for 2003, 2004, 2005 and 2006, or 0 if otherwise
INDUSTRY_{pit}	:	Set of industry dummies that, respectively, take a value of 1 for companies categorized in construction, consumer products, industrial products, infrastructure project companies, hotels, plantations, properties and technology, or 0 if otherwise

The second part of the regression analysis relates to the influence of large shareholder's identity on the magnitude of dividend payout ratio. The study use random-effects Tobit regressions, where the model to be estimated can be expressed as:

$$Y_{it}=\alpha+b_1\text{LARGEST}_{it}+\sum_{k=1}^{3}b_k\text{TYPE}_{kit}+++\sum_{l=1}^{5}b_l\text{CONTROL}_{lit}+\sum_{m=1}^{4}b_m\text{TIME}_{mit}+\sum_{n=1}^{8}b_n\text{INDUSTRY}_{nit}+\mu_{it}$$

(Equation 2)

The observable left-censored dependent variable Y_{it} can be stated as:

$$Y_{it} = \begin{cases} Y_{it}^{*} \text{ if } Y_{it}^{*} > 0 \\ 0 \text{ if } Y_{it}^{*} \leq 0 \end{cases}$$

(Equation 3)

Where Y^{*}_{it} is the dependent variable, which is dividends by earnings ratio (DIVE). Details of independent and control variables are explained in Table 1.

Table 1: Variable Measurements

Notation		Explanation
Independent Variables		
Types of the Largest Shareholder		
FAMILY	:	Dummy variable equal to 1 if the largest shareholder is a family group, 0 if otherwise
GOVERNMENT	:	Dummy variable equal to 1 if the largest shareholder is the Government, 0 if otherwise
INSTITUTIONAL	:	Dummy variable equal to 1 if the largest shareholder is an institutional shareholder, 0 if otherwise
Control Variables		
ROA	:	is the ratio of earnings before interest and taxes to total assets
SIZE	:	is the natural log of total assets
INV	:	is the ratio of market capitalization to total assets
DEBT	:	is the ratio of the book value of total debt to total assets
RISK	:	is the standard deviation of monthly share returns

4.0 Findings and Discussion

Table 2 highlights the largest shareholder ownership based on identity of ownership. The results show that 73.71 percent of the sample companies are owned by a family group. The institutional-owned companies and foreign-owned companies are relatively smaller in the sample, where 4.90 percent and 7.51 percent are owned by an institutional shareholder and a foreigner, respectively. On average the holding of the largest shareholder which is categorized as a FAMILY is 37.68 percent. Even though FAMILY has a large presence as a large shareholder in the sample companies, the mean value of the shareholding is lower than the mean value of the holding of the largest shareholder that is categorized as GOVERMENT, INSTITUTIONAL and FOREIGN.

Table 2: The Largest Shareholder Owner's Identities For 245 Malaysian Companies, 2002-2006

	N	Percentage Holding		
		Mean	Median	Standard Deviation
Type of largest shareholder				
FAMILY	903	37.68%	37.62%	0.158
GOVERNMENT	170	46.82%	45.88%	0.154
INSTITUTIONAL	60	49.33%	52.89%	0.177
FOREIGN	92	46.89%	40.41%	0.148

Table 3 shows the dividend payout of Malaysian companies over the period from 2002 to 2006. On average, Malaysian listed companies paid around 29 percent of their earnings as dividends. This figure is lower than the average dividend payout ratio report by La Porta et al. (2000), who found that Malaysian companies paid out 38 percent of their earnings as dividends.

Table 3: Dividend Payout of 245 Malaysian Listed Companies, 2002-2006

	N	Mean	Median	SD
Average 2002-2006	1225	29.14%	13.43%	154.41%
2002	245	12.56%	9.16%	130.71%
2003	245	32.75%	12.53%	130.92%
2004	245	19.30%	13.76%	139.44%
2005	245	34.29%	15.31%	122.92%
2006	245	46.64%	16.46%	224.01%

A possible reason for the higher dividend payout ratio in their study is that the companies in their sample mainly focus on the largest companies listed on the stock exchange. In contrast, this study randomly selected companies on Bursa Malaysia, which might include wider coverage of company sizes.

Table 4: The Influence of the Largest Shareholder's Identity o the Likelihood of Dividend Payments

Dependent Variable	DIVPAYER			
	1		2	
INTERCEPT	-9.730	**	-11.303	***
DEBT	-6.209	***	-6.208	***
INV	0.425	*	0.423	*
ROA	2.301	*	2.314	*
SIZE	1.107	***	1.109	***
RISK	-11.532	***	-11.518	***
LARGEST	2.350	*	5.381	**
FAMILY	-1.598			
GOVERNMENT	-0.800			
INSTITUTIONAL	-1.868			
FAMILY*LARGEST			-3.252	
GOVERNMENT*LARGEST			-1.939	
INSTITUTIONAL*LARGEST			-3.212	
Year dummies	Yes		Yes	
Industry dummies	Yes		Yes	
No. of observations	1225		1225	
Wald test	77.56	***	61.49	***
Log-likelihood	-429.636		-430.178	
Sigma u	3.199		0.095	
Rho	0.757		0.751	
LR test of rho=0	245.54	***	257.98	***

Table 4 presents the results of random-effects Logit model estimations which focus on the association between the identity of the largest shareholder in sample companies and the decision of whether or not to pay dividends. The analysis observes that the coefficient signs and significance levels of the control variables are statistically significant. The results in Table 4 show that the dividend decision of Malaysian companies is not related to the identity of the largest shareholder. The coefficient for the FAMILY variable in model specification 1 is negative, implying that companies are less likely to pay dividends when the largest shareholder is categorized as a family, although the coefficient are statistically significant. The results also show that there is no statistically significant evidence that Government or institutional shareholders have an influence on the likelihood of companies in paying dividends, hence, reject the hypothesis of this study. Furthermore, the analysis finds that the interaction between the largest shareholding variable and the FAMILY, GOVERNMENT and INSTITUTIONAL variables, respectively, are not statistically significantly related with the DIVPAYER variable. Our results, thus, provide no

evidence that the identity of the largest shareholder influences the propensity of Malaysian companies to pay dividends, and do not support the findings by Renneboog and Szilagyi (2006) and Truong and Heaney (2007). However, we also find that the coefficient for the LARGEST variable is positive and statistically significant at the 10 percent level in model 1 and at the 5 percent level in model 2. This indicates that the greater the largest shareholding, independent of identity, the more likely companies is to pay dividends.

This study also investigates the determinant of dividend payout with particular emphasis on types of the largest shareholder. Model specifications 3 and 4 in Table 5 present the results of the analysis. In these models, the LARGEST variable is positive and statistically significant at 5 percent level. The analysis does not, however, provide any evidence that the identity of the largest shareholder has any influence on dividend payout. The coefficients of the dummy variables of interest, which represent the types of the largest shareholder, are negative, but not statistically significant. The results do not provide support for the argument that the dividend payout ratio is linked to the types of the controlling shareholder as suggested by Gugler (2003), Correia da Silva et al. (2004) and Truong and Heaney (2007). A possible reason for the inconsistent results between the study and previous research is the difference in the institutional background of the countries, the sample of the studies and the definition used for particular shareholder types.

The analysis further tests the notion that the types of the largest shareholder have influences on the magnitude of dividend payout by replacing the dummy variables that represent the types of the largest shareholder with the interaction between the LARGEST variable and FAMILY, GOVERNMENT and INSTITUTIONAL, respectively. This analysis specifically evaluates the effect of the shareholding magnitude of the ownership types on the dividend payout ratio. The results in model 4 demonstrate that the interaction variables are not statistically significant. Overall, the study does not find any relation between dividends and ownership influences exerted by different largest shareholder categories. The results do not support all hypothesis of the study and are not consistent with prior literature, where types of shareholders are found to influence the nature of dividend payout (see Correia da Silva et al., 2004; Gugler, 2003; Truong & Heaney, 2007).

Table 5: The Influence of the Largest Shareholder's Identity on the Dividends To Earnings Ratio

Dependent Variable	DIVE			
	3		4	
INTERCEPT	-1.794	*	-2.529	***
DEBT	-1.060		-1.167	
	-2.39	**	***-2.61***	***
INV	-0.032		-0.346	
	-0.31		*-0.33*	
ROA	2.014		1.989	
	2.72	***	***2.69***	***
SIZE	0.134		0.124	
	1.90	*	***1.75***	*
RISK	-3.443		-3.239	
	-3.14	***	***-2.97***	***
LARGEST	1.057		1.785	
	2.10	**	***2.16***	**
FAMILY	-0.150			
	-0.49			
GOVERNMENT	-0.123			
	-0.34			
INSTITUTIONAL	-0.260			
	-0.58			
FAMILY*LARGEST			-0.149	
			-0.22	
GOVERNMENT*LARGEST			-0.481	
			-0.57	
INSTITUTIONAL*LARGEST			-0.695	
			-0.65	
Year dummies	Yes		Yes	
Industry dummies	Yes		Yes	
No. of observations	1225		1225	
Left-censored observations	387		387	
Wald test	64.89	***	79.66	***
Log-likelihood	-1727.807		-1719.664	
Sigma e	1.335		1.323	
Rho	0.388		0.396	

5. Conclusion

This study investigates the influence of large shareholder's identity on dividend policy of Malaysian listed companies. It is observes that the higher the largest shareholding, the higher the likelihood of paying dividends. The magnitude of dividend payout of Malaysian companies is also found to be higher in companies with

higher largest shareholding. However, the study does not find significant evidence on the influence of the largest shareholder's identity on companies' dividend payout level and propensity to pay dividends. Overall, the study finds that large shareholder, independent of the identity, have an effect on the dividend policy of Malaysian companies.

Nevertheless, there is much more to be investigated and further research is required to tackle various issues that were not considered in this study. Future work can tests whether the concentration level, i.e. whether the majority or block holding of the largest shareholder have an impact on dividend policy. Another issues warrant further investigation is, instead of focusing on large shareholder ownership, an examination of other agencies proxies such as board of director structure on dividend policy would provide deeper insight on the usage of dividends as governance mechanism.

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OPTIMAL PORTFOLIO SELECTION OF *SHARIAH*-COMPLIANT EQUITIES WITH TRANSACTION COSTS

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Abstract

Shariah compliant equity is a type of security that is permissible in Islam for investment purposes. Classification of Shariah compliant equity includes the process of screening firm's nature of business and investment activities that are free from the element of *riba*, *gharar* and *maysir*. In Islamic perspective, risk management is highly encouraged. Therefore, investors are expected to accumulate wealth responsibly by applying risk management measures in their investments. In this study,50 equities has been selected from stocks listed in FBM EMAS KLCI from January 2009 until June 2011 This study intends to enlighten investors in term of constructing optimal portfolio of diversified *Shariah* compliant equities in Malaysian market by applying Markowitz portfolio selection model. The aim of the model is to maximize portfolio's return by specifying investor's tolerable level of risk. Furthermore, this study extended the model with regards to transaction costs in measuring cost effectiveness of portfolio rebalancing. This study will benefit investors in selecting portfolio of *Shariah* compliant equities which are not only optimal but also cost effective. Results from the study shows that by applying Markowitz model, investor can achieve higher return at fixed level of tolerable risk as compared to naïve investment strategy. While the benefits of portfolio rebalancing outweigh the disadvantage when transaction cost is taken into consideration during portfolio rebalancing. The performance of portfolio by applying Markowitz model outperforms the FBM EMAS KLCI index. With this knowledge, *Shariah* compliant investors are capable to invest responsibly in managing their wealth. By applying risk management measure, *Shariah* compliant investor will become more confident investing in *Shariah* compliant portfolio of equities to safeguard and accumulate wealth.

Keywords: *Shariah* compliant equities, optimal portfolio, transaction cost

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1. Introduction

Shariah Requirements in Investment

The science of Islamic economics, suggested by Muhammad Ridhwan Ab. Aziz (2012) is the study of human efforts in allocating resources to meet the needs of life in ways consistent with Islamic teachings. Thus, in the process of meeting the needs in life, Islam promotes the *ummah* on acquiring money and wealth in proper and permissible ways and spends the wealth according to the mandated *Shariah* rules. This in turn will prevent Muslims from poverty and hunger. Thus, investment is one of the modes that can be applied for Muslim to acquire wealth. In line with Islamic economics, investment in Islamic perspective must comply with the principles of *Shariah*. The *Shariah* requirements in investments as highlighted by Said Elfakhani et al (2005) can be categorized further into 3 important aspects which are asset allocation, investment and trading processes and purification.

In terms of asset allocation, it refers to portfolio selection that needs to undergo screening process. In conventional system, as we know can choose freely between debt – bearing and investment bearing in all kinds of industries. Whereas in Islamic systems, set up some requirements in portfolio selection that meet with *Shariah* principles both qualitative and quantitative approach. The qualitative measure does include the process of filtering the nature of a company business that covers the aspects of alcoholic elements or business that deals with human cloning and aborted embryo. In terms of quantitative aspects, the *Shariah* requirements prohibit the elements of *riba'* (interest), *gharar*, refers to selling something that is not owned or something that cannot be describe in accurate detail and *maysir*, which refers to gambling and pure games of chance.

In terms of investment and trading process, the *Shariah* requirements prohibits investors to trade in margin as it involves interfere debt – paying. Besides, the process of sale and repurchasing agreements are also prohibited as involves interest charging indirectly. Speculation, in addition is not allowed to be practiced by Islamic fund managers. The

Islamic investment need to assume and expect risks related after making risk assessment with available information.

The purification aspect of *Shariah* guidelines refers to the process of cleaning tolerable revenues from unacceptable business activities and interest from an investment that has been allowed by some contemporary scholars. For example, suppose an investment of a company has 10 percent interest related income, thus each dividend payment must be cleansed through charity. Another form of purification can be achieved through *Zakah*, a form of charity paid on personal wealth that excess minimum requirement of *nisab*, held idle for one lunar year. A rate of 2.5% of *Zakah* is obligated in terms of monetary wealth and earned income.

These requirements in investment play a major role for an investor to invest in *Shariah* compliant equities or securities. Nowadays there are special bodies designated to screen companies which comply with *Shariah* rules to be classified under *Shariah* compliant equities. Now we shall discuss further on the regulation on *Shariah* compliant equities in Malaysia.

Shariah Compliant Equities Regulations in Malaysia

Referring to Khatkhatay and Nisar (2007), *Shariah* compliant equities regulation in Malaysia focus on the screening process of equities listed in Malaysian stock market. It is done by *Shariah* Advisory Council (SAC) of Securities and Exchange Commission (SEC) Malaysia. The screening process requires information from income statements of companies. Individual funds or investment companies do not make their own *Shariah* screening criteria. This is to ensure reliability and professionalism in *Syariah* screening process.

The core activities of the companies should be compatible with the principles of *Shariah*. Therefore companies with following activities that have been discussed in *Shariah* requirements in investment activities are excluded. While for companies with activities comprising both permissible and non – permissible elements, there are two additional

criteria proposed by SAC which are the public perception of the company must be good and the core activities of the company are important and considered as *Maslahah* (in the public interest) to the Muslim *ummah* and the country. While the non – permissible element is very small and do involves matters such as *umum balwa* (common plight and difficult to avoid), *uruf* (custom) and the rights of the non – Muslim community which are accepted by Islam.

In terms of mixed activities, the SAC has set up certain level in benchmarks of tolerance. If the contributions in turnover or profit before tax from non – permissible activities of a company exceed the benchmark, the securities of the company are classified as *Shariah* non – approved. The benchmark level are as follows :-

a) 5 percent benchmark which applied to assess the level of mixed contributions from the activities that are clearly prohibited such as riba, gambling, liquor and pork
b) 10 percent benchmark which applied to assess the level of mixed contributions from the activities that involve the element of *umum balwa* which is a prohibited element affecting most people and difficult to avoid. Examples include interest income from fixed deposits in conventional banks.
c) 25 percent benchmark which used to assess the level of mixed contributions from activities that are generally permissible according to *Shariah* and have an element of *Maslahah*, but there are other elements that may affect the *Shariah* status of these activities. Examples are hotel and resorts operations, share trading which may involve other activities that are deemed non permissible according to the *Shariah*.

While in debt and liquidity of a company, there is no restriction on the proportion of liquid asset in total assests.

With the strict screening practice, investors could now rely on the *Shariah* classification produced by SAC. Thus investors become more confident in selecting equities which comply with *Shariah* rules to be included in their portfolio. Until now, approximately 86% of stocks available in Malaysian market are classified as *Shariah* compliant. However, the large number of stocks would become a challenge for investors in term of

selecting the right stocks for their portfolios. Therefore, with profound understanding on the concept of portfolio management, investors will be able to make investment decision which could be tailored to match their risk appetite.

The Concept of Portfolio Management

According to Drake and Fabozzi (2010), portfolio theory deals with the selection of portfolio that maximizes expected return which consistently with the level of risk accepted by an investor. This, in turn is the goal of an investor in terms of portfolio selection. While discussing on portfolio selection, an investor needs to understand the concept of diversification in selecting stocks in his portfolio. Portfolio diversification is defined as inclusion of number of investable asset in a portfolio. It deals with asset allocation matter, which focuses on the number and weight of a single asset to be included and invested when constructing a diversified portfolio. While constructing a diversified portfolio, an investor need to consider certain indicators like return and risk that the investor wish to bear.

The concept of portfolio selection developed by Harry Markowitz (1952) which also known as mean – variance portfolio analysis highlights the benefits of portfolio diversification. This theory of portfolio selection emphasizes on maximization of return with a certain level of risk or minimization of risk with certain level of return. The concept of portfolio developed by Markowitz is later known as Modern Portfolio theory.

Apart from that, an investor needs to apply suitable approach to manage a portfolio. According to Collins and Stampfli (2005), there are two types of portfolio management approach which are active and passive portfolio management. An active portfolio management includes tactical asset allocation and rebalancing. Whereas passive approach deals with buy and hold strategy over a long investment period. Rebalancing plays an important role in active portfolio management strategy as it relates reallocating assets over a short time period. Furthermore, in investment strategy, rebalancing is vital to ensure that the outcome from the investment in line with an investor's risk and return objective.

On the other hand, the simplest portfolio diversification strategy is known as naïve investment strategy in which investor allocate their fund equally in each asset available for investment during each rebalancing date. DeMiguel et al (2007) defined this strategy as a portion of 1/N of wealth is allocated to each of N number of assets available. This strategy is also known as 1/N heuristic portfolios.

For the purpose of the study, we will compare on active portfolio management by applying periodical portfolio rebalancing. On the other hand, during the whole investment period, an investor needs to bear certain transaction cost. It is also important factor where transaction cost need to be taken into consideration to ensure cost effectiveness of an investor's strategy in managing his or her portfolio.

Therefore, question has been raised in terms of how to help *Shariah* compliant investor to invest responsibly in accumulating and managing their wealth. Apart from that, this study focuses on how to provide knowledge of risk management approach towards investor in *Shariah* compliant equities in Malaysian market. The objectives of the study are :-

a) To construct an optimal portfolio of diversified *Shariah* compliant equities in Malaysian market
b) To apply Markowitz model that maximize portfolio return with predetermine level of tolerable risk of *Shariah* compliant equity investor.
c) To incorporate transaction cost in Markowitz model in ensuring cost effectiveness of investment strategy that includes portfolio rebalancing.

This paper has been organized in the following way. The paper first gives a brief introduction of *Shariah* requirements in investing and portfolio management process. In part 2, it focuses on literature review that is related in this study. While in part 3 emphasizes on methodology used in solving the optimal portfolio selection with certain assumptions. Part 4 will discuss on the results from the study and conclusion will be made in part 5.

2. Literature Review

Investment and Risk Management in Islamic Perspective

In investment activity based in Islamic financial activities, it is important that an investor needs to bear the risk. Asyraf Wajdi Dusuki (2012) clarifies this based on the principle of *al – ghunm bi al – ghurm*, which means that entitlement to profit is accompanied by responsibility for attendant expenses and possible loss. This has been backed by the hadith collected by al – Thirmidi, Abu Dawud, Ibn Majah and Ahmad, '*Inna al – kharaj bi al – daman,*' which means the entitlement to profit from something is dependent on responsibility for attendant expenses and possible loss and defects. Thus, according to Dusuki (2012), any investment based on the separation between *al- ghunm* (profit) and *al – ghurm (loss),* where an investor are qualified to receive profit without bearing daman (responsibility for losses or risk) are not allowed.

Risk Management in Islamic perspective plays a vital role in investment since it does include the protection of property which emphasize on defending the rights in ownership. This has been argued by Mohammed Obaidullah (2002) which lies in the context of *Maslahah* and *Maqasid al – shariah*, whereby *Maslahah* takes into consideration that secure benefit and prevent harm but harmonious with *Maqasid al – shariah*. While Asyraf Wajdi Dusuki (2012) on the other hand, supports this argument which claims that risk management is important in preservation of wealth while suggesting that risk in property must be resolved and curbed. In consistent with the *Maqasid al – shariah*, it emphasize that any investment activities must include comprehensive analysis to determine the benefits and harm before it is executed.

Optimal Portfolio Selection

The theory of portfolio selection and diversification developed by Markowitz (1952) served as a platform for further studies on portfolio management. It does include the development in solving Markowitz model via linear programming model. Even though there is claim that Markowitz quadratic programming is cumbersome and time consuming, but based on the findings from Papahristodoulou and Dotzauer (2004), it is

proven that Markowitz quadratic programming yields the lowest risk compared to Maximin and Minimization of Absolute Definition (MAD). In fact, Rubinstein (2002) suggests that after 50 years, Markowitz modern portfolio theory still being used in many investment houses for decision making and measuring performance.

The portfolio concept developed by Markowitz has been benefited investor in terms of portfolio selection and diversification. In emerging market like Ukrainian Stock Market, the benefits of portfolio diversification have been highlighted by Shabalina and Zhuravlyova (2011). This study suggests that the application of Markowitz is more appropriate rather than Sharpe Model in terms of portfolio selection for investors in Ukrainian Stock Market. While in Malaysian market, Anton Abdulbasah Kamil et al (2006) conduct portfolio analysis from stocks listed in Kuala Lumpur Stock Exchange (KLSE). By applying Markowitz model, it helps the investor to achieve the objective of maximizing portfolio return and minimizing portfolio risk while investing in KLSE. In consistent with the application of Markowitz, Plessis and Ward (2009) prove that the application of Markowitz in portfolio construction from stock listed in Johannesburg Stock Exchange (JSE) shows that the portfolio constructed outperformed the market as compared to FTSE/JSE 40 index. While in Nepalese Stock Exchange (NAPSE), Paudel and Koirala (2006) provide the evidence that the application of Markowitz benefits the investor in terms of risk reduction and offers better option towards investor in terms of decision making in the choice of optimal portfolio in NAPSE.

The trading and investment activity in equities does include the element of transaction cost that an investor needs to bear. Thus, further studies in mean – variance portfolio selection developed by Markowitz (1952) has been extended further with the inclusion of transaction cost. Based on studies made by Borkovec et al. (2010), the incorporation of transaction cost estimated in mean – variance portfolio construction helps the investor in terms of reduced level of risk and provides an improvement of net returns made by an investor. In addition, Yoshimoto (1996) suggests that the transaction cost needs to take into consideration during portfolio construction. It does has an important factor since the transaction cost charged and incurred to an investor is certain while the return on a

security is uncertain. This provides an important argument in terms of risk and return tradeoff. While Denteh (2004) offers the same argument towards investor in the aspect of tradeoff between risk and return while an investor considers a fixed level of risk, return increases when transaction cost is reduced. Moreover, when at certain level of return, higher transaction cost will results higher level of risk and the return is altered.

Portfolio Rebalancing

In investment activity, an investor needs to consider as an important strategy while investing in a portfolio of securities. Several literature have been discussed the needs and benefits of portfolio rebalancing. As been highlighted by Weinstein et al. (2003), rebalancing helps to bring the portfolio aligned with the original target weight of each asset in order to maintain the risk profile of an investor. While Gitsham (2011) offers the same argument where rebalancing helps in ensuring a portfolio remains in line with risk and return objective of an investor where portfolio must be rebalanced periodically to the strategic assets allocation. Jaconetti et al. (2010) also offers the importance of rebalancing in terms of assets allocation since over the time during investment period, it may results in different returns and the portfolio is likely to drift from its target asset allocation. Rebalancing serves as tool in terms of risk reduction, where Weinstein et al (2003) clarifies that rebalancing helps to reduce risk in portfolio investment while never rebalance portfolio will results in slightly lower return and more risk towards an investor.

While in periodical rebalancing, a study conducted by Nersesian (2006) proves that regular quarterly rebalancing return performed better than the less active annual rebalancing approach and the more frequent monthly rebalancing strategy. In contrast, Jaconetti et al (2010) claims that return form portfolio investment are not meaningfully different whether a portfolio is rebalanced monthly, quarterly or annually. In portfolio rebalancing, it will incur certain transaction cost towards an investor. Nersesian (2006) states that longer rebalancing period will possess lower transaction cost. But this will results in the disadvantage of increased tracking errors in portfolio investment. While transaction cost is a key consideration of disadvantage in portfolio rebalancing, studies made by Weinstein et al. (2003) proves that the benefits of portfolio rebalancing

outweigh the disadvantage of portfolio rebalancing while transaction cost is taken into consideration in portfolio investment in terms of preventing higher risk level than intended by an investor and improves absolute performance in portfolio investment.

3. Research Method

Markowitz Quadratic Programming with Transaction Cost

For the purpose of this study, we will apply Markowitz Quadratic Programming that will maximize the return on portfolio of an investor. By referring equation (1), further extension has been made by the inclusion of transaction cost that refers to brokerage fees that an investor needs to bear.

Thus, the formulations are as follows:-

$$\text{Maximize } \left(\sum_{j=1}^{n} \bar{r}_j x_j\right)\mathrm{T} - C \qquad (1)$$

where

$$C = c_1 + c_2 \qquad (2)$$

if

$$|x_{jt} - x_{j\,t-1}| > y$$

$$c_1 = \sum_{i=1}^{n} |x_{jt} - x_{j\,t-1}| \times \omega \qquad (3)$$

else if

$$0 < |x_{jt} - x_{j\,t-1}| \leq y$$

$$c_2 = \varepsilon \times k \qquad (4)$$

subject to the following constraints

$$\sum_{i=1}^{n} \sum_{j=1}^{n} \sigma_{ij} x_i x_j \leq \alpha \qquad (5)$$

$$\sum_{j=1}^{n} x_j = B \qquad (6)$$

$$x_j \geq 0 \qquad (7)$$

where

$$i = 1, 2, \ldots, n$$

$$j = 1, 2, \ldots, n$$

$$\sigma_{ij} = \frac{1}{T} \sum_{t=1}^{T} (r_{it} - \bar{r}_i)(r_{jt} - \bar{r}_j) \qquad (8)$$

n = number of securities
i, j = securities
T = total period
t = period
σ_{ij} = covariance of equities *i* and *j*
r_{jt} = monthly return of equity *j* per Ringgit Malaysia over period *t*
$\bar{r}_j$ = average monthly return of equity *j* over the entire period *T*

x_j = portfolio allocation of equity *j* in Ringgit Malaysia
x_{jt} = portfolio allocation of equity *j* in Ringgit Malaysia over period *t*
x_{jt-1} = portfolio allocation of equity *j* in Ringgit Malaysia over period *t-1*
C = total transaction cost $c_1 + c_2$
c_1 = transaction cost 1
c_2 = transaction cost 2
ω = brokerage fees in percentage %
k = brokerage fees in Ringgit Malaysia
ε = number of transaction
y = transaction value in Ringgit Malaysia
α = acceptable level of predetermine risk measured by portfolio variance
B = maximum capital to be invested

While implementing this model, two assumptions have been made adapted from Markowitz. The first assumption is return on an equity is multivariate normally distributed. While in terms of investor's behavior, an investor is a risk averse investor, that prefer high return but low level of risk.

The first constraint as from equation (5) is imposed to indicate the tolerable risk level that should be lower than or at most equal to an investor risk level, denoted by α. The model above will develop an optimal portfolio that in turn will provide at most or lower than the risk level that has been tolerable by an investor. The second constraint, equation (6) is known as capital constraint, *B* which gives the maximum capital available to be invested. It is assumed that all the capital is invested in the optimal portfolio construction.

The transaction cost could be divided into two parts. It concerns with a certain minimum transaction amount and minimum brokerage fees. Transaction cost c_1, from equation (2) is imposed when the amount of transaction exceeds the transaction value, y. While, transaction cost c_2 in equation (3) refers to minimum brokerage fees k when the number of transaction has value is less than or equal y and greater than zero.

Finally in equation (7), investment in each stock is set to be equal or more than zero to avoid short selling. It is in line with *Shariah* principle and Bursa Malaysia regulation that prohibits investor to practice short selling while trading in securities.

Data Selection and Assumptions

For the purpose of the study, we apply Markowitz quadratic programming by adapting monthly returns for *Shariah*–compliant equities listed in FTSE Bursa Malaysia Emas Index (FBMEMAS) from January 2009 to June 2011. In total, there are 290 companies listed under FBMEMAS. The companies that do not have adequate data during the whole study period have been eliminated. We select companies from various sectors. The selection process includes the consideration of equity's average return and variance for the measurement of tolerable level of risk.

The proportion of selected companies is tabulated as follows.

Table 1: The Proportion of Selected Companies

Sector	Total Companies	Selected Companies	Proportion (%)
Basic materials	29	5	17.24
Consumer goods	64	11	17.19
Consumer services	13	3	23.07
Financials	33	7	21.21
Health care	12	2	16.67
Industrial	90	13	14.44
Oil and gas	20	4	20.00
Technology and telecommunication	17	3	17.64
Utilities	12	2	16.67
Total	290	50	

It can be shown that from the table, there are 50 companies selected in the sample that comprises 17.24% of the total equities listed in FBM EMAS KLCI. The percentage of companies selected from each sectors ranging from 16.67% to 23.07%.

During the study period, we divide the data into five sub periods which consists of 6 months in each period. These include, January 2009 to June 2009, July 2009 to December 2009, January 2010 to June 2010, July 2010 to December 2010 and January 2011 to June 2011. This will allows us to measure the performance of portfolio rebalancing for every six month based on the six month optimal portfolio selected by using Markowitz quadratic programming. In order to make sure that our investment strategy is cost effective, the extension has been made in this study by taking into consideration of

transaction cost during the whole investment period that include initial investment and portfolio rebalancing. In contrast with studies done by Kamil Anton Abdulbasah et al. (2006) on portfolio analysis for stocks listed in KLCI via Markowitz model, further extension has been made in our study by the inclusion of periodical portfolio rebalancing for equities listed in FBMEMAS.

In additions, few assumptions have been made by us in order to test the model. We assume that an individual has RM100000 budget allocation, *B* to invest in equities. The acceptable risk level, $\sqrt{\alpha}$ is set up at rate of 3.53% based on average standard deviation of 50 selected companies. The transaction cost is set up based on average brokerage fees that been imposed in Malaysia stock market which are minimum at RM40 for the number of transaction below minimum transaction value of RM 6666. For the transaction value of above RM6666, the transaction cost is imposed at rate of 0.6% of the total transaction amount. The transaction costs are taken into consideration during initial investment and portfolio rebalancing where we assume an investor rebalances his portfolio every 6 month. We incorporate transaction cost in the model by deducting transaction costs from portfolio return.

In this study, we will use return from FBMEMAS index as a benchmark in this study. Besides, we will compare the findings of performance between naïve investment strategy and optimal portfolio derived from Markowitz Portfolio Optimization Model. The process of analyzing and constructing of an optimal portfolio via Markowitz model will be done through Excel Solver.

4. Results and Discussions

FBMEMAS Return

The return from FBMEMAS Index serves an important role as a benchmark for our study. Table 2 shows the performance of FBM EMAS KLCI index in each semiannual period.

Table 2: Performance of FBM KLCI Index in each semiannual period

Period	Jan – June 2009	July– Dec 2009	Jan – June 2010	July – Dec 2010	Jan – June 2011
Average monthly Return, (%)	4.05	2.86	0.73	2.67	0.76
Monthly Standard Deviation, $\sqrt{\alpha}$ (%)	6.06	3.61	3.28	1.83	2.08

Base on the table, it can be shown that the highest average monthly return recorded is 4.05 % during the period of January – June 2009 with the standard deviation of 6.06%. While the lowest return is recorded on Jan – June 2010 with standard deviation of 3.28%. While during the whole investment period, the total recorded is 66.38% with the average monthly return of 2.21% and standard deviation of 3.67%.

Naïve Investment Strategy

In our study, we apply naïve investor's strategy in portfolio allocation where with the assumptions of budget RM100 000 with the 50 equities that have been selected, we allocate 2% or RM2000 on each equity. We do the same strategy in each 6 months. We then examine the performance of portfolio via measuring the return and risk, where risk is measured by standard deviation of the portfolio. Table 3 shows the performance of portfolio on each 6 months period.

Table 3: Portfolio performance by adapting Naïve Investor's Strategy

Period	Jan - June 2009	July - Dec 2009	Jan - June 2010	July - Dec 2010	Jan - June 2011
Monthly Return(%)	7.16	4.23	3.13	5.83	2.54
Monthly Standard Deviation (%)	4.03	0.97	2.11	1.35	1.25

Optimal Portfolio Based Markowitz Portfolio Optimization Model

We then conduct our study by analyzing portfolio allocation via Markowitz portfolio optimization model. We divided the findings into two sections, where the first sections we apply passive portfolio management through buy and hold strategy and the second category we apply active portfolio management by practicing semiannual periodical

rebalancing. We examine portfolio allocation on each sectors and measure portfolio return with the acceptable predetermine risk level as measured by standard deviation.

Buy and Hold Strategy

In this strategy, the investor constructs a diversified portfolio of *Shariah* – compliant equities that cover the period from January 2009 until June 2011. All the budget allocation is fully invested while constructing a diversified portfolio of *Shariah* – compliant equities. The transaction cost is taken into consideration during beginning of the whole investment period. The optimal portfolio allocation of equities in each sector is represented in table 4.

Table 4: Sectors and Portfolio Allocation to construct optimal portfolio during the whole investment period

Sectors	Portfolio Allocation (%)
Basic Materials	7.62
Consumer Goods	27.53
Consumer Services	9.48
Financials	4.85
Health Care	6.06
Industrials	27.49
Oil & Gas	4.91
Technology& Telecommunications	6.06
Utilities	6.00
Total	100.00

By setting up predetermine risk level at 3.53% for the whole period of portfolio investment, it can be shown that the highest level of portfolio allocation is 27.53% in consumer goods sector and the lowest portfolio allocation is 4.85% in financial sector. The buy and hold strategy generates portfolio return of 146% with average monthly return of 4.86% after deducting transaction cost during initial investment period worth RM1640.00.

Periodical Semiannual Rebalancing

With the same budget allocation of RM100000, the investor invests all the allocation in diversified portfolio of *Shariah* – compliant equities from January 2009 until June 2009.

Then the portfolio rebalancing occurs semiannually in each 6 months where the transaction cost is taken into consideration during the portfolio rebalancing. The acceptable predetermine risk level is set as the same in buy and hold strategy at 3.53%. The optimal portfolio allocations in each sector for each period are tabulated in table 5.

Table 5: Sectors and Portfolio Allocation to construct optimal portfolio in each semiannual period

Sectors	Jan – June 2009	July - Dec 2009	Jan - June 2010	July - Dec 2010	Jan - June 2011
Basic Materials	8.36%	0.00%	24.01%	45.36%	44.48%
Consumer Goods	22.76	6.20	21.20	16.11	10.25
Consumer Services	6.22	0.00	11.75	4.40	5.96
Financials	13.72	0.00	3.48	8.24	9.44
Health Care	3.98	90.51	5.56	1.67	2.59
Industrials	27.28	3.30	25.55	13.66	15.95
Oil & Gas	8.00	0.00	2.74	5.39	5.74
Technology & Telecommunications	5.19	0.00	4.16	3.42	4.63
Utilities	4.48	0.00	1.54	1.74	0.97
Total allocations (%)	100.00	100.00	100.00	100.00	100.00
Average Monthly Return (%)	6.99	13.48	8.29	11.34	5.84
Monthly Standard Deviation (%)	3.53	3.53	3.53	3.53	2.66
Transaction cost (RM)	1960.00	2450.29	2528.51	2270.75	2405.26

With the consideration of transaction cost on each period, the highest monthly return recorded is 13.48% in the period of June – July 2009.Due to the efficient frontier, with the lower monthly standard deviation 2.66%, the maximum return generated is 5.84% in the period of Jan – June 2011. In consistent with the assumptions made by Markowitz where investor is risk averse, thus it is proven that the portfolio that is being selected is the one which provides high return with lower level of risk based on the outcome in the period of Jan – June 2011.

Based on the findings from naïve investment strategy, during the whole investment period, the total return generated is137.44% with a transaction cost of RM2000 at the beginning of the investment period. While application of Markowitz in buy and hold

strategy generates return of 146% at predetermine risk level at 3.53%.Interestingly, by practicing semiannual portfolio rebalancing in active portfolio management, the total return generated for the whole investment period is 343.8% at the same predetermine acceptable risk level of 3.53% where the lowest transaction cost recorded is RM1960.00 during the early period in January – June 2009 and the highest transaction cost occurred during January – June 2010 worth RM2528.51 and the total cost recorded for the whole period is RM11614.81.

Discussions

Based on the performance of portfolio by applying Markowitz portfolio optimization model, it outperforms the return from FBM EMAS KLCI in the whole investment period and in each semiannual period. This is in line with findings made by Plessis and Ward (2009) where the application of Markowitz has been used in portfolio construction for stocks listed in Johannesburg Stock Exchange (JSE) outperformed the market as compared to FTSE/JSE 40 index.

The current study of portfolio selection in *Shariah*–compliant equities listed in FBMEMAS by Markowitz portfolio optimization model produces results which indicate that the application of Markowitz model will produce return that outperforms naïve investment strategy throughout the investment period. Investors are now being offered a wide range of portfolio diversification by applying Markowitz model while in the process of maximizing portfolio return with the acceptable level of predetermined risk and choosing the optimal portfolio of diversified *Shariah*–compliant equities. The findings of this study is in line with the findings made by Paudel and Koirala (2006) where proved that application of Markowitz offers better option towards investor in terms of decision making of optimal portfolio listed in NAPSE. While in Malaysia, this study is in agreement from studies made by Anton Abdulbasah Kamil et al (2006) that apply Markowitz model in portfolio analysis for stocks listed in KLCI while in the objective of maximizing return and minimization of risk level with the consideration of transaction cost and the exclusion of portfolio rebalancing.

The application of Markowitz in buy and hold strategy and periodical semiannual rebalancing provides an interesting argument. With regards to the high total transaction cost which is a key consideration of disadvantage of portfolio rebalancing, findings from this study indicates that it is worth towards the investor since it is proven from this study which indicates that the returns of periodical semiannual portfolio rebalancing outperforms the non – rebalanced portfolio during the whole investment period during January 2009 until June 2011 with the similar rate of fixed level of acceptable predetermine risk. On top of that, the result from rebalancing portfolio clearly shows the advantage in terms of achieving an investor's goal in maximizing portfolio return while keeping up the same rate of acceptable predetermine risk level. The result of this study is in line with findings made by Weinstein et al. (2003) where the advantage of portfolio rebalancing outweigh the disadvantage when transaction cost is taken into consideration and helps the investor in improving absolute performance of a portfolio investment. While ensuring the benefits of portfolio rebalancing which maximize portfolio return, the findings support the argument made by Gitsham (2011) where rebalancing must lock in return towards an investor. This provides a positive argument of ensuring cost effectiveness of portfolio rebalancing.

5. Conclusion

Nowadays, *Shariah* compliant equities investors especially in Malaysia are bewildered with the large number of equities that can be included in their equities portfolio. Thus, investment decision should be wisely made to avoid wastage of wealth and also safeguarding wealth as suggested in Islamic teachings. Therefore, this study suggested the application of Markowitz portfolio optimization model to find the balance between risk and return in equity investment. Furthermore, rebalancing is done every six month period by taking into consideration transaction cost which is a vital issue especially when investors decide to change equities' allocation in their portfolios. This study serves an important tool towards the *Shariah* – compliant equities investor in terms of applying suitable risk management measure while investing in equities. The knowledge of

diversification is vital in optimal portfolio construction and also during portfolio rebalancing. While *Shariah*–compliant is a main concern of equity investment in Islamic perspective, investor can maximize portfolio's return by actively monitoring and rebalancing their portfolios using Markowitz model. This study shows that portfolio rebalancing for every six month period is cost effective and gives higher return to investor compared to passive strategy.

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THE INFLUENCE OF RELIGIOSITY AND MATERIALISM ON STATUS CONSUMPTION PURCHASE INTENTION AMONGST MALAYSIAN MUSLIM YOUTH.

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Abstract

This conceptual paper aims to look at the relationship between religiosity and materialism on the purchase intention on status consumption goods amongst the Malaysian Muslim Youth. In the rapid and increasingly globalized world, religion still plays a significant role in influencing social and consumer behaviour. Rising income capacity has an influence on the higher demand of status consumption goods, and in tandem the rising level of household debts among the young Malaysians. Empirical evidence is crucial in determining the significance of the relationship of all the variables in the conceptual framework. The conceptual framework is developed based on existing literature and hypothesis would be tested on Young Malaysian Youth ranging from the age of 18 to 22 years of age. This research is deemed important as the reports have shown that households in Malaysia are spending half of their income in paying off their debts. Thus findings of research is crucial for parents, educational institution, and the government itself in shaping the youth as the leaders of the future in spending wisely and preventing them to over indulge and leading to financial instability.

Keywords: Religiosity, Materialism, Status Consumption, Malaysian Muslim Youth

1. Introduction

Increasing wealth and a growing middle class have seen an intensification of new consumption patterns and practices amongst the growing affluence that has created a new Malay middle class segment. In tandem so is the luxury brand consumption. The branding practitioners and scholars are eager to explore the USD 2,587 billion industry in all of Asia- Pacific by 2016 (Seetharaman et al., 2001; Ahmad, 2010; Teimourpour & Hanzaee, 2011). According to Cleveland et al., (2011); some researchers have suggested that the high social premium placed on status symbols, including imported luxury goods is higher among consumers in emerging markets (Sharma, 2011), because these materialistic possessions serve as markers of upward

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social mobility (Cleveland & Chang, 2009); the salience of which is higher under conditions of rapid social change (Ger and Belk, 1996b).

The youth are often characterised by attributes including technological suaveness, inflated self-esteem, fashion consciousness and the need for greater social approval (Twenge & Campbell, 2008; Heaney, 2007). Their greater image consciousness may lead them to perceive that a materialistic lifestyle can produce the identity of success (Nga, Yong & Sellapan, 2011). As a result of social pressures and materialism, it is widely documented that compulsive spending and excessive debt is rampant among today's youth (Penman & McNeill, 2008; Pirog & Roberts, 2007; Xu, 2007).

The Muslim Malays constitute over 60% of the population being the largest group but also the most homogenous; despite considerable variations in cultural practices such as traditional dress, handicraft, architecture, artistic expression and social organizations among Malays from different regions in the country is Muslim society and Islam sets of life and serves as one of the principal sources and markers of identity (Wong, 2007). Findings of past literature have suggested that significance differences exist in shopping orientation among consumers with different levels of religiosity in Malaysia (Mokhlis, 2009). Alam, Mohd & Hisham, (2011) found that, religious Muslims consider Islam as their source of reference and they spend moderately as religiosity acts as a full mediating role in the relationship between relative and contextual variables, and purchase behaviour of Muslim consumers.

Many spiritual leaders have argued that materialistic pursuits are incompatible with following a spiritual life (Stillman et al., 2011). And in the same study, the research found that higher levels of spirituality correspond to a decreased desire to consumer materials goods in a conspicuous manner. Nevertheless Flouri (1999) posited that materialism in adolescents is positively related to peer influence and is negatively related to satisfaction with one's mother, religious service attendance and economic socialization.

On the contrary, according to the report that was conducted by MasterCard (2009), the average annual growth rate of luxury consumption was at 12 percent. As highlighted at the same report, the growth rate of Malaysia is the highest score in all

Asia-Pacific countries and the percentage of luxury consumption in Malaysia, from 2006 to 2016, will increase by 350 percent. In addition, it is noted that the consumption of luxury brands in local and global markets have been increasing significantly throughout the worldwide (Danziger, 2005; Karpova et al., 2007; Christodoulides et al., 2009).

Therefore, this research will look at the inverse relationship between materialism and religiosity on the status consumption goods of the Malay Muslim youth in Malaysia.

2. Literature Review

Malaysian Muslim Youth

Malaysia is a country in Southeast Asia that consists of two large regions, Peninsular Malaysia and East Malaysia. The capital city of Malaysia is Kuala Lumpur, while Putrajaya is the seat of the federal government. According to the Muslim Youth Survey Southeast Asia in 2010, the Malaysian population is at 28.7 million and about more than half population (16 million or 60.4 percent) are Muslims. It also consists of 64.4 percent young generations who are in the age of 15 to 64 years old.

In understanding consumer market, Kotler (2010) had stated that the buyer response is strongly influenced by the buyer's black box which is the buyer characteristics and buyer decision process. The buyers characteristics are affected by the buyer response behaviour whether to consume or not a product are cultural, social, personal and psychological factor (Kotler, 2010). Cultural is defined by the Oxford Dictionary as "the ideas, customs, and social behaviour of a particular people or society". Culture, subculture and social class are part and among the terms used in explaining further on cultural definition (Kotler, 2010; S.S.Alam, Rohani & Badrul 2011). The religious group has been a part of subculture as to be referred by buyer in helping them during buying decision process.

Thus religion plays an important role and gives impact to the buyer consumption. In today modern era, with available information and consumers' knowledge, price or promotion (internal factors) is not the only references that makes consumer buy but as well as other external influences. The external factors such as economic, cultural, social and politic has gave impact on the business climate, pattern of buying and

consumer behaviour local and globally. Among of all population, youth group seem to be the largest population especially in Asia (Muslim Youth in Southeast Asia Survey, 2010). They become a source of marketer attraction as a target market in gaining revenues.

Religiosity

Religiosity has been described as a beliefs to God (McDaniel and Burnett, 1990), set of consumption norms (Minkler and Metin, 2004), belief system and practices (Arnold, Price and Zikhan 2004) and moral attitudes (Al-Ansari, 2002). Religiosity can be said when one person has a beliefs to God, he or she will give his or her obligation and commitment to behave what to be expected by their religion. As we know, all religions urge the followers to do good and noble deeds. Thus, religion secures and guides every followers or believer acts in all cases including good relation not only to God but also to other human being. For some countries or society, the religion also can be influenced by culture.

For instance, in Malaysia, marriage custom had been influenced from Hindu and Muslim beliefs. This is due to the history factor which, Hinduism is the first religion to be arrived and embraced in Malaysia. As for the consumption norms, Muslim for example are not suppose to eat pork as it is prohibited by Islam as one of the great sin. Muslim also believes in the "day of judgement" after death. Thus in order to be placed in heaven, they are required to be good devotees in beliefs and practice. Clearly, that beliefs, consumption norms, practices and moral attitude can be influenced by religion and it has its role in each individual and society. A research done by Ateeq-ur-Rehman and M. S. Shabbir (2010) has found that the attitude of Muslim consumers has affected towards the adoption of new products. Therefore, it will be necessary to prove whether the youth especially in Malaysia and Islam in particular where the character is always looking for a challenge and trying new things are been affected to new product adoption as a way of consumption.

Youth, as defined by this survey is to cover the ages of 15-25 years old but there is no available data for this range of age (Muslim Youth in Southeast Asia Survey, 2010). They are easily influenced by the environment and society. These two factors play important roles in shaping their behaviour as consumer and individual especially in

terms of lifestyle, values, religious belief, social relation, political affiliation and many more. This group has grown up in modernization and globalization, thus it makes them easily to absorb and adopt with the fast and latest technology developments. This can be proven when they interested so much on IT and telecommunication gadgets where more than 90 percent of them, own and use mobile or smart phone. Most of them prefer to watch television, listening to music and surfing Internet. (Muslim Youth in Southeast Asia Survey, 2010).

However, Malaysian youth who are Muslim and majority group, hold a strong belief in God (Allah) as from this survey, they answered "to believe in God" had scored 9.88 out of 10.00 scales. More than half (69.3 percent) think that wearing a headscarf is a compulsory for a woman compared to only 0.5 percent think women should not wear headscarf. It has shown that despite Malaysian Muslim youth are demand for modern lifestyle, they still belief in God and religion. As mentioned and research done by Ahasanul, Sabbir and Ismail (2011), beside ethnocentric behaviour, religion has shaped the young Muslim consumers' buying behaviours and had stated that "religion is an essential element of our traditions and is connected to many aspects of individual life and behaviours" (Bailey and Sood, 1993; Lupfer et. al., 1992; McDaniel and Burnnett, 1990; Wilkes et. al., 1986).

Nevertheless, the degree acceptance in religion is depends on the practice and values of specific religion and individual (Assadi, 2003). For example, the Malaysian government and Department of Islamic Development Malaysia (Jakim) are responsible to plan the development and advancement of Islamic affairs in the country, reserve the sanctity of faith and the teachings of Islam, formulate and standardize laws and regulations as well as evaluate and coordinate the implementation of the "syariah" law and administration that related to Islam and Muslim and many more (www.islam.gov.my). Since majority of the Malaysia population is Muslim and Islam, therefore it is an obligation to practice Islam as a ways of life for example belief in Allah as God, performs prayers five times a day, fasting, covering "aura", implementation of "halal" and many more. Islam is the values that they holding accordance with the teachings and guidance of the Quran and Sunnah with the belief that Allah is the Only God and Muhammad is the God's Messenger.

In short that research has proven that religiosity is a strong element of Malaysian youth. Previous research by S.S.Alam, Rohani and Badrul (2011), has shown that religious Muslim do take Islam as their source of reference when making purchase in general to specific product and from the results, they concluded that the purchase decision made by Muslim consumers in Malaysia have great influence from Islam religion (S.S.Alam, Rohani and Badrul, (2011).

Materialism

The growing literature on materialism in the fields of marketing and economic psychology attests to the recognition of its important role in consumer behaviour (Goldsmith et al., 2012).

A materialistic lifestyle appears to be an increasingly important part of the modern living in most countries, in which is catalysed by the forces of marketing and media, technology, travel and migration more than ever before. Cleveland et al., (2011) posits in their research that these agents of global culture "…have fuelled consumerism throughout the world" (Appadurai, 1990), a phenomenon characterised by a "…widespread and unquenchable desire for material possessions" according Ger and Belk, (1996).

Richins (2004) defines materialism (MAT) as "..the importance ascribed to the ownership and acquisition of material goods in achieving major life goals or desired states (p.210). MAT has three main areas: (1) the centrality of possessions in a person's life, (2) possession acquisition as the pursuit of happiness and satisfaction, and (3) the use of possessions to infer success of oneself and others (Richins& Dawson, 1992).

Prendergast and Wong (2003) investigated the relationships of materialism and expenditure and social consumption motivations and expenditure. Social motivation and materialism appear to be important factors in making decisions (Heaney et al., 2005). Previous findings positively relate prestige sensitivity to social consumption motivation (Gil et al., 2011).

Scholars have proposed several antecedents that promote the development of materialistic tendencies according to Goldsmith et al., (2012). Although according to Giddens et al., 2009, there does not seem to be a genetic origin for materialism; evolutionary psychologist argue that the desire for material goods stems from evolved survival strategies among modern human ancestors (Saad & Gill, 2000). Goldsmith et al., (2012) referred to political sociologist, Inglehart (1990) for arguing that materialism is a preoccupation in favour of lower order needs for material comfort and physical safety to the neglect of high order needs such as self-expression, belonging and quality of life. These materialistic impulses derive from early life experiences of deprivation.

Goldsmith et al., (2012) has also quoted from other researchers such as Ahuvia & Wong, 2002 and Kasser, 2002; in which argues that consumer culture, the emphasis in the media and by other socializing agents on buying, owning and possessing material goods, can be identified as a mainspring of materialism. The Social Comparison theories stress the influence of other people and the comparisons consumers make with the reference groups on encouraging materialistic tendencies (e.g. Dittmar, 1992). Previous research has indicated that materialism is important in both public and personal contexts, because an individual is able to identify with a particular status group and increase personal development of his or her own self-esteem (Heaney et al., 2005; Prendergast & Wong, 2003).

Eastman et al., (1999) show that materialism is strongly related to seeking social status by acquiring goods among United States college students, and Heaney et al. (2005) replicated study in Malaysia and found the same findings amongst the students. This present paper would like to extend the research specifically among the Muslim youth in Malaysia, and analyse to the context of inverse relationship of materialism and religiosity.

Malaysian Muslim Youth and Materialism

The youth market has been always the favourite segment for a lot of industries. Researchers have suggested that teenagers are lavish spenders when it comes to branded and luxury products (Piacentini & Mailers, 2004; Tan, 1999; Taylor & Consenza, 2002). Although the researcher like Piacentini and Mailer (2004) and

Wong and Ahuvia (1998) have indicated that western teenagers are more likely to be involved in luxury consumption; new studies in the Asian perspective are growing rapidly too. A study by Durvasula and Lysonki (2010) indicated as China is undergoing radical change of industrialization and modernization, money is taking an increasingly important role especially among the young Chinese and has a direct significant relation with the growing materialistic culture. As of the Malaysian context there is still a scant literature in area of materialism and the youth.

Moore and Moschis (1981) in their research had indicated that age is a very strong predictor of materialistic values. Their findings were later confirmed by Belk (1985) in showing significant relation between age and materialism. In this context it is crucial to determine if this finding can be applicable to the Malaysian Muslim youth.

Workman and Lee (2010) mentioned that decision making by both male and female consumers is influenced not only by external motives (e.g. advertising appeals to social status), but also by a number of internal motives (e.g. vanity, public self-consciousness) as quoted in the study by Fenigstein et al., 1975; Netermeyer et al., 1995. The literature review on fashion consumer groups and gender would suggest that vanity is a construct that might be helpful in explaining their consumer behaviour (Park et al., 1999; Beaudoin et al., 2000; Workman & Studak, 2006, 2007).

Consumer decisions are often motivated by internal needs including the need for others' approval (Roth, 1995; Durvasula et al., 2001). Individuals who are high in public self-consciousness care about how others perceive them. Publicly self-conscious consumers are likely to be concerned about fashion and their appearance (Miller & Cox, 1982). Due to one's self-view and concern with appearance can be affected by comparison with others, there is reason to believe that social comparison theory can enlighten our understanding of how vanity motivates consumer decision making in particularly materialism.

Research has also shown that higher urge to purchase has been found in individuals with low self-esteem (Shoham&Brencic, 2003; D'Astous, 1990). A higher degree of materialism has been found among consumers that splurge on expensive tangible items which later results in post-purchase guilt emotions (Fitzmaurice, 2008). In many

cases splurge spending is often undertaken to keep up with peer pressure (Rutherford & DeVaney, 2009).

Synthesizing from the studies above, it is concluded that among the youth there is a need to maintain a preferred social image among peers that leads to materialistic culture that catalyses status consumption spending. Even in Muslim majority countries like Malaysia, where religion plays an important role in the decision making process, the degree of influence overshadows the act of compulsive spending of status consumption goods.

3. Discussion and Conclusion

As studies on youth is increasingly an interest to Malaysian scholars in particular on their financial behaviour (Bakar et al., 2006; Ibrahim & Isa, 2009; Sabri et al., 2008). Few researchers (Kamaruddin & Mokhlis, 2003; Masud at al., 2004) have examined the financial behaviour in Malaysia on the basis of gender; however the study on status consumption goods, influenced by Materialism and Religiosity are scarce.

The primary goal of this paper was to examine the relationship Materialism (MAT) and Religiosity and the purchase intention of status consumption goods. With the review of the literature, there is an inverse relationship of Materialism and Religiosity towards the purchase intention.

The findings of this research would shed light to scarce literature in Malaysia pertaining to the area of the study. To date, most of the research area is generated and tested in Western countries like the United States. An important theoretical contribution pertains to the application of marketing constructs and models in overseas settings, with the aim of augmenting consumer behaviour theory across cultures. From the practical perspective the government, education system and religious institutions can play an active role in curbing the high spending which is commonly resulting in high debts in Malaysia (Nga et al., 2011). The implication of this study is there is a need for more relevant financial planning education role and reinforcement from the relevant religious bodies to enforce the message to the Malaysian Muslim youth

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THE INFLUENCE OF SELF CONGRUITY ON CONSUMER SATISFACTION

Syadiyah Abdul Shukor[1]

Abstract

Self congruity refers to the match between consumers' self-concept and the user image (or "personality') of a given product, brand or store. Research indicates that self congruity can affect various consumer behaviours. This paper reports findings from a research study which was conducted to determine the effect of self congruity on consumer satisfaction. A questionnaire was sent to 222 British Muslims in the UK. Results indicated that self congruity was a predictor of consumer satisfaction. Respondents with higher levels of self congruity showed higher levels of satisfaction as compared to those with lower levels of self congruity. Limitation and recommendation for future study are discussed at the end of the paper.

Keywords: Self congruity, Consumer satisfaction.

1. Introduction

Consumer self concept researchers have long theorized that a product-user image interacts with the consumer's self concept generating a subjective experience referred to as "self image congruence" (Sirgy et al., 1997). "Self image congruence", "image congruence", "self congruence", and "self congruity" are used interchangeably in the consumer behaviour literature. According to the theory of self congruity, consumers prefer product or services that similar to their self concept. In other words, consumers are more likely to purchase product or brand that is congruent with its self concept.

A review of the literature suggests that self congruity affects consumer behaviours such as attitude (Sirgy et al., 1997, Sirgy, 1982, Kleijnen et al., 2005, Graeff, 1996), purchase intentions (Ericksen, 1996, Graeff, 1996, Hong and Zinkhan, 1995) and product evaluation (Graeff, 1996, Quester et al., 2000). Despite efforts to investigate the relationship between self congruity and pre purchasing behaviour, only a limited number of studies have been conducted to measure the influence of self congruity on post purchase behaviours such as consumer satisfaction. Studies have indicated that

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consumer satisfaction is a desired outcome of marketing activities because satisfaction reinforces consumers' loyalty, affect the likelihood that consumers will buy the product again (Szymanski and Henard, 2001, Cronin Jr et al., 2000, Anderson and Sullivan, 1993, Oliver, 1980) and increase consumer intention to revisit a store (Kincade et al., 1992). In addition, satisfied consumers tend to spread good word of mouth about the company (Szymanski and Henard, 2001, Reynolds and Beatty, 1999) and it is linked to profitability (LaBarbera and Mazursky, 1983, Fornell, 1992). On the other hand, dissatisfied consumers may negatively impact the retailers (Kincade et al., 1992) as it leads to public complaints, negative word of mouth communication, and change in terms of consumer shopping behaviour (Day, 1977).

Therefore, this paper aims to investigate the effect of self congruity on consumer satisfaction. The paper begins by reviewing the concept of self congruity and consumer behaviour. Then, methodology used for data collection is described. This is followed by results and findings section. Finally, conclusion, limitation and recommendation are presented at the end of the paper.

2. Self Congruity and Consumer Behaviour

Consumer self concept researchers have long theorized that a product-user image interacts with the consumer's self concept generating a subjective experience referred to as "self image congruence" (Sirgy et al., 1997). "Self image congruence", "image congruence", "self congruence", and "self congruity" are used interchangeably in the consumer behaviour literature. According to the theory of self congruity, consumers prefer product or services that similar to their self concept. In other words, consumers are more likely to purchase product or brand that is congruent with its self concept.

The positive relationship between self congruity and product preference has been supported by a number of researchers (Kleijnen et al., 2005, Ericksen, 1996, Heath and Scott, 1998, Jamal and Goode, 2001) for different types of products and services such as automobiles, magazines, jewellery, clothing and retail banking services. The results from this research suggest that consumers are often more likely to prefer products or brands that have images similar to their own self concept. The studies also suggest a purchase is not likely to take place when there is incongruence (Onkvisit

and Shaw, 1987). Furthermore, where incongruence exists and a purchase does take place, consumers are unlikely to repeat such a purchase (Onkvisit and Shaw, 1987).

In addition, previous research also indicates that self congruity can affect consumers purchase intentions (Graeff, 1996, Ericksen, 1996, Hong and Zinkhan, 1995). For instance, Ericksen (1996) in her study involving European consumers related to an American automobile, the Ford Escort, found that a relationship did exist between self image congruency and intention to purchase the automobile. That is, the more closely a product's image matches the buyers' self concept, the higher purchase intention is for that product. Other studies (Graeff, 1996, Hong and Zinkhan, 1995) examining the effect of self image congruence on purchase intentions also show the same findings. The studies showed that purchase intention was found to be stronger for respondents whose self concept and perceived brand image are congruent.

Besides that, other researchers (Graeff, 1996, Quester et al., 2000) suggest that self image congruence is positively related to consumers' product evaluation. Study by Graeff (1996) demonstrated that congruence between self image and brand image is positively related to consumers' product evaluations in different product categories which include footwear, automobiles, beer and magazine. His study suggests that consumer's positively evaluate a product for respondents whose self concept and perceived brand image are congruent.

Kleijnen et al. (2005), Sirgy (1982), Ericksen (1996) and Sirgy et al. (1997) found that self image congruence facilitates positive word of mouth and attitudes towards products. For instance, Kleijnen et al. (2005) examine the effect of self congruity on attitudes and intentions to adopt wireless services. They found that self image congruence have a substantial effect on consumers' attitudes. The same findings were supported in Graeff's (1996) study whereby higher customer's self congruity had more favourable attitudes towards advertising than those with lower self congruity.

The significance of self congruity has also been demonstrated in the selection of retail stores (Stern et al., 1977, Ibrahim and Najjar, 2007). Stern et al. (1977) and Ibrahim and Najjar (2007) findings strongly support the proposition that consumers tend to patronize those stores where characteristics are seen as congruent with their self

concept, while staying away from stores that are perceived to be different from their self perception.

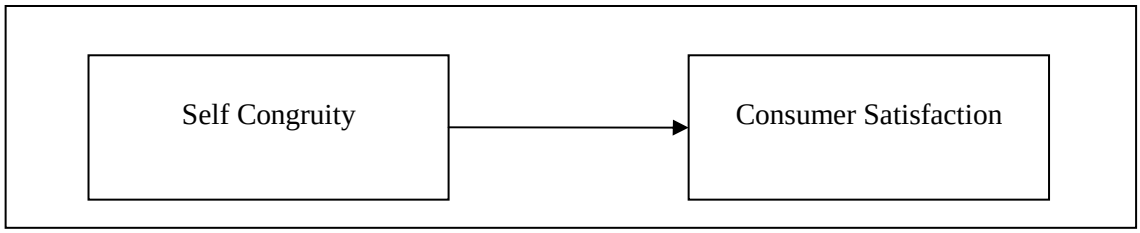
The significance impact of self image congruence has also been explained in advertising effectiveness (Hong and Zinkhan, 1995). In the study, advertising effectiveness has been conceptualized as brand memory, brand attitude and purchase intentions. Their results indicate that brand memory is not mediated by the extent to which advertising expressions are congruent with viewers' self concept. However, brand preference and purchase intention were shown to be influenced by the self congruency of an advertisement.

Limited studies have examined the effect of self image congruence on post purchase behaviours such as consumer satisfaction and loyalty. Indeed, studies have also shown that, self image congruence can lead to consumer satisfaction (Sirgy et al., 1997, Jamal and Goode, 2001, Ibrahim and Najjar, 2007, Litvin and Kar, 2004, Chon, 1992). For instance, study conducted by Jamal and Goode (2001) suggest that match/fit between the consumers' self concept and product image was a good predictor of consumer satisfaction in the precious jewellery market in the UK. The same results was found by Litvin and Kar (2004) and Chon (1992) whereby tourists who perceived a low discrepancy between a destination's user image and his or her self image were most satisfied with the destination. On the other hand, the tourist who perceived a high discrepancy between a destination's user image and his or her self image were least satisfied. This situation occurs because the greater the congruity of self concept with a particular product, the greater the likelihood that the product will satisfy a consumer (Heath and Scott, 1998). The significant effect of self image congruence on consumer satisfaction has also been found in study conducted by Ibrahim and Najjar (2007) for retail store. Following the previous results, it is expected that self congruity is positively related to consumer satisfaction. Therefore, it is hypothesised that:

H1: Self congruity is positively related to consumer satisfaction.

The conceptual model developed for this study is graphically shown in Figure 1. The model posits self congruity affects consumer satisfaction.

Figure 1: Conceptual Framework



3. Methodology

In this study, self congruity was operationalized using items used by Sirgy et al. (1997) while consumer satisfaction items were taken from (Hellier et al., 2003). All items were measured on a seven point Likert scale ranging from '1' (strongly disagree) to '7' (strongly agree) and respondents were asked to state the degree of agreement for each statement given. The data collection process for quantitative research was conducted over a period of six weeks. For the purpose of this study, web based questionnaires was used as the main data collection method. The respondents were selected using a non probability sampling; a combination of self selection and snowballing. These individuals were approached in social network (Facebook) either through personal invitation or group invitation. It must be noted that sampling frames were collected from members of group of interest located in the online social network (Facebook). The decision to construct a sampling frame from social networking was made because young people in the UK is actively involved in using the internet (UK National Statistics, 2007). Furthermore, social networking has become a mainstream online activity among all age groups in the UK and the penetration was highest amongst 25 to 34 year olds (89%) and 15 to 24 year olds (86%) (comScore, 2009).

4. Findings and Discussion

Respondents' profile

The net number of usable survey questionnaire was 222. As illustrated in Table 1, 82.6% of the respondents were female while 17.4% were male. There were high numbers of female respondents because this study focuses on clothing as the product category. According to Weekes (2001), 92% of young adults women in the UK tend to place more emphasis on clothes shopping. Therefore, this could be the reason that contributed to the high number of respondents among females compared to male

respondents. The information on marital status of respondents demonstrated that more than half (78.2%) were single, followed by married/living with partner (19.9%) and divorced (1.9%). With regards educational background, majority of respondents obtained undergraduate degree (53.4%).

Table 5: Demographic Profile of Respondents

Demographic Variables	**Category**	**Sample (N=222)**	
		Frequency	**(%)**
Gender	Male	36	17.4
	Female	171	82.6
Marital Status	Single	161	78.2
	Married/Living with partner	41	19.9
	Divorced	4	1.9
Occupation	Student	129	62.3
	Housewife/husband	12	5.8
	Professional/senior management	30	14.5
	Clerical staff	8	3.9
	Technical staff	5	2.4
	Self employed	6	2.9
	Unemployed	12	5.8
	Other	5	2.4
Education	GCSEs/ O Level	11	5.4
	A Levels	36	17.6
	Professional Qualification/Diploma	21	10.3
	Undergraduate degree	109	53.4
	Postgraduate degree	27	13.2

Regarding the respondents occupation, the largest group comprised of student (62.3%), followed by professional/senior management (14.5%), unemployed (5.8%), housewife/husband (5.8%), clerical staff (3.9%), self employed (2.9%), technical staff (2.4%), and others (2.4%). With regards educational background, majority of respondents obtained undergraduate degree (53.4%). While others attended at least high school and obtained qualifications to GCSEs/O Level (5.4%), A Levels (17.6%), professional qualification/diploma (10.3%), and postgraduate degree (13.2%).

Regression Analysis

Table 2 shows results of regression analysis. The results showed that self congruity contributed to consumer satisfaction (Beta=0.166, t=3.281, p=0.001). Hence, H1 is accepted. This result is parallel to that by Sirgy et al. (1997) and confirmed the

finding of Jamal and Goode (2001), in their study of the relationship between self congruity and consumer satisfaction.

Table 2: Regression with Consumer Satisfaction as a Dependent Variable for Self Congruity

Hypothesis 1	Self Congruity → Consumer Satisfaction (+)		
Results			
	Standardised Coefficients B	**t-value**	**p-value**
Self Congruity	0.166	3.281	0.001
Model Statistics			
R^2 =0.054	Adjusted R^2 = 0.049	F-value = 10.767	

5. Conclusion, Limitation and Recommendation for Future Research

This study aims to investigate the effect of self congruity on consumer satisfaction. Results showed that self congruity is positively related to consumer satisfaction. The results obtained from this empirical work must be interpreted in the light of the study's limitations. Firstly, snowball sampling method was used to recruit respondents in this study for quantitative research. This sampling method requires the existing respondents to recruit future respondents from among their families and friends. If the respondents distributed the survey to friends or families with similar values, this may have caused a potential bias. In this study, data was collected through web based questionnaire whereby respondents were asked to complete the questionnaire on their own. This method was employed because errors in the coding of answers can be avoided (Bryman and Bell, 2007) but on the other hand, it is hard to measure the response rate, and the respondents may fill out the questionnaire arbitrarily. Generally, the results generated from this study should be interpreted carefully with consideration to limitations. Future studies involving a representative sample from different countries and demographic profile, as well as additional questions, would improve the validity of results.

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ANTECEDENTS AND CONSEQUENCES OF CUSTOMER SATISFACTION TOWARDS ISLAMIC PAWN BROKING

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Hisham Sabri

Abstract

The introduction of Islamic pawnbroking (i.e. Ar-Rahnu) in Malaysia is seen as a new micro credit instrument as it provides a financial product for the lower income group and small businesses which usually have limited capital or have been excluded from the financial system. This study reviews literature related to customer satisfaction with the aim to empirically test a conceptual model of antecedents and consequences of customer satisfaction towards Ar-Rahnu. Based on the literature, it is proposed that service quality (core, relational and tangible) leads to customer satisfaction towards Ar-Rahnu and will lead to repurchase intention, loyalty and word of mouth. In order to achieve the aim of this study, this research will involve two phases of data collection; qualitative and quantitative phase. Focus groups will be carried out with the aim of exploring antecedents and outcomes of customer satisfaction towards Islamic pawnbroking service and to develop items for the survey questionnaire. The quantitative phase will involve data collection via survey questionnaire. Once data for the present study is collected, analysis will be done using Structural Equation Modelling (SEM). This research intends to make contribution to both theory and practice of marketing by providing marketing implications concerning the targeting of Ar-Rahnu customers.

Keywords: Ar-Rahnu, Customer Satisfaction.

1. Introduction

The first Islamic pawnbroking in Malaysia was established by the Terengganu State Government by the name of Muassasah Gadaian Islam Terengganu (MGIT) in 1992. The establishment of MGIT is to provide immediate financing to assist individual in overcoming cash flow needs through methods which are considered *halal* by the *Shari'ah* regulation (Majlis Agama Islam dan Adat Melayu Terengganu, 2012). Ever since the introduction of Islamic pawnbroking, the demand for it increases continuously.

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Researchers have shown interest to study the Islamic pawnbroking, however, despite the increasing quantity of research, the findings and knowledge on Islamic pawnbroking are limited on consumer awareness on Islamic pawnbroking (Appannan and Doris, 2011) and factors influence utilisation of the service (Appannan and Doris, 2011, Amin, 2011). Little empirical research has investigated antecedents and outcomes of customer satisfaction towards Ar-Rahnu. Studies have reported that customer satisfaction is a desired outcome of marketing activities (Anderson and Sullivan, 1993, Szymanski and Henard, 2001). Customer satisfaction can be considered the essence of success in today's highly competitive world of business (Jamal and Naser, 2002). Consequently, customer satisfaction is increasingly becoming a corporate goal as more and more companies strive for quality in their products and services. Hence, it is of paramount importance to assess the antecedents and consequences of customer satisfaction towards Islamic pawnbroking in Malaysia.

This paper aims to present an overview of literature that is relevant to customer satisfaction and propose some research propositions that will be empirically investigated by data collected from Ar-Rahnu consumers. The paper begins by providing literature on customer satisfaction. This includes defining the concept of customer satisfaction and reviewing antecedents and outcomes of customer satisfaction. Then, the next section addresses the proposed conceptual framework. Finally, a brief discussion on methodology and conclusion will be presented at the end of the paper.

Customer Satisfaction

Studies indicate that customer satisfaction is a desired outcome of marketing activities because satisfaction reinforces consumers' loyalty, affect the likelihood that consumers will buy the product again (Anderson and Sullivan, 1993, Cronin Jr et al., 2000, Oliver, 1980, Szymanski and Henard, 2001) and increase consumer intention to revisit a store (Kincade et al., 1992). In addition, satisfied consumers tend to spread good word of mouth about the company (Reynolds and Beatty, 1999) and it is linked to profitability (LaBarbera and Mazursky, 1983, Fornell, 1992). On the other hand, dissatisfied consumers may negatively impact the retailers (Kincade et al., 1992) as it leads to public complaints, negative word of mouth communication, and change in terms of consumer shopping behaviour (Day, 1977).

From the marketing literature, it is generally accepted that customer satisfaction is the essence of success in today's highly competitive world of business (Jamal and Naser, 2002), however, researchers have defined satisfaction in various ways. As noted by Oliver (1997), "Everyone knows what satisfaction is until asked to give a definition. Then it seems, nobody knows". This statement shows that there is still lack of consensus in terms of its definition (Giese and Cote, 2000). For instance, Garbarino and Johnson (1999) view satisfaction as overall evaluation based on the total purchase and consumption experience with a good or service over time while Fornell (1992) defined satisfaction as an overall post purchase evaluation. Oliver (1997) views satisfaction as a consumer's overall emotional response to the entire service experience for a single transaction at the post purchasing point. Churchill and Suprenant (1982) have conceptualised satisfaction as an outcome of purchase and use resulting from the buyer's comparison of the rewards and costs of the purchase in relation to the anticipated consequences. LaBarbera and Mazursky (1983) have defined the construct as an evaluation on the surprise inherent in a product acquisition and/or consumption experience and Spreng et al. (1996) defined the term as an affective state that is the emotional reaction to a product or service experience.

Although these definitions differ, Giese and Cote (2000) noted that there are some areas of consensus among the different definitions. Firstly, customer satisfaction is treated as a response to an evaluation process. Secondly, customer satisfaction can occur at certain time such as at purchase or product consumption or post consumption (Oliver, 1981). Last but not least, there are at least two common formulations of satisfaction – one is transient (transaction-specific) while the other is overall (or cumulative) satisfaction. Transactional satisfaction is defined as the post choice evaluative judgment of a specific purchase occasion (Oliver, 1980, Oliver, 1993), whereas cumulative customer satisfaction is an overall evaluation based on the total experience (Fornell, 1992, Johnson and Fornell, 1991). For the purpose of this study, customer satisfaction is addressed at macro level (overall satisfaction). Specifically, for the purpose of this study, customer satisfaction refers to customer satisfaction towards Ar-Rahnu.

Antecedents of Customer Satisfaction

A review of the literature suggests that customer satisfaction is often closely associated with many factors. For instance, research on customer satisfaction has largely relied on the disconfirmation paradigm, that is when customers perceived the product performing better than expected, they became more satisfied (Churchill and Suprenant, 1982). Other researchers linked customer satisfaction with the measurement of service quality (Anderson and Sullivan, 1993, Cronin Jr and Taylor, 1992, Rust and Oliver, 1994).

Service quality refers to customers' overall impression of the relative inferiority/superiority of the organization and its services (Bitner and Hubbert, 1994). Previous studies suggest that service quality is not a uni-dimensional construct. Rather, service quality incorporates a number of dimensions such as reliability, tangibles, responsiveness, assurance and empathy (Parasuraman et al., 1985, Parasuraman et al., 1988). However, there are two overriding dimensions of service quality (Gonroos, 1984, Levesque and McDougall, 1996). The first one refers to the core aspects of the service (e.g. reliability) and the second one refers to the relational or process aspects of the service (e.g. tangibles, responsiveness, assurance and empathy (Parasuraman et al., 1991). Therefore, in this study, it is proposed that both the core and relational dimensions of service quality are likely to be antecedents of customer satisfaction.

Service customers such as Ar-Rahnu often make inferences about the service quality on the basis of tangibles (the buildings, the physical layout etc.) that surround the service environment (Bitner, 1990). For instance, Dabholkar, Thorpe, and Rentz (1995) reported that the tangible aspects of department stores do influence customers' perceptions of service quality. Similarly, in the context of this study, it is proposed that the tangible dimension of service quality is also likely to be an important factor in developing customer satisfaction.

Outcomes of Customer Satisfaction

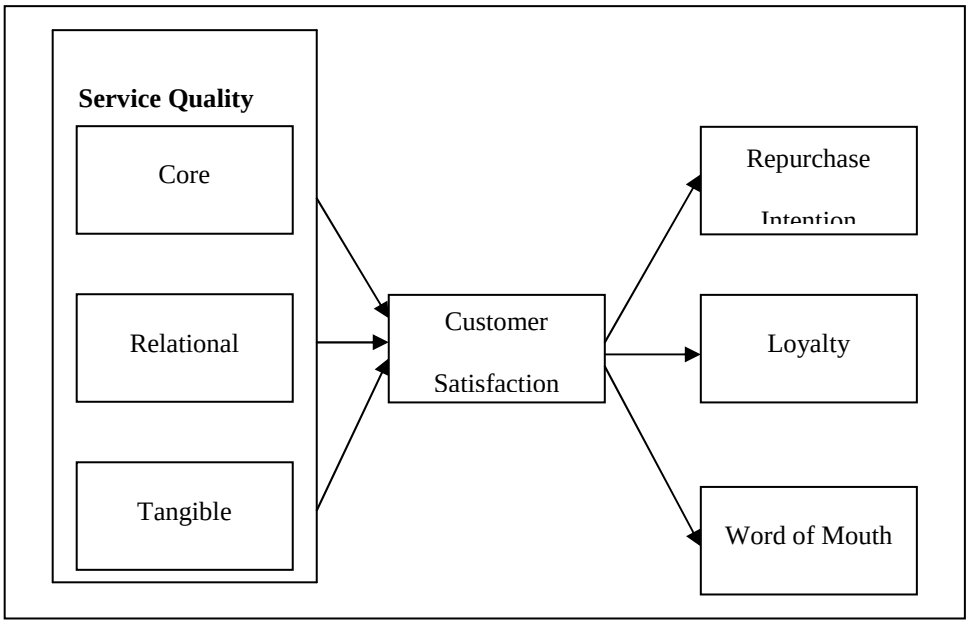
Szymanski and Henard (2001) in their meta analysis findings on customer satisfaction reported that only a few outcomes of satisfaction have been investigated and no studies have investigated the outcomes of customer satisfaction towards Ar-Rahnu.

Previous research showed that repurchase intention, loyalty and word of mouth are important outcomes of customer satisfaction (Anderson and Sullivan, 1993, Cronin Jr et al., 2000, Kincade et al., 1992, Reynolds and Beatty, 1999, Szymanski and Henard, 2001). Hence, it is expected that customer satisfaction to be related to repurchase intention, loyalty and word of mouth in the context of this research.

2. Conceptual Framework

On the basis of the review of the literature, a conceptual model for this study is developed as illustrated in Figure 1. The model posits that service quality (core, relational and tangible) leads to customer satisfaction towards Ar-Rahnu. Customer satisfaction will lead to repurchase intention, loyalty and word of mouth. The model also introduces the variable of demographic factors such as gender, level of education and occupation in explaining customer satisfaction towards Ar-Rahnu.

Figure 1: Proposed Conceptual Framework



3. Methodology

This study will involve two phases of data collection; qualitative and quantitative phase. The qualitative phase will involve focus group method. Focus groups will be conducted with the aim of exploring antecedents and outcomes of customer

satisfaction towards Islamic pawnbroking and to develop items for the survey questionnaire development.

The quantitative phase will involve data collection via survey questionnaire. Survey questionnaire will be distributed to customers utilizing Ar-Rahnu service. Once data for present study is collected, analysis will be done using SEM. This statistical analysis is chosen because it estimates interrelated dependence relationships in a single model, it has the ability to represent unobserved concepts in these relationships, and it is able to correct for measurement error in the estimation process. In addition, SEM allows the researcher to validate the measurement model before making any attempt to evaluate the structural model. SEM provides a better way of empirically examining a theoretical model by involving both the measurement model and the structural model in one analysis.

4. Conclusion

This paper is based on an on going research and therefore, the research propositions reported here are based on the current findings on literature review. The research aims to empirically test a conceptual model of antecedents and outcomes of customer satisfaction towards Ar-Rahnu. This model will help institutions providing Ar-Rahnu service in satisfying their customers. Findings from this research will also be useful to attract customer patronising Ar-Rahnu instead of the convential pawn broking. It is hoped that by understanding antecedents and outcomes of customer satisfaction towards Islamic pawnbroking will be able to eliminate the informal lending activities such as 'loan shark' or 'along' which have clearly opressed and victimised the lower income group.

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FACTORS INFLUENCE SWITCHING BEHAVIOR OF ISLAMIC BANK CUSTOMERS: DOES SYARIAH ISSUE MATTER?

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Abstract

An Islamic bank is now not only facing competition from its peer Islamic banks but also from conventional bans, which offer Islamic banking products through their Islamic subsidiary. When the competition becomes tougher, customers are given more options to choose their banks and switch from their current bank to other Islamic banks. Thus, the objective of this study is o evaluate factors influence the switching behavior of Islamic banking customers, in the case of Malaysia, based on the *syariah* compliance issues. Using logistic regression, the results show that the customer's religion, type of account, and whether or not they have account in conventional bank are the significant factors to influence their switching behavior when they encounter non-syariah products and practices in their Islamic bank.

Keywords: Islamic banking, switching behavior, *syariah* issues, logistic regression.

1. Introduction

In spite of the current vagueness in the global financial market, the Islamic banking and finance industry has continued to retainhigher performance. Growth estimates for the industry have remained impressive, ranging from 15 percent to 20 percent per annum. According to the UK Islamic Finance Secretariat, part of the CityUK lobby group, the global market for Islamic finance at the end of 2011 was worth around $1.3 trillion. The total value of s*haria*-compliant assets has grown by 150% since 2006 with banks hold over 90% of Islamic assets.

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The sustained demand for the Islamic banking and finance services during the current global financial markets uncertainties can partly be attributed to the increasing interest from the conventional investors who are considering these services as viable alternatives to those of the conventional banking and finance. As a result of the increased customer demand, many of the conventional financial services providers have started to offer Islamic banking products and services either through the Islamic banking windows or establishing a full-fledged Islamic subsidiary.

Due to these developments, the industry now comprises of larger number of players, resulting in stiffer competition not only among the Islamic banking institutions, but also from the conventional banks that are offering the Islamic banking products. The integration of the Islamic financial institutions into the global financial market has also resulted in competition from the international players. In this very challenging environment, it is vital for the Islamic banks need to improve on their services and expand the customer base by attracting new customers as well as retaining the existing ones. Maintaining the existing customer is particularly demanding in the era of advanced information and communication technology since it is relatively easy for the customers to gather the various information on the options of banking services that are available in the market. Also, the increased consumer sophistication in the context of modern banking is posing a great challenge for the Islamic banks. As competition intensifies, customer's satisfaction on service quality becomes highly critical, thus becoming the deciding factor for the customers whether to stay on or to switch to another bank (Naser et al., 1999). In this regard, the ability of banks to retain existing customer, in addition to attracting new ones, is a major factor determining the Islamic banks' performance and survival in the industry.

Thus, the ability to ensure long-term customer relationship is highly critical for the survival of the banking institutions. Banking institutions resort to various strategies to retain their customers since the customers are able to "switch" from one institution to another that are deemed able to offer them better services. Furthermore, the cost of acquiring new customers is relatively high, but the probability that they would stay is quite low. Amid the intensifying competitive pressure among the financial services providers, considerable attention is given towards establishing "customer loyalty" to ensure or long-term relationship between the service providers and their customers. In

this regard, investigating switching intentions among customers enables the service providers to implement suitable marketing strategies for their customers.

2. Literature Review

Empirical studies on consumption market show that, customer satisfaction is positively correlated with repeat purchase intention (Oliver & Swan, 1989; Taylor & Baker, 1994). So, improving customer retention rate or at the same time is decreasing the switching rate, is the main target in customer satisfaction management (Fornell, 1992).

Customer Satisfaction in Islamic Banking

Customer satisfaction is a measure of how organization's total product performs in relation to a set of customer requirements (Hill and Alexander, 2006). In the banking industry, as competition increases its level, banks should be more focusing on increasing customer satisfaction and customer retention by improving the service quality level of their banks (Goode and Moutinho, 1996).

Levesque and McDougall (1996) argues that customer satisfaction is essential for retail banks as it has an impact on the organization's profit. Furthermore, in today's competitive environment, providing quality service is an essential strategy for success and survival (Liang and Wang, 2004). In line with this, Trubik and Smith (2000) and Garland (2002) identify direct and strong relationship between customer loyalty and customer profitability in retail banking, while Wisskirchen et al (2006) found that long-term growth and profitability of banks rely on banks' ability to attract and retain loyal customers.

In term of service quality dimensions in the financial services industry, there were various dimensions have been revealed. Parasuraman et al. (1985), for instance, identify 11 dimensions of service quality which are reliability, responsiveness, competence, access, courtesy, communication, credibility, security, competence, understanding the customer, and tangibles. However, based upon their findings, Berry et al. (1985) and Zeithaml and Bitner (1996) indicate that service quality consists of five dimensions which are tangibles (appearance of physical facilities, equipment,

personnel, and written materials), reliability (ability to perform the promised service dependably and accurately), responsiveness (willingness to help customers and provide prompt service), assurance (knowledge and courtesy of employees and their ability to inspire trust and confidence), and empathy (caring and individual attention the firm provides its customers).

In the case of Islamic banking, papers attempted to study customer satisfaction upon Islamic banking service quality are still scanty. Among those are papers written by Naser et al (1999), Al-Tamimi and Al-Amiri (2003), Okumuş (2005), Abdul Kader and Norizan (2009), Osman et al (2009), Hossain and Leo (2009), Golmohammadi and Jahandideh (2010) and Abduh (2011).

Those studies reveal that customers of Islamic banking are showing considerable degrees of satisfaction and dissatisfaction from many Islamic bank's facilities, services, and products in various countries. The customers are aware of specific Islamic banking products such as murabaha, musharakah, and mudarabah; however, Naser et al. (1999) and Okumuş (2003) find that those customers only deal with some of them. The service quality dimensions uncovered by those studies are similar with what has been done within the conventional banking framework except for Abduh (2011) which recognizes syariah compliant dimension.

In terms of ranking the importance level of the service quality dimensions, many studies from different countries have presented different results. For instance, Al-Tamimi and Al-Amiri (2003) in UAE, Hossain and Leo (2009) and Abdul Kader and Norizan (2009) in Qatar find that tangibles and empathy are the most important dimensions. In Iran, Golmohammadi and Jahandideh (2010) confirms that reliability is the most important dimension and tangible is the least important dimension for Iranian customers. Abduh (2011) verifies that the Islamic banking customers in Indonesia perceived syariah compliant and convenience as the most important dimensions of Islamic banking.

Customer Switching Behavior in Islamic Banking

Within the conventional banking framework, switching behavior of bank customers is modeled together with perceived value and customer satisfaction. Woodruff (1997)

states that perceived value represents customer cognition of the nature of relational exchanges with their service providers, and satisfaction reflects customers' overall feeling derived from the perceived value while Varki and Colgate (2001) shows that customer value impacts customer satisfaction and there is an inter-linkage between perceived service value, customer satisfaction evaluation and intention to switch to other service providers. Similarly, findings from Wang et al. (2004) and Oh (1999) support the direct influence of customer perceived value on customer satisfaction and loyalty towards financial institutions.

In the case of Islamic banking services, Hashim and Latifah (2010) studies the relationship between customer perceived value, relationship quality and switching intention among Islamic banking customers in Malaysia. Using 456 observations, Hashim and Latifah (2010) evidences that customer perceived value significantly influence the level of customer satisfaction which then affecting the intention to switch. The relationship between customer perceived value and the level of customer satisfaction is positive whereas the relationship between the level of customer satisfaction and switching intention is negative.

In Indonesia, Suryani and Chaniago (2011) conducts a field survey towards Islamic bank customers in Surabaya in order to find the switching behavior among the Islamic bank customers. By using exploratory factor analysis, the result indicates that there are five factors that underlying customer switching behavior in Islamic banking services, namely: bank-customer relationship, syariah compliance issues, service quality, switching cost and risk perceived by customers. In addition, discriminant analysis shows that intention to retain is significantly affecting the customers' switching behavior in Islamic banks.

Therefore, the objective of this research is to study the customer switching behavior in the Malaysia Islamic banking industry. As to narrow and focus the discussion, this paper analyzes only the customer switching behaviorwith regard to the issues of *syariah* compliance in the Islamic banking products and practices. It is conducted in Klang Valley area of Malaysia using self-administered questionnaire distributed to more than 600 Islamic banking depositors. The number of usable questionnaires is

500 which reflects 83.33% response rate. The statistical method used is binary logistic regression.

3. Research Method

Regression analysis (OLS) has become an important method of inferential statistics used with any data analysis concerned with describing the relationship between a response variable and one or more explanatory variables. Many journal papers had been produced under this technique, either utilizing it as an analytical tool to cut into pieces the cake of data or to develop a new advanced technique based upon OLS ideas and therefore can be applied in a particular circumstance.

Amongst the techniques developed under the regression analysis framework is logistic regression. Hosmer and Lemeshow (2000) and Studenmund (2006) enlighten what distinguishes a logistic regression model from the OLS model, which is that the outcome variable in logistic regression is binary or dichotomous, whereas in OLS, it is a continuous numerical data. It is an estimation technique for equations with dummy dependent variables that avoids the unboundedness problem of the linear probability model by using a variant of the cumulative logistic function.

Model specification

There are a number of distribution modelsthat are suggested to be used in the analysis of a dichotomous dependent variable. However, the logistic model is the most widely used by researchers worldwide. Cox and Snell (1989) in Hosmer and Lemeshow (2000) mentioned two primary reasons for choosing the logistic distribution; firstly, from a mathematical point of view, it is an extremely flexible and easily used function, and secondly, it lends itself to a clinically meaningful interpretation.

In linear regression, we assume that the mean may be expressed as a linear equation in x (or some transformation of x or Y), such as

$$E(Y \mid x) = \beta_0 + \beta_1 x \qquad (1)$$

This expression shows that it is possible for $E(Y \mid x)$ to take any value as x ranges between -∞ and +∞. However, in the logistic regression model, the specific model used is:

$$E(Y \mid x) = \pi(x) = \frac{e^{\beta_0 + \beta_1 x}}{1 + e^{\beta_0 + \beta_1 x}} \tag{2}$$

where, e = euler's number (2.7183)

πx = function of x in logit model

And in order to give a meaningful interpretation, $E(Y \mid x)$ is transformed with logit transformation to become:

$$g(x) = \ln\left[\frac{\pi(x)}{1 - \pi(x)}\right] = \beta_0 + \beta_1 x \tag{3}$$

The significance of this transformation is that $g(x)$ now has many of the desirable properties of a linear regression model. The logit, $g(x)$ is now linear to its parameter. Hence, the relationship of dependent – independent variables in this study is expressed in the following equations:

$$p = \exp[a + b_1 x_1 + b_2 x_2 + ... + b_{13} x_{13}] / (1 + [a + b_1 x_1 + b_2 x_2 + ... + b_{13} x_{13}]) \tag{4}$$

$$\log(p / 1 - p) = a + b_1 x_1 + b_2 x_2 + ... + b_{13} x_{13} \tag{5}$$

Fitting the Logistic Regression Model

In linear regression, the method used most often for estimating unknown parameters is the least squares method. In that method, concisely, we choose those values of β_0 and β_1 which minimize the sum of squared deviations of the observed values of Y from the predicted values based upon the model. It is proven that the least squares method produces estimators with a number of desirable statistical properties. Unfortunately, this does not work with a dichotomous outcome model.

In a model with a dichotomous response as the dependent variable, the Maximum Likelihood Estimation (LME) is used. The difference is, when the least squares method seeks to minimize the sum of squared distances of the data points to the regression line, the Maximum Likelihood Estimation method seeks to maximize the log-likelihood, which reflects on how likely it is (the odds) that the observed values of the dependent may be predicted from the observed values of the independents.

Since likelihood is a probability, therefore its values vary from 0 to 1. The log-likelihood is the log of the probability and its value varies from 0 to minus infinity because the log of any number less than 1 is negative. The log-likelihood is calculated through iteration, using the maximum likelihood estimation (Garson, 2010). The log-likelihood tests the significance of the researcher's model as a whole. In presenting information on the log-likelihood, statistical packages usually present not the log-likelihood itself but the log-likelihood multiplied by -2. The reason for this is that the log-likelihood when multiplied by -2 has approximately a Chi-square distribution (Menard, 1995). A finding of significance leads to the rejection of the null hypothesis that all of the predictor effects are zero. In other words, if this likelihood test is significant, at least one of the predictors is significantly related to the dependent variable.

In assessing the significance of the independent variables that can therefore be included in the model, the guiding principle is to compare observed values of the response variable to predicted values obtained from models with and without the variable question (Hosmer and Lemeshow, 2000).

$$G = -2\ln\left[\frac{(likelihood - without - the - \mathrm{var}\,iable)}{(likelihood - with - the - \mathrm{var}\,iable)}\right] \tag{6}$$

A non-significant likelihood ratio test indicates no difference between the full and the reduced models; hence justifying dropping the given variable in order to have a thriftier model that works just as well. On the other hand, for the significant variables, the larger the chi-square value, the greater the loss of model fit if that term is dropped (Garson, 2010).

4. Results

Responses from 500 respondents are incorporated in this study consisting of 207 (41.4%) female and 293 (58.6%) male. In addition, 159 (31.8%) respondents are in the age group of 25 years and above while those in the age group of less than 25 years are 341 or 68.2% of the total respondents. Most of the respondents hold undergraduate degree and above (71.4%), meanwhile, those with diploma and high school are 28.6%. Thus, this survey is believed to represent the educated customers with good knowledge in banking, good experience and high frequency of dealing with the Islamic banks. Table 1 shows the completed descriptive statistics of the respondents' demography.

Table 1. Demography of Respondents

Variable		Code	Frequency	Percentage
Gender	Male	1	207	41.4
	Female	0	293	58.6
Age	> 25 years	0	159	31.8
	25 years and below	1	341	68.2
Religion	Others	0	42	8.4
	Islam	1	458	91.6
Education	Diploma and Below	1	143	28.6
	Undergraduate and above	0	357	71.4
Monthly Income	RM5000 and below	0	442	88.4
	> RM5000	1	58	11.6
Customer Period	3 years or less	0	268	53.6
	> 3 years	1	232	46.4
Account type	Others	0	42	8.4
	Saving	1	458	91.6
Interaction Frequency	Others	0	271	54.2
	Once in a week	1	229	45.8
Services used	Internet Banking	0	167	33.4
	ATM	1	333	66.6
Bank Status	Subsidiary	0	188	37.6
	Full-fledged	1	312	62.4
Bank Ownership	Foreign	0	31	6.2
	Local	1	469	93.8
Conventional Bank	No	1	152	30.4
Customer	Yes	0	348	69.6

In this study, the dependent variable is "the intention to switch" when issue of non-syariah compliance in Islamic banking products and practices encountered by the customers with response is equal to "1" for "willing to switch" and "0" for otherwise. The independent variables are as depicted in Table 1. Table 2 depicts the classification ability of logistic regression. It shows that 73.2 percent of the

respondents are classified correctly. It confirms the mediocre level of the classification ability of the model.

Table 2. Classification table from logistic regression

Observed		Predicted: Have you ever think to switch other banks?		Percentage Correct
		Never	Yes	
Have you ever think to switch to other banks?	Never	13	121	9.7
	Yes	13	353	96.4
Overall Percentage				73.2

Table 3 shows that the variable of religion, type of account, and whether or not they have account in conventional banking are statistically significant in influencing their switching behavior due to syariah compliance issues. In detail, Muslim customers have probability to switch for almost three times (2.787) bigger than non-Muslim customers when they encounter non-syariah compliance products and practices in their bank. Furthermore, saving account holders have shown that their switching intention is bigger compared to non-saving account holders, two and half times. Lastly, customers who have account in conventional banks are more reluctant to switch when they encounter non-syariah compliance products and practices in their Islamic bank as compared to those who do not have account in conventional banking.

Table 3. Variables in the logistic regression equation

Variable	B	S.E.	Wald	Sig.	Exp(B)
Gender (1)	-.083	.227	.135	.713	.920
Age (1)	.649	.343	3.591	.058	1.914
Religion (1)	1.025	.374	7.514	.006	2.787
Marital (1)	-.023	.342	.005	.946	.977
Education (1)	-.254	.334	.579	.447	.776
Monthly Income (1)	.813	.430	3.580	.058	2.255
Customer Period (1)	-.234	.219	1.145	.285	.791
Account type (1)	.919	.418	4.844	.028	2.507
Interaction frequency (1)	.204	.222	.846	.358	1.227
Services Used(1)	.105	.240	.192	.661	1.111
Bank Status (1)	.111	.232	.228	.633	1.117
Bank Ownership (1)	.165	.422	.154	.695	1.180
Conventional Bank Customer (1)	.640	.232	7.640	.006	1.897
Constant	-1.735	.666	6.780	.009	.176

5. Conclusion

This study aims to investigate the customer switching behavior in the Malaysia Islamic banking industry, with regard to the issue of non-syariah compliance products and practices. Using logistic regression, the variable of religion, type of account, and whether or not they have account in conventional banking are found to be statistically significant in influencing their switching behavior due to non-syariah compliance issues.

This study is believed as the first empirical study in the field of switching behavior in Islamic banking under the framework of syariah issues. Thus, limitations in this study are inevitable. Among the limitations are (i) it focuses only to one aspect which is syariah aspect; and (ii) it does not include psychological aspect of the respondent as independent variables. Therefore, at least two suggestions for future researches, which are (i) study the customer switching behavior in Islamic banking not only from syariah aspect but also profitability and service quality, and (ii) incorporate psychological aspects of respondents in the independent variables.

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FACTORS AFFECTING CUSTOMER LOYALTY IN ISLAMIC BANKING: EVIDENCE FROM MALAYSIAN BANKS

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Abstract

There is a prediction of the size of Islamic banks worldwide in early 2014 to be up to two trillion dollars, a growth rate ranging between 24 and 30 percent. However, Islamic banks are experiencing strong competition not only among Islamic banks but also from their non-Islamic counterparts. Therefore, this study presents valuable information on the market behaviour of Islamic banking customers in Malaysia which attempted to determine the factors that affecting loyalty among the Islamic banking customers. It was carried out by selecting a sample of 250 respondents from Islamic banks. Principle component analysis (PCA) was used to determine the effect of the factors on customer loyalty. The results of the PCA showed that nine factors (service encounter, social value, service experience, trust, reliability, service dependability, satisfaction, expectation and convenience value) that might have significant positive influence on customer loyalty. In general, respondents displayed positive level of loyalty. Due to the results, this study should be referred by Islamic banks management in Malaysia in building trust to place prime consideration of customers. For that reason, managers of Islamic banks have got to place importance of customers by building these factors to enhance customer loyalty.

Keywords **:** Customer loyalty, factors, Islamic banking.

1. Introduction

Islamic banking is a financial concept which complies fully with Islamic 'Shari'ah' Law and has creative and progressive financial engineering that offers efficient and competitive banking, investment, trade finance, commercial and real estate financing services (Abdul Qawi and Lynn, 2001). According to Henry et al., (2004) there are now over 300 Islamic banks and financial institutions worldwide with an estimated asset of between US$200 – US$300 billion. According to the writers, Islamic banking is increasingly gaining popularity and large international conventional banks are turning their interest towards Islamic banking system. However, Islamic banks are experiencing strong competition not only among Islamic banks but also from their non-Islamic counterparts (Naser and Moutinho, 1997). This aspect brings about the concern that only ‘customer loyalty’ can ensure competitiveness and their continuous

survival (Ahasanul Haque et al., 2009). Therefore it is important to assess the degree of customer loyalty towards these growing financial institutions. This paper attempts to determine the factors that contributed to customer loyalty in Malaysian Islamic banks.

The concept of Islamic banking is not only of interest to Muslim customers but able to attract non-Muslims customers due to the advantages from the system (Naser and Moutinho, 1997). Muslim customers have the opportunity to place their investment in a bank that complies with their religious beliefs. According to the writers, Non-Muslim customers have equal opportunity to either place their investment in Islamic banks or conventional banks. Under this circumstance, Islamic banks compete in the same market segment with conventional and foreign banks. Despite the difference, Islamic banks are still competing in the same market in terms of complementary products and services offered (Naser and Moutinho, 1997). Both Islamic and conventional banks share typical banking facilities such as saving accounts, current accounts, credit cards and other products and services (Naser and Pendlebury, 1997; and Naser et al., 1999).

2. Literature Review

There were vast literature available relation to measuring customer satisfaction and customer loyalty relating to Islamic banking. It elaborated that, there is strong relationship between customer satisfaction, service quality, perceived value, and trust with customer loyalty.

2.1 Customer Loyalty

Loyalty is simply defined as customer's intention or tendency to repurchase from the same firm (Edvardsson et al., 2000). Customer loyalty is a one of the marketing research theme which has turn out to be a vital concern for managers and this growing interest is generally due to strong competition, especially in service industries as the level of competition rises, the association between loyalty and competition has becomes more intense especially in the services industries where there is a wide range of choices and rapidly emerging innovative services (Stevens, 2000). According to Dimitriades (2006), loyal customers are defined as those customers who hold favorable attitudes toward an organization, recommend the organization to other

consumers and exhibit repurchase behavior; all at once customers who remain loyal to service providers are likely to take on in favorable or unfavorable behavioral responses (Hoq and Amin 2010).

2.2 Factors Affecting Loyalty

To leverage the greatest benefits presented from customer loyalty it is vital to understand the factors of loyalty (Terblanche and Boshoff, 2006). Understanding the factors of customer loyalty will allow management to concentrate on the major influencing factors that lead to customer retention (Chi and Qu, 2008). Several researches were conducted globally to investigate the influence of the factors of loyalty in various service industries for example, financial services, tourism/travel, mobile phone services, airlines, etc. Han et al. (2008) in their study of the Chinese customers from airlines, banks, beauty salons, hospitals, hotels and mobile telephone industries found that key loyalty factors are customer satisfaction, commitment, service fairness, service quality and trust.

Previous research in the context of Malaysian service providers on customer loyalty cover the financial services, hotel, childcare centre services and audit services. Akbar et.al (2010) in their research of hotel guests found that service quality had positive effects on loyalty, while perceived value and satisfaction mediated the relationships between hotel service quality and loyalty. Hoq and Amin (2010) in their research of bank customers found that satisfaction is the most important driver to enhance customer loyalty. Omar et.al (2009) in their research of childcare centre customers found that trust holds a greatest role in the formation of loyalty towards the childcare centre but satisfaction has no direct impact on loyalty. Razak, Chong and Lin (2007) in their research of bank customers found the linkages between service quality and satisfaction and between service quality and loyalty. Ismail et.al (2006) in their research of external audit customers found that satisfaction partially mediate the relationship of service quality and loyalty.

To summarize on the various research conducted in service industry worldwide, there are number of common factors affecting loyalty that have been studied i.e. satisfaction, switching costs, perceived value, service quality, trust, price and image.

The details of each study findings are then reviewed to determine the relevance of the factors in determining loyalty of the banking sector.

2.3 Satisfaction

Loyalty of customers is considered to be a function of satisfaction and loyal customers contribute to company profitability by spending more on company products and services, via repeat purchasing, and by recommending the organization to other consumers (Fecikova, 2004). Therefore, satisfaction is a necessary precondition for building long term customer relationships and likely to increase loyalty (Bloemer et.al, 1995). Consuegra et, al (2007), and Wong and Zhou (2006), Hoq and Amin (2010) stated that satisfaction is one of the most important factors increasing customers' loyalty. Empirical research has confirmed that satisfied customers are more likely to have repurchase intentions and use positive word-of mouth communication (Blodgett and Anderson, 2000; Maxham and Netemeyer, 2002). The more consumers fulfill their expectations during their service usage, the higher the probability that consumers will repeat purchase in the same establishment (Wong and Sohal, 2003); Hoq and Amin (2010) in their research of customer satisfaction found higher customer satisfaction leads to a lower customer intention to switch banks. In general, it can be concluded that loyalty is facilitated by the satisfaction. In the absence of satisfaction, customers are unlikely to spend more on company services and recommend the services to others. Thus, it can be concluded that satisfaction has a very important role to inculcate customers' loyalty behavior. Therefore, it is crucial that satisfaction is selected as one of the main factors determining loyalty in this study.

2.4 Service Quality

Service quality is an important factor for profitability, and thereby service providers' success. Service quality is considered as one of the few means for service differentiation and competitive advantage that attracts new customers and contributes to the market share. In order to compete among each others, providing high level of service quality is very crucial for service providers (Yoo & Park, 2007; Bharati & Berg, 2005; Kemp, 2005). Perceived service quality is the consumer's impression of the service provider efficiency and it is significantly related to customer satisfaction (Shin and Kim, 2008). Service quality is also typically considered as the customer's

impression of the superiority or inferiority of a service provider and its services (Tsoukatos & Rand 2006).

Service quality also enhances customers' tendency to use the service more, to use more services, to become less price-sensitive and to tell other friends about favorable and useful services provided (Venetis & Ghauri, 2000). Jones et.al (2002) have pointed out that there is a positive relationship between service quality and repurchase intention, recommendation, and resistance to better alternatives. All these three elements; repurchase intention, recommendation and resistance to better alternatives are behavioral intentions and constitute customer loyalty.

2.5 Perceived Value

Lai et al. (2009) argued that value is at the heart of what consumers pursue from an exchange. Park et al. (2006) observed that in deciding whether to return to service provider or not consumer always consider the extent to which they received 'value for money'. Service organizations also have increasingly becoming aware of the need to enhance internal activities in order to create and distribute value to customers (Roig et al., 2006). Perceived value has gained recent attention as a stable construct to predict buying behavior (Anderson and Srinivasan, 2003; Chen and Dubinsky, 2003; Hellier et al., 2003). Additionally, customers' value perceptions have been found to increase their willingness to buy and decrease their search intentions for alternatives (Hellier et al., 2003). According to Roig et al., (2006) research found value is only perceived by customers, and cannot be determined objectively by the seller. Merely the customer is able to perceive whether or not a product or service offers value.

A customer's positive perception of the value received from a service provider could motivate the customer to patronize the provider again. Customer-perceived value is positively related to customer loyalty (Sirdeshmukh et al., 2002; Wathne, Biong, and Heide, 2001; Yang and Peterson, 2004). There is strong link between perceived value and future intention (Park et al., 2006; Kuo et al., 2009). In the study of Turkish airline passengers, Atalik and Arslan (2009) found that creating value to customer leads to loyalty. In a study of Chinese mobile phone consumer, Lai et al (2009) found that perceived value is one of the significant factors of loyalty.

2.6 Trust

According to Kuusik et al. (2009), trust is one the major group of factors affecting loyalty. Trust is the cornerstone for a successful and lasting relationship with customer. Trust has been defined as users' thoughts, feelings, emotions, or behaviours that occur when customers feel that the provider can be relied upon to act in their best interest when they give up direct control (Patrick, 2002).

Trust has been conceptualised in the literature as "a willingness to rely on an exchange partner in whom one has confidence" (Kwon & Suh, 2005). Trust is built when the service provider is interested in satisfying the customer needs, and provides products and services that create customer value. Effective customer's retention helps firms to grow in size and popularity, thereby increasing their profitability. Trust also exists when one party has confidence in an exchange partner's reliability and integrity. Trust, in social psychological science is the belief that other people will react in predictable ways. In the context of a buyer-seller relationship, trust is considered as the belief of one party on the reliability of the other party, and its willingness to fulfil his or her obligations in the exchange relationship (McKnight & Chervany, 2001).In brief, trust is a belief that one can rely upon a promise made by another (Pavlou, 2003), therefore trust can be viewed as trusting belief and trusting intention (McKnight and Chervany, 2002). All of the social relationships would fail and not able to function normally without trust (Patrick, 2002).

When a customer trusts a service provider, their loyalty towards the vendor will increased (Kassim & Abdullah, 2008). Kassim & Abdullah (2006) investigated and extended the trust-relationship commitment model to internet banking. They indicated that bankers need to realise that more favourable communication environments must be created to attract customers and to make them more committed to conduct online transactions over the internet. They found that in order to develop trust and attract more users to internet banking, it is not enough to make the system easy to interact with. It is also important for banks to develop internet banking systems which are trustworthy, secured, and private for their users.

Table 1 represents studies on factors that affect customer loyalty of banking services in the Malaysian context, as well as in two other countries, i.e. Spain and Malta. The

factors identified are satisfaction, switching costs, perceived value, service quality and trust. These factors are either similar or bear close resemblance to the present study.

3. Methodology

Data collected via self-reported questionnaires which were distributed to customers of two full-fledged Islamic banks in Malaysia. Both the outlets are located in the Kajang District. Likert scales were used to measure responses from 1= Strongly Disagree to 5= Strongly Agree. Principle component analysis was performed using Statistical Package of Social Sciences (SPSS) to identify the major factors which influencing customers' loyalty.

Table 1: Summary of previous research on loyalty in various industries

No	Author	Choice of respondent	Location	Independent variables	Moderate variables	Dependent variables	Findings
1.	Hoq and Amin (2010)	Bank customer	Malaysia	Satisfaction	-	Loyalty	Satisfaction is the most important driver to enhance customer loyalty.
2.	Ndubisi (2007)	Bank customer	Malaysia	Trust commitment, communication and conflict handling	-	Loyalty	The four variables have a significant effect and predict a good proportion of the variance in customer loyalty. Moreover, they are significantly related to one another.
3.	Razak, Chong and Lin (2007)	Customers of the bank at four branches	Malaysia	Service quality	-	Satisfaction and loyalty	The study confirmed the linkages between service quality and customer satisfaction and between service quality and loyalty.
4.	Ndubisi (2006)	Bank customers	Malaysia	Trust, commitment, communication	Gender	Loyalty	Four variables are directly associated with customer higher levels of trust in the bank. Gender does not moderate the relationship between commitment.
5.	Beerli, Martin and Quintana (2004)	Customers of the six banks with the largest market share	Spain	Quality, Satisfaction, Switching Cost	-	-	Satisfactions together with personal switching costs are antecedents leading directly to customer loyalty.
6.	Caruana (2002)	1,000 retail banking customers	Malta	Service Quality	Satisfaction	Loyalty	Satisfaction plays a mediating role in the effect of service quality on service loyalty. The effects of a number of demographic indicators on service loyalty are also reported.

4. Findings And Discussion

4.1 Profile of the Respondents

For data collection purposes, 250 questionnaires were distributed, but only 124 responses were received resulting in a response rate of 49.6%. Table 2 shows information on respondents' profile of this study.

Table 2: Profile of the respondents (N=124)

Variables	Categories	N	(%)
Gender	Male	64	51.6
	Female	60	48.4
Age	18-25	41	33.1
	26-35	37	29.8
	More than 36	46	37.1
Marital Status	Single	61	49.2
	Married	62	50
	Divorce	1	0.8
Academic qualification	Bachelor's degree	60	48.4
	Master's degree	47	37.9
	PhD	7	5.6
	Others	10	8.1
Islamic banking services used	Savings	94	75.8
	Investment	5	4
	Financing	14	11.3
	Others	12	9.7
Experience in using Islamic banking services	Less than one year	10	8.1
	1-3 years	69	55.6
	4-6 years	24	19.4
	More than 7 years	21	16.9

4.2 Factor Analysis

Factor analysis is one of the important steps in data analysis, primarily meant to understand the underlying dimensions or proposed dimensionality of variables in a proposed model or relationships in empirical research (Hair et.al 2010). The following sections discuss the results of factor analysis using principal components with varimax rotation methods. The criteria used to identify the factors are that eigenvalue must be greater than 1 and that they each have at least 1 item to ensure stability. Factor analysis of the 46 items making up the 100% extracted 10 factors with eigenvalue of 1 or more, which jointly explained 68.7% of the variations in the items. The results for each factor analysis conducted are summarised in Table 3.

Table 3: Factor analysis results

Factor	Eigenvalue	Percentage of variance	Cumulative percentage
1	14.659	31.867	31.87
2	4.007	8.710	40.58
3	2.677	5.820	46.40
4	1.984	4.312	50.71
5	1.905	4.141	54.85
6	1.562	3.396	58.25
7	1.400	3.044	61.29
8	1.246	2.709	64.00
9	1.103	2.398	66.40
10	1.050	2.283	68.68

In this study, the "cut-off" point chosen for significant loading is 0.50 and above as suggested by Hair et al. (2010) for a sample of 124. After Varimax rotation, 1 factor i.e. factor 10 was not loaded as there is no items loaded on this factor. Table 4 summarizes the 9 factor loadings after Varimax with Kaiser Normalization rotation, the items loading greater than 0.50 on each factor, and the percentage of variance explained by each factor.

Table 4: Factor loadings of loyalty determinants

Factor	Items Loading greater than 0.5	Loading	Percentage of variance
1	The Islamic bank performs the service right at the first time.	.558	31.87
	The Islamic bank tells me exactly when services will be performed.	.534	
	Customer service staff gave me prompt services.	.709	
	Customer service staffs are always courteous with customers.	.535	
	Customer service staffs are always ready to respond to customer requests promptly.	.537	
	I can trust the Islamic Bank customer service staff.	.581	
	I feel safe in the transaction with the Islamic bank.	.640	
	Customer service staffs are polite.	.680	
	Customer service staffs have adequate support from the service provider to do their job well.	.685	
2	Using this Islamic bank services helps me to feel accepted by others.	.677	8.71
	Using this Islamic bank services makes a good impression on other people.	.775	
	Using this Islamic bank services gives me social approval.	.814	
	Using this Islamic bank services gives me pleasure.	.769	
	Using this Islamic bank services makes me feel good.	.784	
	I used this Islamic bank services to experiment with new ways of doing things.	.672	

3	Customer service staffs have knowledge to answer customer.	.617	5.82
	The Islamic bank gave customer individual attention.	.615	
	The Islamic bank has customers' best interest at heart.	.584	
	Customer service staffs understand customer specific needs.	.755	
	Customer service staffs gave their personal interest.	.757	
	The Islamic bank has operating hours and location that are convenient to all its customers.	.502	
4	I trust my current Islamic bank that I use.	.722	4.31
	I feel that I can rely on my current Islamic bank services to serve me well.	.604	
	I trust the billing system used by my current Islamic bank.	.653	
	I believe that I can trust my current Islamic bank because the company will not try to cheat me.	.731	
5	My current Islamic bank is reliable because it is mainly concerned with the customer interest.	.564	4.14
	Using the Islamic bank enhances my self-confidence.	.655	
	My Islamic bank provides me the help I need to complete my tasks effectively.	.681	
	My Islamic bank has the overall capabilities that I need.	.640	
6	The Islamic bank physical facilities are visually appealing.	.556	3.40
	When the Islamic bank promises to do something by certain time, it does do.	.671	
	When I have problem, the Islamic bank show sincere interest in solving it.	.651	
	The Islamic bank is dependable.	.639	
7	My choice to use this Islamic bank was a wise one.	.675	3.04
	Using this Islamic bank has been a good experience.	.674	
	I am satisfied with this Islamic bank.	.676	
8	My Islamic bank meets my pre-usage expectations.	.763	2.71
	My Islamic bank completely meets my expectations.	.744	
9	I value the ease of using this Islamic bank services.	.672	2.40
	Using this Islamic bank services is an efficient way to manage my time.	.710	
	I value the convenience of using this Islamic bank services.	.663	

Based on the factor loadings, the nine factors that remained are named accordingly: service encounter, social value, service experience, trust, reliability, service dependability, satisfaction, expectation and convenience value.

4.3 Reliability Test

The reliability of the instrument used in this study was tested using Cronbach's Alpha. For the purpose of this study, a minimum reliability (i.e. Cronbach's Alpha) of 0.5 was set as suggested by (Hair et al. and Byrne, 2010). Table 5 represents the result of the reliability test for each of the factors. As shown, the Cronbach Alphas of the

measures were all comfortably above the lower limit of acceptability that is α >.50. Hence, all the measures were highly reliable.

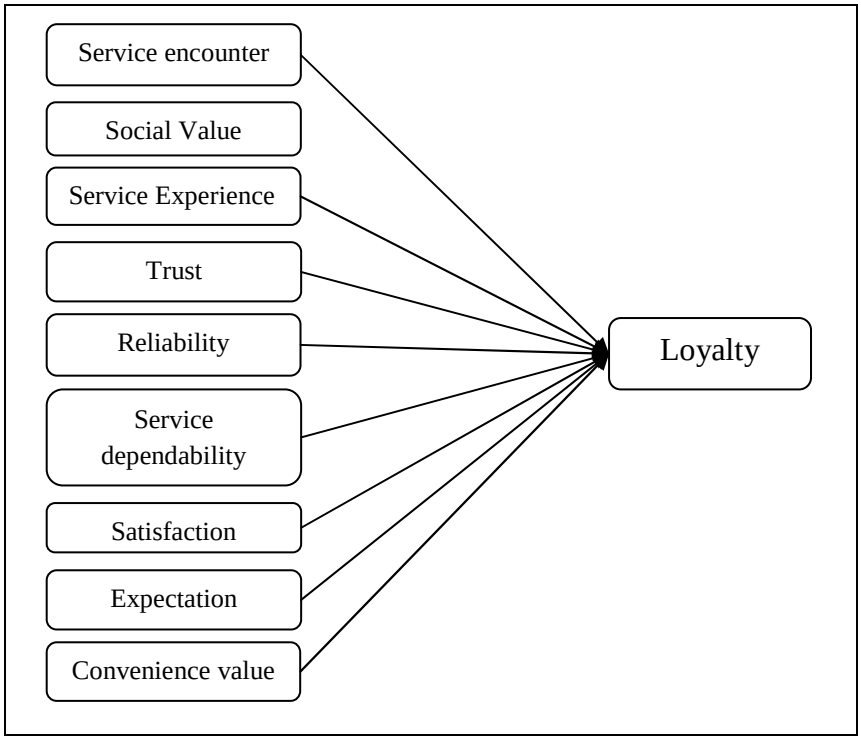
Table 5: Reliability coefficients for the variables in the study

No.	Variables	No. of items	Cronbach Alpha
1	Service encounter	9	0.882
2	Social value	6	0.895
3	Service experience	6	0.851
4	Trust	4	0.853
5	Reliability	4	0.865
6	Service dependability	4	0.764
7	Satisfaction	3	0.780
8	Expectation	2	0.769
9	Convenience value	3	0.791

4.4 Statement of Hypotheses

In light of the results of the factor analysis, the proposed framework of this study is demonstrated as in Figure 1. The hypothesis for this study is that there are relationships between each of the dimensions and customer loyalty.

Figure 1: The framework of this study



5. Conclusion

This study attempted to determine the factors that affecting loyalty among the Islamic banking customers. A result of principle component analysis indicates that, service encounter, social value, service experience, trust, reliability, dependability, satisfaction, expectation and convenience value are significantly important factors in customer loyalty of Islamic banking in Malaysia. It is suggested that this study must be extended in order to consider hypothesis testing and other relevant results that might benefited the practitioners and academics. Due to the results, this study should be referred by Islamic banks management in Malaysia in building trust to place prime consideration of customers. They have to focus in enhancing customer loyalty by revising their strategies to retain existing customers and attract new ones that have potential to be loyal.

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ROLES IN JOB SATISFACTION AND TURNOVER IN GUARANTEEING QUALITY OF WORK LIFE AT THE INSURANCE INDUSTRY

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Abstract

In Malaysian current business scenario, organizations are called to acquire core competencies and maintain their competitive challenges in the globalization market. A major challenge for them is to retain talented and valuable employees (Roger Herman, 1991).In this context, if an organization is unable to fulfill the employee's requirements and the employees are not satisfied with their work conditions, turnover may happen (Schultz,1994) Malaysian Employers Federation (MEF) pointed out that 12.12% of turnover rate among executives in banking, finance and insurance industry between July 2010 and June 2011. For that reason, this paper attempts to measure job satisfaction and determine its relationship with turnover in the insurance industry. The results showed that satisfied with the job (M=3.68); people are managed, directed or influenced by the own commitment to achieving the goals of organization (M=3.55); know and understand the policies and processes in order to do their job well (M=3.54). These results are important in clearly showing the relationship between job satisfaction and organizational commitment were closely inter-related and correlated with turnover. This may be due to external factors, such as job market conditions and working environment which may influence perceived opportunities for career advancement. As job satisfaction and organizational commitment have strong correlation with turnover, it is very important to reinforce them by applying the right human resource strategize to retaining best talent in the organization.

Keywords: *Job satisfaction, turnover, quality of work life, insurance industry*.

1.0 Introduction

With the world economic recession, each country is implementing pump-priming policies. Malaysia been hit hard by the global financial crisis through the decline in global demand for its exports, but it has succeeded in containing the negative impact on its overall economy and on the labor market. The crisis of economic directly

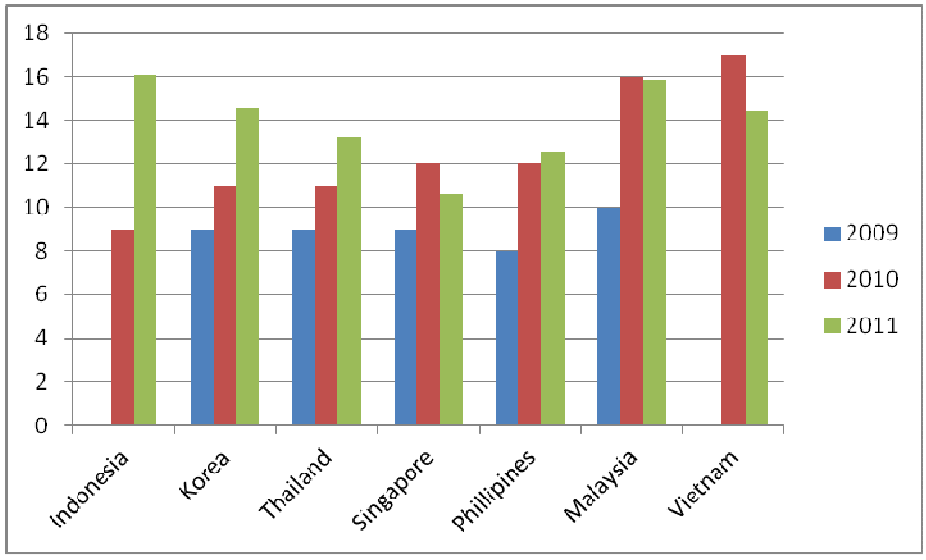
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affected to the organization especially in the private sector. It affects all organizations at some level and enables companies to evaluate issues like turnover during times of varying economic stability (Haruhiko Kuroda, 2012) .The economic turmoil inevitably exists now around the world, and there are activities of downsizing going on in the regions of many major employment giants of the world, such as Toyota, GM, Intel and Dell to name a few.

Same situation happened in Malaysia within the past 20 years. The unexpected crisis which affect on employee turnover rate involved voluntary and involuntary cases. There were some serious job cuts in the manufacturing industries and a number of prominent factories in Malaysia began cutting their expenditures by temporarily shutting down their plants and letting their staff go for forced leave. Therefore, the government had taken the efforts and measurements like donated sustention fund to secondary industry, the efforts of employers are vital to minimize the employee turnover (The Star Online, 2012).

Figure 1: Year attrition rate in percentage (2009- 2011)



Source: AON Hewitt SIS Study 2009-2011

One of the important aspects that contribute to employee turnover is organizational commitment which generally related to the employee's psychological attachment and loyalty to the organization. For every organization, the improvement of the psychological attachment of the workers with their job is very crucial so that the

employees would become more committed to their organization (Allen et al, 1990). When the employee is attached to the organization, it will reduce the incidence of turnover. As per Figure 1, it is showed where in 2011; Malaysia was placed at number sixth in the Asia-Pacific countries for staff turnover with a 15.9% attrition rate. According to Kelly Services marketing director for Singapore and Malaysia Jeannie Khoo (The Star Online, 2012), this trend is predominantly seen in Gen Y, where they work not because of the money but also must have a work-life balance.

Table 1: Average yearly turnover rate of executive between July 2010 and 2011

No.	Types of industry	Annual average (%)
	Manufacturing	
1.	Basic and fabricated metallic products	23.9
2.	Electrical and electronics	23
3.	Plastic/rubber	19.9
4.	Food and beverages	17.9
5.	Transport/machinery Manufacturing	16.7
6.	Printing/publishing/paper/timber/wood products	11.9
7.	Petroleum/chemical	7.1
8.	Pharmaceutical/toiletries/non metallic/mineral	9.6
	Sub-total	18.8
	Non-manufacturing	
1.	Information technology/communication	75.7
2.	Association/societies	33
3.	Hotel/restaurant	32.4
4.	Professional/consultancy/education/training	29.3
5.	Transport/warehouse services	26.9
6.	Medical services	19.8
7.	Holdings and investment/plantation	17.4
8.	Business services	15.7
9.	Property/construction	15.6
10.	Wholesale/retail/trading	18
11.	Banking/finance/insurance	12.1
	Sub-total	22.44
	Total	20.88

Source: Malaysian Employers Federation (MEF 2012)

According Table 1, its shows the retaining worker in an organization is a big challenge for the management levels on 143 companies across the sectors in Malaysia. Data on retrenchments, temporary lay-offs, and salary cuts in large enterprises points in the same direction. In those sectors, Malaysian companies are seeing an attrition rate of between 9.6% and a phenomenal 75%, based on its survey conducted on executive level in June 2010 till July 2011. From the survey, it shows that the highest annual average turnover rate in the non-manufacturing sector are

information technology/communication (at 75.7%), associations/societies (at 33%), and hotel/restaurant (at 32.4%). The manufacturing sector saw relatively lower annual average turnover rates, with the highest being the basic and fabricated metallic products (at 23.9%), electrical andelectronics (at 23%), and plastic/rubber (at 19.9%).

2.0 Literature review

2.1 Job Satisfaction

Job satisfaction is important to an organization's success. It's refers on how well employee provides the job to fulfillment of a need or want, or how well it serves as a source or means of enjoyment. According to Rose (2001), an employee is intrinsically satisfied if they receives no apparent reward except the activity itself, while extrinsic satisfaction is defined as the opposite concept (that is, an employee is extrinsically satisfied if he receives monetary compensation or other material rewards to modify his behavior). Much research has been conduct into ways of improving job satisfaction of workers in various sectors of the Malaysian economy, including the academic sector (Wong and Teoh, 2009; Noordin and Jusoff, 2009). Locke (1976) described job satisfaction as "a pleasurable or positive emotional state resulting from the appraisal of one's job or job experiences". A survey on "Quality of working life in the Czech Republic" was carried out by European Foundation for the Improvement of Living and Working Conditions and reported in 2006 that the satisfaction of workers depends upon the quality of the people one works with, providing good service to customers/ colleagues, base pay, nature of work, being treated with respect, work life balance, learning and development, long term career potential, bonuses, flexible working arrangements, promotion opportunities and benefits.

In study done by Seta, Paulus and Baron (2000) pointed out that by knowing the factors contributing to the employees' satisfaction; the organization can plan properly and take an appropriate step to increase positive behavior among employees. Gregory (2007) supported the idea that behavioral intention to quit has been found to be strong predictor of personal turnover across industries and theoretically is believed to be an important antecedent to turnover.

2.2 Turnover

Turnover or staff turnover or labour turnover is the rate at which an employer gains and loses employees. Turnover is measured for individual companies and for their industry as a whole. If an employer is said to have a high turnover relative to its competitors, it means that employees of that company have a shorter average tenure than those of other companies in the same industry. High turnover may be harmful to a company's productivity if skilled workers are often leaving and the worker population contains a high percentage of novice workers (Hutchunson and Jand Beruvides, 1997).

Turnover can be classified as "internal" or "external" (Ruby, 2002). Internal turnover involves employees leaving their current positions and taking new positions within the same organization. Both positive (such as increased morale from the change of task and supervisor) and negative (such as project/relational disruption, or the Peter Principle) effects of internal turnover exist, and therefore, it may be equally important to monitor this form of turnover as it is to monitor its external counterpart. Internal turnover might be moderated and controlled by typical HR mechanisms, such as an internal recruitment policy or formal succession planning. (Ruby, 2002)

Turnover can be differentiated between instances of voluntary turnover, initiated at the choice of the employee, and those involuntary instances where the employee has no choice in their termination (such as long term sickness, death, moving overseas or employer-initiated termination(Martin, 2003). Typically, the characteristics of employees who engage in involuntary turnover are no different from job stayers. However, voluntary turnover can be predicted (and in turn, controlled) by the construct of turnover intent. According to Connolly and Connolly (1991), turnover is costly for the organization. It involves the separation cost such as the cost use in recruiting and selecting new employee, and the cost involved during the training period. Turnover is the voluntarily and involuntarily permanent withdrawal from the organization (Robbins and Judge, 2007). Voluntarily turnover incurs significant cost, both in terms of direct cost (replacement, recruitment and selection, temporary staff, management time, or in terms of indirect costs like morale, pressure on remaining staff, cost of learning, product/service, organizational memory (Dess and Shaw,2001)

High turnover often means that employees are unhappy with the work or compensation, but it can also indicate unsafe or unhealthy conditions, or that too few employees give satisfactory performance (due to unrealistic expectations, inappropriate processes or tools, or poor candidate screening). The lack of career opportunities and challenges, dissatisfaction with the job-scope or conflict with the management had been cited as predictors of high turnover (Taylor, 2006).

Low turnover indicates that none of the above is true: employees are satisfied, healthy and safe, and their performance is satisfactory to the employer. However, the predictors of low turnover may sometimes differ than those of high turnover. Aside from the fore-mentioned career opportunities, salary, corporate culture, management's recognition, and a comfortable workplace seem to impact employees' decision to stay with their employer. Many psychological and management theories exist regarding the types of job content which is intrinsically satisfying to employees and which, in turn, should minimize external voluntary turnover. Examples include Hertzberg's two factor theory, McClelland's Theory of Needs, and Hackman and Oldham's Job Characteristics Model.

According to Thomas, Clarke and Lavery (2003)suggests that there tends to be a higher level of stress with people who work with or interact with a narcissist, which in turn increases absenteeism and staff turnover, according to Armstrong (2006), the Chartered Institute of Personnel and Development (CIPD) stated that,' labour turnover may be a negative function of job attitudes, low job satisfaction, combined with an ability to secure employment elsewhere, that is the state of the labour market. On the other hand, labour turnover is a normal part of organizational functioning, and while high labour turnover may be dysfunctional, a certain level of labour turnover is to be expected, and can be beneficial to an organization.

2.3 Relationship between Job Satisfaction and Turnover

Work in today's organizations is characterized by increasing complexity, rapid change and increasingly competitive business environments (Cascio, 2003). In such a turbulent environment, the organizations are facing a gradual shift in the traditional employment relationships. Job satisfaction can be used to predict turnover.

Organizational loyalty is reported to be in decline as turnover rates increase, average job tenure falls and employees go "job shopping" (Neumark, 2001). Under these recent developments employee turnover has been viewed as an important organizational problem. According to Cordery et al. (1993), low levels of extrinsic job satisfaction were associated with unfavorable attitudes toward change, while Gardner et al. (1987) observed significant interactions between satisfaction and job change. The process how job dissatisfaction leads to thoughts of quitting is well explained by Mobley's (1977) turnover model which posits that job and working conditions affect job satisfaction which in turn leads to the thought of quitting, to evaluate the utility of searching behavior, job search.

Job satisfaction can be used to predict turnover. Hom and Kiniki (2001) also agreed on the motion that job satisfaction can be used to understand turnover process. According to Milkovich and Boudreau (1997), a study of Singapore accounts found that job satisfaction is the main predictor of turnover intention. Newstorm and Davis (1984) had recognised that high turnover at any organizational levels constitutes a waste of human resources.

Retaining workers in an organization is a big challenge for the management levels. In this situation, if the organization fails to fulfill the workers' needs and the workers are not satisfied with their job, turnover will happen. It is proven from the study of Shultz and Schultz (1994), in which they concluded that it can be assumed that high job satisfaction is related to employee's positive attitudes such as high
job performance and low turnover. Some employers give less attention to the older or to be-retired employee's job satisfaction (Cranny, Smith & Stone, 1992).

Seta, Paulus and Baron (2000) pointed out that by knowing the factors contributing to the employees' satisfaction; the organization can plan properly and take an appropriate step to increase positive behaviour among employees. However, no one would seriously challenge the idea that mismanaging organizational change can result in people choosing to leave (Jackofsky *et al*, 1986). This investigation is important as an early preparation for the organization to deal with this change because of work opportunities are low and turnover intention of employees will also increase.

Muchinsky and Morrow (1980); Muchinsky (1993) in their study believe that under good economic conditions with plentiful of jobs, dissatisfaction could cause the turnover if other opportunities are available in the market. On the other hand, conditions of high unemployment will decrease the feelings of dissatisfaction among employees. According Bray (1991) the organization should not feel overly satisfied with the good attitudes shown by their employees during the hard economic times.

Muchinsky (1993) in his book saying that 'Mobey (1997) had proposed a model of employee turnover based on several hypothesizes linked between satisfactions and quitting. The several links includes thinking out quitting, looking for another job, intending to quit or stay and actually deciding to quit or stay'. Mobley found that dissatisfaction would lead people to thoughts of quitting. Mobley's, model shows a major step of thinking job dissatisfaction to turnover (Muchinsky, 1993).Besides, Mobley (1997) specified that negative evaluations of an employee's present job increases job dissatisfaction and that negative feelings increased quit intentions. Employee turnover demands management attention because when high performing employees' leave, it puts pressure on the organization scarce source. According to Valentine (2001), much turnover research has focused on identifying individual characteristics that cause job separation, which include tenure, education, job satisfaction and organizational commitment.

2.4 Job Satisfaction from Islamic perspective

Job satisfaction is about a person's evaluation attitude of individuals about their jobs. It is stated that job satisfaction is a results from their perception of their jobs (Ivancevich and Matteson, 1990). Besides, the content of this definition involves a strong emphasis on feeling which is also called "affect". This emotional or evaluative component refers to an individual's positive, neutral or negative feelings of what might be called the attitude object, or the focus of attitude (Greenberg and Baron, 2000). Job satisfaction provides indication of how individuals or employees feel about their job as well as everything else related to their job such as pay, office setting, co-workers, superiors, policies and a few other factors. The employees who believe that their organization is ethical are likely to increase their job satisfaction. In addition to the belief that job satisfaction is a summary evaluation that people make of their

work, it should still be remembered that Allah said in al-Quran, verse 2:264: “O you who believe, annul not your voluntary almsgivings with reproach and injury, as one who expends of his substance to show off to men and believes not in God and the Last Day.” According to ibn Umar al- Zamakhshari, all the good actions which have been completed without sincerity will not be accepted by Allah in the Hereafter. In other words, sincerity is very important as a basic condition in rewarding any good action.

In addition, for organization to perform effectively, employer needs good team work and environment as motivation for them. This point has been highlighted in al-Quran, verse 5:2 when Allah said: “Help one another to righteousness and piety; do not help one another to sin and enmity.” According to al-Mawardi, Muslims must help each other to do a good action either the relationship is between man and God such as worshipping Him or the relationship is between man and man in this world. Furthermore, it is forbidden for any Muslim to help each other to commit bad actions and sins. In short, working together as a team to achieve the right objective is highly encouraged in Islam because it can become the motivation for them to keep and increase their momentum in achieving their goals. Evidently, organizations perform more efficiently and effectively when they have people who works closely and helpful with each other in carrying out their jobs.

3.0 Methodology

This paper employed survey method by using self-administered questionnaire. In order to suit the objectives of the research these items are adapted from standard application produced by National Institute of Occupational Safety and Health (NIOSH, 2010) incorporated with Glaser (2005) and Moorhead & Griffin (2001). Based on the information gathered, the researchers obtained the responses from 16 items pertaining to JS.

This questionnaire had been given to the respondents by end of 2011 to 155 staff. Thus, 94 completed questionnaires used in the analysis, which gave a usable rate of 60.7 percent. The result was 0.945 from the reliability analysis, showed a strong inter-item consistency reliability of the items measured. For the purpose of the study, the additional information needed is on the socio-demographic status of respondents. Table 2 presented the partial findings from the survey concerning the respondents’

demographic profile, which involved their rank in the insurance company, marital status and tenure in the particular sector.

Table 2: Demographic profile of the respondents

Characteristics		Percentage
Rank	Executive	34.0
	Non-executive	66.0
Marital status	Single	44.7
	Married	48.9
	Divorced	6.4
Tenure	0-3 years	23.4
	4-9 years	17.0
	10-19 years	45.7
	20 years and above until 55 years old	13.8

4.0 Findings and discussion

Table 3 summarized the sources of JS and mean scores. Findings show respondents are particularly dissatisfied with most of the job. However, they indicated moderate satisfaction towards health care benefits, working environment, flexible work hours, relationship with co-workers and superiors as well as opportunity to work independently.

Table 3: Mean and standard deviation for job satisfaction

No.	Items	Mean	S.D.
1.	I am satisfied with my job overall.	3.68	1.226
2.	I know where to go and who to contact to help me get the job done.	3.12	1.279
3.	My companies encourage teamwork and professionalism.	3.27	1.234
4.	I know and understand the policies and processes in order to do my job well.	3.54	1.089
5.	I have the experience and knowledge to perform my role efficiently.	2.06	1.085
6.	My companies encourage meeting the challenges of the task and finding a better prospect.	2.88	1.364
7.	My management is supportive, responsive, and concerned about the personal concerns and needs of those who work under them.	1.97	1.635
8.	My management is encouraging and motivating.	3.37	1.027
9.	I trust that all the outstanding issues will be resolved overtime.	3.10	1.293
10.	I am committed to doing my part at improving the working relationship in the organization.	2.57	1.309
11.	People are managed, directed, or influenced by their own commitment to achieving the goals of the organization	3.55	1.280
12.	If rules, systems, or procedures get in the way, people tend to ignore or by-pass them to accomplish their tasks or perform their jobs better.	2.97	1.419

13.	The salaries we receive are as good as what other organizations offer their employees.	3.37	1.329
14.	Employees are expected to be good team workers, supportive and cooperative, who get along well with others.	3.09	1.379
15.	Tracking and feedback are carried out as agreed during the planning phase.	2.79	1.423
16.	The only feedback that I receive is when I deliver poor performance.	2.96	1.253

Those relatively high scores are respondents satisfied their job in the company and felt high workload in their career (3.68 mean, SD = 1.226). Among this reasons it shows the positive effects of job satisfaction. According to McCormick (2000) which has made a study on the relationship between job satisfaction, shows that the organizational commitment, and commitment to career development was a concepts of "career flexibility" among the members of the profession. Studies based on the demographic survey of a statistically significant relationship to the wages received and the commitment to the organization. Past researchers also have observed that in early stages of careers, individuals are often willing to sacrifice their personal lives in the interests of their career progression. However, as individuals advance in age to the maturity stage of their career, they have been finding to place a greater emphasis on a balance between their work and family lives.

Figure 2 shows the influence of employees' perception on job satisfaction towards marital status. From results showed the sources of married person are disagree on job satisfaction (2.362 mean; SD =1.516) of total population. It appears those married groups want to achieve a new kind of balance between works and various dimensions of their lives. The married person emphasized the life dimensions related to work, thus indicating the importance afford to balance their personal and leisure in phase of social development for work life balance. These findings are consistent in the work context, that requires a person to be exposed to highly autonomous decision-making in the workplace would result in higher work-family enrichment (Grzywacz, 2002).

Figure 2: Cross tabulation job satisfaction and marital status

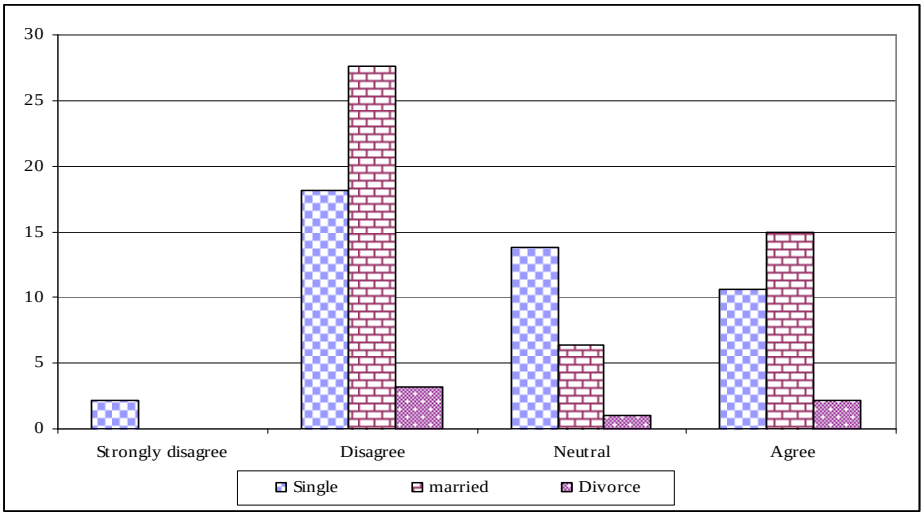
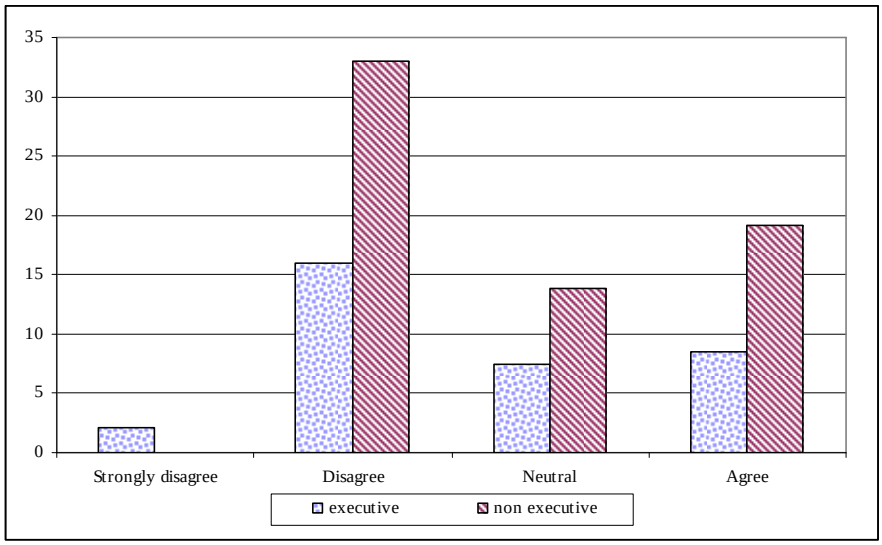


Figure 3: Cross tabulation job satisfaction and rank

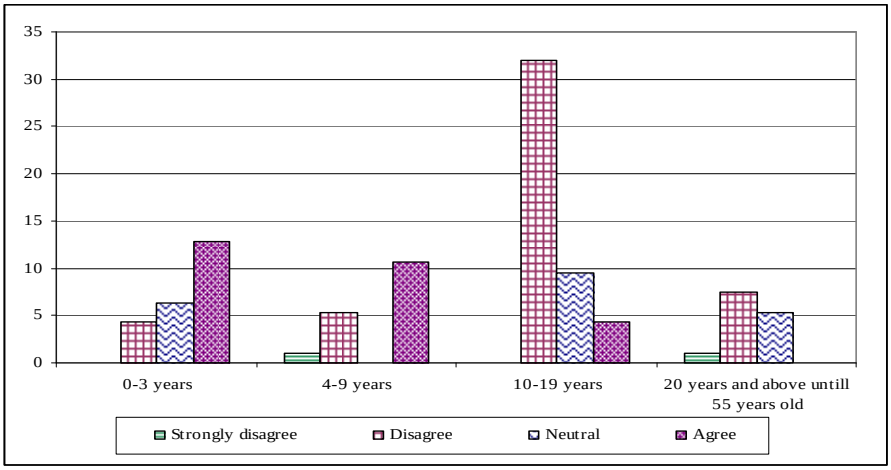


The above Figure 3 indicates those married people are relating to adequate work of life. The married people are able to satisfy important personnel needs through their experience in the organization extrinsic traits of jobs: wages and salaries, incentives, facilities and other benefits are still more essential to maintain QWL. The contribution of meaningfulness, pessimism and autonomy elements to JS is cognitive elements and relationship with job satisfaction (Speitzer et. al, 1997). The results confirm that the JS can provide an indication of workers' health well-being and of organizational performance in different areas of work life.

The most significant findings were the differences in employees and viewpoint based on their tenure. Figure 4 shows the workers dissatisfaction increased with age,

significant differences between young workers (aged under 25 years old) and older age workers (aged 45 year old and above). Older workers were also more likely to have higher levels of dissatisfaction with the amount of work they had to do, their career prospects and their levels of pay relative to other employees doing similar work. The survey found that the JS was the extraordinary increase in female participation when it comes to balancing work and family life. It shows that those respondents who had experiences of 20 years and above had low satisfaction compared to other tenure.

Figure 4: Cross tabulation job satisfaction and tenure



5.0 Conclusion

The results of this survey intended to assist decision makers in insurance industry to identify key workplace issues. From the findings, overall job satisfaction was moderate in the industry. Furthermore, job satisfactions among married employees were higher due to establishment in their life compared to bachelor staff. In fact, the Prophet (PBUH) stated:

"When a man has married, he has completed one half of his religion. Then let him fear Allah for the remaining half." (Baihaqi).

In contrast with the practice in the Japanese working culture, participated Malaysian employees in the study had higher dissatisfaction towards their job. As perceived by employees, the most important determinant of job satisfaction is career achievement,

followed by satisfaction and balance of the work life. Therefore, this study concerning job satisfaction and intention of turnover can assist particular organizations to retain their best talent in the industry. Past studies proposed management to make adjustments on their current policies and procedures as an effort to retain workers from leaving the organization. Perhaps, this study could be extended to cover broad aspects of job satisfaction, turnover and job retention among employees in across industries.

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THE INFLUENCE OF PERSONAL ENCOUNTER AND CUSTOMER INVOLVEMENT ON CUSTOMER SERVICE EXPERIENCE IN MALAYSIAN PUBLIC UNIVERSITIES

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Abstract

Managing customer service experience effectively has become an important issue for both academician and practitioners in recent years. Organizations are realizing that customers have different customer service experiences everytime they have contact with their service provider. In essence, how to manage customers' service experience in every contact point of business is a critical element in increasing the likelihood of success of the firm. The purpose of this study is to explore the impacts of personal encounter and customer involvement on customer service experience at Academic Affairs Department in Malaysian public universities. Based on an extensive review of literature, measures of customer service experience, personal encounter, and customer involvement are identified. A model is developed for the study and hypotheses are formulated. Primary data was collected through a survey from a sample of academic staff from public universities in Malaysia. The data analyses for the study includes descriptive analysis, Factor Analysis, Regression and Correlation Analysis using SPSS 18.0. The findings are hoped to provide empirical evidence of customer service experience and its correlates. In addition, the findings of the study also provide useful insights to Malaysian public universities' management in providing better facilities to enhance their customer service experience.

Keywords: Customer service experience, personal encounter, customer involvement

1.0 Introduction

In this ever changing business environment, organizations need to create unique offerings to their customers. Creating superior customer experiences seems to be one of the central objectives in today's service environments. Firms around the globe have embraced the concept of customer experience management, with many incorporating the idea into their mission statements. A recent IBM report identifies customer experience as a key factor for companies to use in building loyalty to brands, channels and services (Badgett,

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Boyce, and Kleinberger, 2007). Similarly, it has been argued that the success of Starbucks is based on creating a distinctive customer experience for their customers (Michelli, 2007).

Each and every organization starts with the employees, the people who bring the organization alive and who are responsible for the output. Without the employees the organization would be just a structure made of steel, iron, and glass. Employees are the most important asset the company has. Employee satisfaction levels can affect the quality of service, and therefore are believed to be related to customer satisfaction issue in the service industry, where front line employees have constant interaction with customers and can affect the overall company's profitability and success.

In organizations where service is important, people provide the product. This product is the personal day-to-day contact with customers, and these individual service contacts determine the success or failure of the product. When service organizations put employees and customers first, a shift occurs in the way they manage and measure success. As organizations today become more and more competitive, they must be able to differentiate themselves from the competition. Top-level executives of outstanding service organizations sped little time setting profit goals or focusing on market share; instead, they understand that, in the new economics of service, front-line workers and customers need to be the center of management concern.

1.1 Background of the study

In recent years, Malaysia has emerged as an unexpected contender in the world market for international students in higher education. Recognizing this sector as a potential new source of growth and export revenue, Malaysia aims to become a regional hub for higher education. Malaysian public universities are committed towards becoming world class universities by the year 2010 in line with requirements of the MQA (Malaysian Qualifications Agency) intoduced by the Ministry of Higher Education. The major concerns and attribute that cannot be compromised is the issue of quality which leads to

satisfaction. One of the major components highlighted in both standards (ISO & QA) are meeting customer requirements and satisfactions.

There has also been an increased interest in university ranking systems around the world and the challenge of evaluating university performance. A number of factors has been driving this trend: internal needs to benchmark university performance, the need to demonstrate effective use of resources to government funding agencies, and growing interest among the public in university rankings.

There is a need to identify what are the determinants for the service experience in public higher education institutions. Little is being done to assay this phenomenon from a scholarly business perspective (Verhoef et al., 2009). According to Ling et al. (2010), service experience has become an important area in services marketing literature due to its effect on cost, profitability, customer satisfaction, and customer retention. "Today $1 spent on advertising yield less than $5 in incremental revenue, whereas $1 spent on good customer experience yield more than $60 in incremental revenue" (Odgers, 2004, p. 24). It has been proven that to increase the company's revenue, successful customer experience management is crucial for every business in the market place.

According to Berry and Parasuraman (1992), they argue that the strategic success of a service organization depends on the ability of service providers to enhance their images by consistently meeting or exceeding customers' service expectation. These components must be measured regularly to response to the changes of the environments where the expectation of the stakeholder is becoming higher. The outcomes of the measurement are very useful for the university's administrators to provide plans and solutions for the continuous improvement so that the service offered by the university's departments are significant to its' customers.

Although personal encounter, customer involvement and customer experience have been researched separately in a number of studies, these variables have not been examined simultaneously in public service context. The present study aims to fill this gap by

examining the relationships among personal encounter and customer involvement with customer service experience in the context of Malaysian public universities.

1.2 Objectives of the study

The objectives of the study are:

1.2.1 To examine the influence of personal encounter on customer service experience.

1.2.2 To study the influence of customer involvement on customer service experience.

2.0 Literature Review

This section reviews relevant literature by exploring the background and definition of customer service experience, personal encounter, and customer involvement.

2.1 Customer Service Experience

A customer's experience has many definitions. Grewal et al. (2009) see it as including every point of contact at which the customer interacts with the business, product or service. Akin to their definition is the one put forth by Verhoef et al. (2009) that the "customer experience originates from a set of interactions between a customer and product, a company, or part of its organization, which provoke a reaction" (p. 33). Meyer and Schwager (2007) consider it to be both an internal and subjective response that people have to any direct or indirect contact with a company.

Based on the literature review, a number of common definitional themes have materialized as well as a few areas of dissension. The following paragraphs examine the common themes and areas of dissonance. First, experiences are events or occurrences that happen outside of the daily routine experience and that climax at the peak or transformative experience. The majority of researchers conceptually agree that "experiences," regardless of their different titles, are uniquely different from the daily routines of everyday lives (Arnould & Price, 1993; Csikszentmihalyi, 1990; Pine & Gilmore, 1998).

Second, it is generally presumed that experiences are positive encounters, but negative experiences are also possible. It is interesting to note that when experiences are described and defined, researchers generally imply positive or pleasant events or feelings (Lashley, 2008; Oh et al., 2007; Pine & Gilmore, 1998). Experiences are often described, for example, as memorable, emotionally intense, obscure, and diverse phenomena, and they are often initiated by environmental dimensions and emotive and internal responses. In contrast, Walls et al. (2009) noted that physical incongruence and unprofessional employee behavior contributed to negative consumer experiences.

Next, though it is not necessarily stated implicitly in the research literature, this study posits that an experience can only occur when a consumer is willing and able to participate in the experience. For example, an "unwilling" consumer seeking a coffee "to go" in the concierge lounge of a luxury hotel, may choose to make his or her own coffee and minimize or forgo the staged human interaction and downplay or ignore the environmental cues. Conversely, a consumer who is on a leisure holiday may be more "willing" and open to an experience and opt to savor a cup of coffee and examine and enjoy the environment as he or she consumes the product. Regardless, each consumer, depending on his or her circumstances and individual characteristics, will determine each consumer's willingness and capability for the experience.

2.2 Personal Encounter

Personal encounters are viewed as a period of time during which a consumer interacts with service personnel (Bitner, 1990). The quality of personal interaction encounters can be assessed based on the service provider's competence, listening skills, and level of dedications (Chandon et al., 1997). Coye (2004) also found that a service provider's behavior at the point of delivery may influence consumer expectations toward the service offering.

Pullman and Gross (2004) argued that "effective experiential design creates loyalty when the service provider relies on its employees and customers to enact a shared identity and emotional connection during the customer's experience" (p. 556). A company should

focus not only on its product or service but also on the entire consumer experience it offers (Yuan & Wu, 2008), including both physical environment dimensions and human interaction dimensions. Schmitt (1999) posited that consumer experiences occur in response to some staged situation. This concept was supported by Bitner's (1992) work, in which she recommended that companies consider environmental dimensions, participant internal responses, and employee and consumer behaviors. Carbone and Haeckel (1994) agreed, stipulating that the most effective interactions occur when physical environment dimensions and human interaction dimensions are concurrently integrated.

According to Gilmore and Pine (2002), the key to creating memorable encounters lies not in improving the functionality of a service but rather in layering an enjoyable experience on top of an existing service. Stated otherwise, memorable guest experiences are achieved when a company engages individual customers in an inherently personal way. This construct lends itself to postulating that, in order for an organization to be competitive and to survive in the service industry, it must look for ways to embrace new experience-staging techniques and to employ them in a way that has a maximum effect on service encounters.

In her study of hypothetical travelers, Bitner (1990) established that when employees made customers feel unique or pampered through attentive or lengthy service, satisfactory encounters resulted. An additional study that focused on service experiences was Mattila, Grandey, and Fisk's (2003) analysis of the interplay of gender and affective tone in service counter satisfaction. They found that women were more sensitive to emotional cues than men and were more able to accept both service failure and a wider spectrum of affective tone in employee responses to service failure. In prolonged encounters, perceptions of positive relational contexts (i.e., duration, affective content, and proxemic intimacy between clients and service providers) were found to play a significant role in customers' positive roles and satisfaction (Price, Arnould, & Tierney, 1995). In a study involving consumer experiences in a VIP circus environment, Pullman and Gross (2004) measured human interactions between guests and service providers and

between various guests and found that emotionally engaged guest's were more satisfied than unengaged guests. These related experiences often surpass the individual and involve social influence, social roles, kin relations, cultural values, group memberships, brand communities, social identities, and social categorizations.

2.3 Customer Involvement

Involvement is defined as "perceived relevance of the object based on inherent needs, values, and interests" (Zaichkowsky 1985, p. 342) in exploring enduring and intrinsic relevance of an object. Involvement has been considered an imperative variable in understanding and predicting consumer behavior. Hoyer and Maclnnis (2004) suggested that people more actively processed information and formed attitudes when their involvement was high. Cacioppo and Petty (1984) proposed that the different levels of involvement caused different persuasion processes to occur. When involvement is high, people use more cognitive efforts to process persuasive information. This process is called the "central route" (p. 668). However, people depend more on affective cues to evaluate persuasive information when involvement is low. This process is known as "peripheral route" (p. 668). In general, consumers are more willing to receive marketing messages, be influenced by marketing communication, and change their attitudes when their involvement levels are high.

Involvement has been developed as a psychological construct predictive of sports related behavior (Funk, Ridinger, and Moorman 2004). Due to the studies spanning several disciplines, involvement has been approached in several different ways. Consequences of involvement are posited in the domain of information processing-attention and comprehension processes (Celsi and Olson, 1988), motivation to process (Bloch et al., 1986), types of processing (Mittal, 1988) and interactions (Levy and Nebenzahl, 2008), as well as repurchase loyalty (Olsen, 2007).

3.0 Research Methodology

The purpose of the study is to investigate the influence of familiarity and customer involvement on customer service experience. Hypothesis testing is implemented to

explain the variance to the research's outcomes. This study employed a correlation study by using a cross-sectional survey design where data were gathered once by means of a structured questionnaire in order to answer the research question of the study.

The unit of analysis for this study is individual, which consists of public university academic staff in Malaysia. A self administered questionnaire was designed in order to collect the data. The sample of this study is public university academic staff who have experienced services at Academic Affairs Department (AAD) in their respective university. Stratified sampling technique was implemented according to the number of universities' academic staff. Data collection involved the researcher approaching the respondent to elicit interest in the reserach project.

A standardized, self-administered questionnaire was developed from an extensive literature review. The questionnaire consisted of four sections: A) customer service experience B) familiarity, C) consumer involvement and D) respondent demographic background.

Personal encounter was adapted from Wakefield and Blodgett (1999) – attentiveness (0.95), reliability (0.79) and responsiveness (0.93). The ten-item instrument – Revised Personal Involvement Inventory (RPII) – developed by Zaichkowsky (1987) was used to measure customer involvement, while customer service experience was measured by adapting a CEI scale which was tested for validity and reliability by Kim et al. (2011). Each of the five scales had Cronbach's alpha coefficients above 0.70; alpha = 0.95 for benefits, alpha = 0.81 for convenience, alpha = 0.87 for accessibility, alpha = 0.70 for utiliy, and alpha = 0.84 for trust. All items used seven-point Likert-type scales with anchors of "strongly disagree" as 1 and "strongly agree" as 7.

Data analysis involved a variety of statistical procedures including descriptive analysis, reliability and validity analysis, factor analysis and regression analysis.

4.0 Results

The results of the research covers descriptive statistics, exploratory factor analysis, correlation and regression analysis.

4.1 Descriptive Analysis

Data collection took place over five months and in total, 454 surveys were completed. An analysis of demographic was shown in Table 1. As noted, respondents were closely divided between females (58.8%) and males (41.2%) with the majority of respondents between the ages of 25-30 (28.0%). Most were married (71.1%) while first degree graduates only (10.8%) and master's degree (68.1%) made up the majority of the education levels. Most were lecturer (60.6%) and 23.3% were senior lecturer and 7.7% were associate professor.

Table 1: Demographic Characteristics

Characteristics		Frequency	Percent
Gender	Female	267	58.8
	Male	187	41.2
Age	Under 25	21	4.6
	25 - 30	127	28.0
	31 - 35	89	19.6
	36 - 40	83	18.3
	41 - 45	66	14.5
	46 - 50	36	7.9
	51 - 55	20	4.4
	Over 56	12	2.6
Marital status	Single	128	28.2
	Married	323	71.1
	Widowed	1	0.2
	Divorced	2	0.4
Academic position	Assistant lecturer	29	6.4
	Lecturer	275	60.6
	Senior lecturer	106	23.3
	Associate professor	35	7.7
	Professor	9	2.0
Level of education	First degree	49	10.8
	Master's degree	309	68.1
	PhD	96	21.1

4.2 Exploratory Factor Analysis

Exploratory factor analysis (EFA) was employed to initially identify underlying dimensions of all constructs and to reduce a large number of variables to a smaller number – in other words, scale refinement. To determine the appropriateness of factor analysis, the Kaiser-Meyer-Olkin (KMO) measure of sampling adequacy and the Bartlett's test of sphericity was examined. The value of 0.60 or above is required for KMO to be considered a good factor analysis (Tabachnick and Fidell, 2001), and results showed that this measure of sampling adequacy was a robust 0.957 for customer service experience, 0.977 for personal encounter, and 0.883 for customer involvement, which is much higher than the recommended value. The chi-square value of Bartlett's test indicated 11690.923 for customer service experience, 12704.072 for personal encounter, and 3247.556 for customer involvement, which were statistically significant at $p<0.01$ level. Both these results show that the sample can be subjected to factor analysis to identify the underlying patterns of the three constructs.

4.2.1 EFA for Customer Service Experience

The 29 customer service experience items were subjected to principle component factoring analysis (PCA) with varimax rotation method using SPSS version 18. The method was selected because it resulted in a better interpretation of the underlying relationship of the variables than did other method. The initial analysis revealed the presence of four factors with Eigenvalues exceeding 1, explaining 52.91 percent, 9.51 percent, 4.43 percent and 3.56 percent of the variance respectively demonstrating a cummulative 70.41% variance explained.

Inspection of the scree plot revealed a leveling off after the third factor. Using Catell's (1966) scree test, four factor will be retained for further analysis.The rotated solution revealed the presence of a number of strong loadings. However, it was determined that a number of items were either below the 0.50 loading guideline or were cross-loading on more than one factor. Through the process of eliminating the poorly loading items (below 0.50) and cross-loading items, an optimal solution was obtained with all items loading substantially on only one factor. The four factor solution explained a total of 70.70

percent of the variance, with factor 1 contributing 53.48 percent, factor 2 contributing 9.13 percent, factor 3 contributing 4.49 and factor 4 contributing 3.60 percent.

The interpretation of the items was slightly different than the initially proposed research framework and resulted in four constructs (accessibility, convenience, environment, and appearance) compared with the five originally proposed (environment, benefits, convinience, accessibility, and trust). Factor 1, accessibility, represented by eleven items which consists of five items from accessibility, three items from trust, two items from convenience, and one item from benefits. Factor 2, convenience is comprised of three of the four original items and five items are absorbed from benefits. While factor 3, environment has retained six of the ten original items and factor 4, appearance, represented by three items which was absorbed from environment.

4.2.2 EFA for Personal Encounter

The 25 personal interaction encounter items (e.g., caring, treated with respect, privacy is valued) of the customer service experience survey were subjected to principle component factoring analysis (PCA). The initial analysis revealed the presence of three factors with Eigenvalues exceeding 1, explaining 68.21 percent, 4.79 percent, and 4.16 percent of the variance respectively demonstrating a cumulative 77.16% variance explained. Inspection of the scree plot revealed a leveling off after the third factor. Using Catell's (1966) scree test, it was decided to retain three factors for further investigation compared to five constructs as originally modeled. The rotated solution revealed the presence of a number of strong loadings. In this case the most optimal solution was found using the principal component factoring with varimax rotation method. The two factor solution explained a total of 77.96 percent of the variance, with factor 1 contributing 71.41 percent and factor 2 contributing 6.55 percent.

Through the process of eliminating the poorly loading items and cross-loading items, an optimal solution was obtained with all items loading substantially on only one factor. The interpretation of the two factors (responsiveness and attentiveness) was different than the initially proposed five construct research framework (caring/attentiveness, professional,

reliable, responsiveness, customer-to-customer). Factor one, the responsiveness, is represented here by three of its original items plus three additional item from customer-to-customer and four items absorbed from trustworthiness. While factor two, the attentiveness construct, consists of four of its original items. The results of this analysis, though different to the original construct, are consistent with personal interaction encounter dimensions. Following the factor analysis, internal consistency of personal interaction encounter construct was examined. Cronbach's alpha for the personal interaction encounter construct was 0.969 and this is good, considered to be an internally consistent measure.

4.2.3 EFA for Customer Involvement

The 10 customer involvement items of the service experience survey were also subjected to principle component analysis. The initial analysis revealed the presence of two factors with Eigenvalues exceeding 1, explaining 56.19 percent and 15.89 percent of the variance respectively demonstrating a cumulative 72.08% variance explained.

Inspection of the scree plot revealed a leveling off after the second factor. Using Catell's (1966) scree test, it was decided to retain two factors for further investigation compared to one factor as originally modeled. The final rotated solution revealed the presence of a number of strong loadings. However, it was determined that a number of items were either below the 0.50 loading guideline or were cross-loading on more than one factor. Through the process of eliminating the cross-loading items, an optimal solution was obtained with all items loading substantially on two factor.

The two factor solution explained a total of 73.95 percent of the variance, with factor 1 contributing 56.31 percent and factor 2 contributing 17.64 percent. Through the process of eliminating the cross-loading item, an optimal solution was obtained with all items loading substantially on two factors. The interpretation of the items was slightly different than the initially proposed research framework and resulted in two factors (facinating and needed compared with the originally proposed (unidimension construct). Factor one, facinating is comprised of five items (fascinating, appealing, exciting, interesting and

involving). Factor 2, needed is also comprised of four items (needed, important, relevent, valuable). The results of this analysis, though different to the original framework, are consistent signifying different type of customer involvement will influence customer differently.

4.3 Hypotheses Results

The Pearson Coefficient of Correlation and multiple regression were utilised to test the hypotheses.

4.3.1 The Pearson Coefficient of Correlation Analysis

The Pearson Coefficient of Correlation was computed to investigate the relationship between customer service experience, personal encounter, and customer involvement. This section discussed the analysis of customer service experience (CSE) based on the mean score of its dimensions; accessibility, convenience, environment, and appearance. Personal encounter measured by mean score of two dimensions; responsiveness and attentiveness. Customer involvement also based on its mean score.

Table 2: Correlation on Customer Service Experience, Personal Encounter, and Customer Involvement

Variables	**CSE**	**PE**	**CI**
Customer Service Experience (CSE)	1	0.752**	0.682**
Personal Encounter (PE)		1	0.678**
Customer (CI) Involvement			1

**Correlation is significant at the 0.01 level (2-tailed)

Table 2 shows the correlation matrix among the variables. Correlation matrix is required to show the association between two variables at a time. Sig. (2-tailed) in the table indicates the probability level from a null hypothesis test and all of them are significant ($p < 0.01$). The Pearson correlation between CSE (Customer Service Experience) with PE (Personal Encounter) is 0.752 (significant at 1%). There is a heavy positive relationship between CSE (Customer Service Experience) with PE (Personal Encounter). The

relationship is heavy positive which means that personal encounter among public universities' academic staff will give a large affect to their customer service experience if other independent variables are absent. However, the Pearson correlation between CSE (Customer Service Experience) with CI (Customer Involvement) is 0.682 (significant at 1%) and it means that there is a medium positive relationship among them.

4.3.2 Multiple Regression

Multiple regression was conducted in multivariate analysis to predict the values on a quantitative outcome variable (customer service experience), using several other predictor variables (personal encounter and customer involvement).

Table 3: Multiple Regression Analysis

R	**R Square**	**Adjusted R Square**	**Std. Error of the Estimate**
0.787[a]	0.620	0.618	0.43994

a. Predictors: (Constant), meaninvolvement2, meanpersonal2
b. Dependent Variable: meanCSE2

According to model summary, Table 3, multiple correlation coefficients indicate the value of 0.787 which means the relationship between dependent variable and independent variables are positive. R square is 0.620 and adjusted R square is 0.618 which are moderate for analysis. Adjusted R square takes into consideration the number of observations and the number of predictor variables to make sure that things are not too inflated. If adjusted R square is at 0.618, it means that all independent variables explained the dependent variable for 68.1%. The other 31.9% remaining explain the dependent variable which comes from other variables that is not included in this study.

For the model coefficients, constant (1.351) indicate the value of customer service experience when all independent variables equal to zero. For personal encounter, the Beta is 0.440 means 1% increase in personal encounter will increase customer service experience by 44% (significance at 1%, $p < 0.01$). While Beta for customer involvement

is 0.332, which means 1% increase in customer involvement will improve customer service experience by 33.2% (significance at 1%, $p < 0.01$).

In conclusion, both research hypotheses for this study are accepted. There are significant influences between personal encounter and customer involvement on customer service experience among academic staff when adopting services from Academic Affairs Department (AAD).

5.0 Conclusions

This research examined the Academic Affairs Department (AAD) customer service experience utilizing a model which attempts to demonstrate the significant effects of personal encounters and customer involvement. This study contributes to a better understanding of customer service experiences in the context of public higher learning industry. The knowledge generated as a result of this research can help universities management to improve their service encounters and guide front line employees-customers interactions in an effort to create satisfactory customer experiences.

In conclusion, the model in this study presents an initial comprehensive view of how customer service experience are composed in a public universities setting. Given the growing need to differentiate in the marketplace and create a competitive advantage, creating a service environment that encourages positive guest experiences is likely to receive academic and managerial attention. Overall , the results of this study reinforces and expands previous work on customer service experience being derived from previous researches (e.g., Bitner, 1992; Brady & Cronin, 2001; Turley & Milliman, 2000).

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A PRELIMINARY ANALYSIS ON COMPLIANCE LEVEL AND DISCLOSURE QUALITY OF FRS136: MALAYSIAN TOP 20 SHARI'AH APPROVED COMPANIES

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Abstract

This study focuses on the disclosure of goodwill impairment process under the new requirements of FRS 136 – *Impairment of Assets*. This primary objective of the study is to investigate the compliance level and disclosure quality of FRS 136 by the top 20 Shari'ah Approved Companies (*Sh*Ac) in Bursa Malaysia as at 2010 based on their market capitalization. In order to achieve this objective, the weighted index is chosen because this index being able to differentiate the quality and importance of each mandatory disclosure under FRS 136. The weighted index was developed by constructing disclosure scoring sheet, obtaining annual reports of 20 firms in 2010, completing scoring sheet for each firms by assigned weighted for the disclosure items and calculating disclosure weighted index. The findings of this study revealed that 13 out of 20 (65%) Shari'ah approved companies failed to comply with the most basic elements of the FRS 136 pertaining to goodwill impairment testing especially in allocating goodwill into the CGUs and key assumptions used in determining the recoverable amount of CGU assets. The results of this study suggest that the performance of the top 20 Shari'ah approved companies must improve before Malaysian practice is truly of international standard.

Keywords: Impairment Testing, FRS 136, Weighted Index, Shari'ah Approved Companies.

1. Introduction

The International Accounting Standards Board (IASB), formerly International Accounting Standards Committee (IASC) produces international accounting standards (International Financial Reporting Standards – IFRS) for use by firms throughout the world. The main objective of IASB is "to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that

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require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital market and other users make economic decision (Epstein & Mirza, 2002, p. 11).

IASB intensively had collaborated with national accounting standard setters to achieve the convergence in accounting standards around the world. According to Choi & Meek (2004), the main principal to issue financial reporting standards is that to increase comparability in financial reports produced by companies regardless of their country of origin. Since 2005, there has been widespread adoption of IFRS standards on the mandatory basis for the firms around the world. The globalization of business and financial institutions has led more than 12,000 firms and more than 100 countries have claimed they have adopted or will adopt IFRS (AICPA, 2008).

However, the possibility of standardized application of IFRS across the different jurisdictions has been questioned because of the differences in compliance and enforcement mechanisms and different cultural and institutional contexts (Ball, 2006; Nobes, 2006; Nobes & Parker, 2008; Soderstrom & Sun, 2007; Zeff, 2007). As a result, it formulates excused for some of firms to adopt the IFRS in overall. Consequently, it increases the attentions and concerns in the comparability of reporting being achieved as well as the role of auditors and accounting standard setters' bodies in promoting compliance among the firms worldwide.

With the introduction of the new standard, the new goodwill and intangible assets accounting should offer group users with enhanced information with which to assess the value of those assets over time, thereby improving the ability to assess future profitability and cash flows. However, with the new standard, there is a higher degree of complexity in relation to the conceptualising, measuring and reporting on goodwill which makes the scholars of accounting concerned with the difficulties associated with. An annual impairment testing of goodwill is expensive and complicated to implement.

Previous studies on firms in different geographical samples which are listed in U.S. Securities and Exchange Commission (SEC), Australia Stock Exchange (ASX) and FTSE Bursa Malaysia (BURSA) and Singapore Stock Exchange (SGX) prove that firms have had difficulty in fully complying with new financial reporting standards of impairment of goodwill (Carlin & Finch, 2010b; Carlin, Finch, & Khairi, 2010c; Carlin, Finch, & Laili, 2008b, 2009b; Sevin, Schroeder, & Bhamornsiri, 2007). The new accounting treatment for goodwill is filled with subjectivity and ambiguity for financial reporting preparers and users, and potentially has serious impacts on financial reports. Therefore, while firms may be claiming full compliance with IFRS especially in impairment of goodwill standard, significant deviations still exist.

Therefore, this study investigates the level of compliance and disclosure quality of the goodwill reporting made by top 20 Shari'ah Approved Companies for the year ended 2010. Since Malaysia has been stating the goal of accounting harmonization since 2006, it is interesting to analyze which firms were already anticipating FRS requirements, especially with respect to goodwill impairment disclosure under FRS 136. In order to attempt the objective of this study, the weighted index is chosen because this index being able to differentiate the quality and importance of each disclosure. However, this study does not attempt to convince financial reporting users that goodwill for impairment disclosures have superior usefulness in terms of information in investment decisions, but instead presents advice as well as provides useful information to them for better future valuation.

In investigating this theme, the remainder of this paper is structured as follows. Section 2 overviews the disclosure requirements of FRS 136. The outlines literature review of rankings, especially compliance and disclosure rankings are discussed in section 3. Section 4 presents the sample and methodology. The results and discussions are describes in Section 5, while section 6 contains some conclusions and implications for further research.

2. Disclosure Requirements of FRS 136 – Impairment of Assets

The accounting reporting framework in Malaysia that deals with the disclosure of impairment of goodwill is prescribed through the combined effects of the new internationalized Malaysian financial reporting standards in FRS 138, FRS 3, and FRS 136. These three standards should or will be applied on acquisition to goodwill acquired in business combinations. Based on the previous standard of goodwill reporting, there are three commonly used methods of goodwill. First, goodwill is capitalization as a permanent item with periodic review for write down purposes. Second, goodwill is capitalized with systematic amortization; and third, it is immediately written-off to reserves.

Now, with the adoption of the new standard, FRS 136required that goodwill acquired in a business combination will no longer be amortized but will be tested for impairment annually or whenever events or circumstances indicate its value may have been impaired. Thus, under this new policy, goodwill with indefinite useful lives will no longer be amortized. Therefore, annual impairment test, instead of fixed annual amortization, should better reflect the underlying economics of the intangible assets(Wang, 2005). Further, Harper (2001)noted that the implementation of impairment test offers a clearer picture to financial reporting users in the goodwill impairment process. Pursuant to the new treatment, the carrying amount of goodwill must be written down to the extent of any impairment and the impairment loss recognized in the calculation of profit (FRS 136).

The accounting standard for goodwill impairment under FRS 136 is effective from 1 January 2006. FRS 136 is applicable to goodwill acquired in a business combination for which the agreement date is on or after 1 January 2006. This standard eliminates goodwill amortization, requiring instead that goodwill be evaluated for possible impairment. The shift from amortization to periodic reviews puts a new and continuous responsibility on management to determine the value of goodwill and also a new burden on auditors, regulatory bodies, and investors to evaluate management's determination (Hayn & Hughes, 2006).

FRS 136 deals with the mechanics of testing goodwill for impairment. FRS 136 requires goodwill to be tested for impairment as part of the impairment testing of the cash-generating unit (hereafter referred to as CGU), to which it relates, using a two-step approach. The carrying amount of goodwill must be allocated, from the acquisition date, to each of the smallest CGUs to which of that carrying amount can be allocated on a reasonable and consistent basis. A CGU is defined as the smallest identifiable group of assets that generates cash inflows from continuing use that are largely independent of the cash flows from other assets or groups of assets.

Massoud and Raiborn(2003)have provided a good summary of what managers need to assess for determining goodwill impairment. They note that the determination of impairment of goodwill leaves significant rooms for management interpretation, judgment and bias. It can be said that managers now can simply "pick a number out of a hat" when determining the impairment of goodwill. Now, managers have applied their own creativity to report the goodwill impairment process in the financial reporting. This is in line with the standard, with respect to goodwill CGUs represent "the lowest level within the entity at which the goodwill is monitored for internal management purposes".

The test for impairment of goodwill under the FRS 136 is carried out at the level of the CGU or a group of CGUs which is representing the lowest level at which internal managements monitor goodwill. In 2009, there is an amendment to FRS 136 and an entity shall apply the amendment to FRS 136 for annual periods beginning on or after 1 January 2010. The amendment to FRS 136 stipulates that the level for assessing impairment must never be more than an operating segment. This study believes that an understanding of the level of aggregation of CGUs is of prime significant. This is important because it has the capacity to impact on the likelihood of an impairment loss being recognized.

Prior research has suggested that one great challenge faced by firms in the context of FRS 136 is the manner in which goodwill is allocated between CGUs for the purposes of impairment testing. Wines et al., (2007)conducted a research in investigating the implications of the IFRS goodwill accounting treatment in Australian firms. They

agreed that the first potential difficulty to implement the goodwill accounting treatment involves in identifying the CGUs. Further, Cearns (1999)found that the identification of an asset's CGU in impairment testing of goodwill is a subjective and so the process is open to be abused.

The allocation of goodwill to CGU is a crucial process as the number of CGUs to which goodwill is allocated has the capacity to impact an impairment loss being recognized. The risk relating to allocate goodwill to CGU's is known as the CGU aggregation problem (Carlin & Finch, 2010a, 2010b; Carlin et al., 2009b), where too few CGUs are defined in the process of allocation of goodwill to CGUs. The inappropriate of the CGU aggregation lead to the risk that impairment charges which should occur are avoided, or at least inappropriately delayed. This is important because various types of operations may have differing prospects of growth, rates of profitability, and also the degrees of risk.

In addition, the test for impairment is a one stage process wherein the recoverable amount of the CGU is calculated on the basis of the higher of (a) the fair value less costs to sell or (b) the value in use, and then compared to the carrying amount. In case the assessed value is lesser than the carrying cost, an appropriate charge is made to the profit and loss account. The goodwill appropriated to the CGU is reduced *pro rata*. The FRS 136 requires detailed disclosures to be published in the firm's annual report regarding the annual impairment tests. These include the assumptions made for these tests (assumptions employed in estimating recoverable amount), and the sensitivity of the results of the impairment tests to changes in these assumptions. Radebaugh et al., (2006)stress that these disclosures are intended to give shareholders and financial analysts more information about acquisitions, their benefits to the acquiring firm and the effectiveness and reasonableness of impairment reviews.

In term of assumptions used in determining recoverable amount through the discounted cash flow modeling, the selection of discount rates, growth rates, and forecast period are key factors contributed to the outcome of impairment assessment especially when using the value in use method. The cash flows are estimated with certain assumption which is reflecting to all financial variables. Furthermore, the cash flow information is useful to annual report users in order to evaluate the ability of a

firm to generate cash in the future and also in valuing the firm's performance. Most of the literature in finance, especially in discounted cash flow analysis agreed that three key assumptions are importance(Boyd, 2003; Stegink, Schauten, & Graaff, 2007).

The importance of these three assumptions in accounting goodwill for impairment testing has been successful explored by Carlin and Finch (2008a)and Lonergan (2006). Both studies reveal that net present value estimates for recoverable amount can be highly sensitive even to small changes of those assumptions. The selection of those assumptions on which its current cash flow projections are usually based on firms consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate. Thus, there are highly correlated those key assumptions and the cash flow forecasting which reflect the value of firms. Detail lists of disclosure requirements of FRS 36 used in developing the disclosure index will illustrate in Section 4.

As an overall, under the new standard of accounting for goodwill impairment, goodwill on the accounting book is more challenging and less predictable. For financial information providers' view, goodwill becomes a more risky asset in that its value can impair abruptly, due to the accounting assumptions or market situation changes. On the other hand, for financial report users' view, the process of charging goodwill to expenses becomes less transparent and more unpredictable in that the measurement and reporting are more subjective to management's assessment. The difficulties faced by the financial information providers as well as the financial statement users make accounting standards setters think ahead to refurbish and also straighten the enforcement when firms report the impairment of goodwill process in their annual report. The next section will presents related literatures to the study.

3. Literature Review

It has been accepted that to obtain an internationally agreed perception of disclosure index as well as its item among the users and preparers of financial statements is extremely difficult(Cooke & Wallace, 1989). It should also be noted here that any

scaling method for assigning numerical, weights or other symbols to individual disclosure items has the potential to mislead. This is because the level of importance which is attribute to a disclosure items varies according to the entities, transactions or events, the user, firm, industry, country and the time of the study. The underlying criterion for scoring each annual report studied was informative by which a firm which gives a group users more information on a particular disclosure item than another firm is awarded a higher score than the other. The financial disclosure level is not easily measured because the development and application of a disclosure index requires subjective assessments by the researcher applying the technique. Most of the literatures, captured by an "index" when study a quality of compliance and disclosure in accounting standards.

The disclosure indices either un-weighted or weighted disclosure index have been used as research tools by a number of researchers including Singhvi and Desai (1971), Buzby (1974), Barrett(1976), Robbins and Austin (1986), Chow and Wong Boren (1987), Botosan (1997), Healy and Palepu (2000), and Guerreiro et al., (2008). The intention has often been to identify the motivation for the disclosure voluntary items of information in corporate annual reports by testing relationships between various firm-specific variables drawn from agency theory and voluntary disclosure. The firm-specific variables of firms adopting IFRS are the independent variables whereas the voluntary adoption of IFRS is defined as a dummy dependent variable.

In most cases attention has been given to the number of disclosures (whether an item in a pre-prepared check list has been disclosed or not). Such items have been scored dichotomously (either 0 for non disclosure as IFRS required, or 1 for disclosure as IFRS required). On the other hand, the studies of Yeoh (2005), Teodori and Veneziani (2007), Tsalavoutas et al., (2009)and Hodgdon et al., (2009; 2008)are to look into the level of compliance among the firms with mandatory disclosure requirements. It can be acknowledged that when we take a look on the previous research techniques applied (through their hypotheses tested and methodology used) the index is important aspect to measure the compliance and disclosure level.

However, this study does not seek to establish any contributory links between levels of disclosure and other firm-specific as mentioned in previous studies. The center of attention is on assessing the compliance level and disclosure quality through requirements of the standard and how really Malaysia Shari'ah approved companies comply with the disclosure requirements of FRS 136.

The index used in this study is more complex with particular attention on the weighted disclosure index which also assesses the compliance level and quality of information disclosures as required in accounting standards. The attach weights to the disclosure items is to portray their importance. Researchers such are Cerf(1961), Robbins and Austin (1986), Chow and Wong Boren (1987), Cooke and Wallace (1989), Wallace and Naser (1995), Hooke et al., (2002), Naser and Nuseibeh (2003), Cheung et al., (2010) and Kang and Gray(2011) usually assessed the quality of disclosure by allocating weightings for the importance of each items to its disclosure. Through the allocating weightings for the importance items, the user groups will be able to compare and ranks the compliance level and disclosure quality among the studied firms. Since this study will focus only one particular standard (FRS 136), the weighted disclosure index is used and relevant for this study because it is important for group users to recognize the goodwill impairment testing process as required by FRS 136. Therefore, firms are required to disclose all the requirements of the FRS 136 as a signal of firm's activities and performance.

A number of studies have been conducted through the weighting index in measuring the level of firms' compliance on requirements of disclosure in the stated standards is continuing to attract researchers in 2000's. Hooke et al., (2002)empirically developed disclosure index to assess the extent and the quality disclosure on the information gaps in annual reports of New Zealand electricity industry. The relative importance of index items is brought into account using a system of weights. Their studies decided to use a score of 5 as representative of standards disclosure. They consider 5 points scale provides enough sufficient range to allow the scorer to differentiate between varying degrees of detail and importance in the disclosures. Therefore, it appears that through using the weighted index in appraising the firm's compliance level, it enables group users to careful monitor firm's activities, assess their performance and also develop on-going understanding their future direction.

Naser and Nuseibeh(2003) investigated the quality of information disclosed by a sample of non-financial Saudi firms listed on the Saudi Stock Exchange. They designed the disclosure index basing on the three major areas which are mandatory, voluntary closely associated with mandatory and voluntary unrelated to mandatory after taking into consideration financial reporting requirements in Saudi Arabia. Their studies employed weighted index in analysis the extent of Saudi firms comply with requirements of accounting standards because is expected to give a more objective index. In giving the weighted, it is based on the importance given to each item of disclosure by seven user groups. The five weighting points is given to items viewed as very important, four points for those viewed as important, and two points for some importance and one point for little importance and ranks the sectors based on its mean and median. The disclosure index scored by each firm was then divided on the maximum score. By using the disclosure index they successful managed to measure the compliance level of studied firms.

To date, there is no theory of financial reporting for the preferred guidance of disclosure indices as a measure of quality compliance among the firms worldwide. Most researchers develop, adapt and modify existing indices to meet their own perceived needs as well as their objectives of research. Therefore, it is extremely difficult and complexity to obtain an internationally agreed perception of “best” disclosure index. It is believed that any endeavor to design and develop a universally “best” disclosure index is unlikely to be meaningful unless such an agreement can be established. That is a reason why this kind of study is really interesting to be explored. As a consequence, this study believed that the disclosure index developed is comprehensive enough to understanding the compliance level of firms under the requirements of FRS 136 with satisfying most user groups. The data collection and methodology is explicates in the next section.

4. Data Collection and Methodology

Data Collection

The main aim of this study as discussed above is to examine the level of compliance and disclosure quality of accounting standard related to the goodwill impairment

regime among the top 20 Shari'ah approved companies in Bursa. The sample and data used in this paper are obtained primarily from the Worldscope DataStream Database. This study examines the selection of 20 Shari'ah approved companies on the Bursa Malaysia that have released their 2010 annual reports as measured by market capitalization. Year 2010 was chosen in this study because it is a year after the new amendment of FRS 136by MASB. The final selection of sample for 2010 comprises firms that satisfy all the requirements stated below:

The first, prepare annual report according to the Malaysia Financial Reporting Standards (FRS);

The second, disclose its accounting policy on goodwill in year 2010;

Details of the final research sample, value of their goodwill balances and market capitalization are set out in Table 1.

Table 1: Overview of Research Sample

No.	Company Name	Goodwill (RM'000)	Total Assets (RM'000)
1	AIRASIA BERHAD	8,378	13,240,300
2	AXIATA GROUP BERHAD	7,314	38,100,966
3	BATU KAWAN BHD	12,194	3,261,310
4	IOI CORPORATION BERHAD	513,830	17,343,417
5	KNM GROUP BERHAD	798,974	3,524,152
6	KUALA LUMPUR KEPONG BHD	289,529	9,163,531
7	LAFARGE MALAYAN CEMENT BERHAD	1,205,889	4,124,362
8	MISC BERHAD	746,650	41,060,188
9	MMC CORPORATION BERHAD	2,043,263	36,018,544
10	NESTLE (MALAYSIA) BERHAD	61,024	1,778,681
11	ORIENTAL HOLDINGS BERHAD	31,866	5,511,524
12	PARKSON HOLDINGS BERHAD	1,244,386	6,738,500
13	PPB GROUP BERHAD	7 4,617	13,914,090
14	SAPURACREST PETROLEUM BERHAD	149,012	3,349,261
15	STAR PUBLICATIONS (MALAYSIA) BHD	54,386	1,363,703
16	TELEKOM MALAYSIA BERHAD	310	20,780,000
17	UMW HOLDINGS BERHAD	258,435	10,023,818
18	YTL POWER INTERNATIONAL BERHAD	6,148,646	33,918,933
19	IJM CORPORATION BERHAD	69,544	12,558,295
20	PROTON HOLDINGS BERHAD	29,008	7,505,152
	TOTAL	13,672,638	283,278,727

Instruments to Measure Compliance: The Disclosure Index (Weighted Index)

The purpose of the disclosure index is to produce a rank of disclosure levels among the firms based on the amount of requirements disclosure in their annual reports. The selection of items included in the index was guided by the standard itself (disclosure requirement of FRS 136). The level of mandatory compliance with FRS 136 was measured by a self-constructed compliance index which is consistent with prior compliance studies(e.g. Bradbury & Hooks, 2005; Cheung et al., 2010; Hooks et al.,

2002; Kang & Gray, 2011; Naser & Nuseibeh, 2003; Wallace & Naser, 1995). The initial step in constructing the index was to develop a checklist and was based on the requirements of disclosure of FRS 136.

The annual reports of sample firm were reviewed and an assessment of the amount of disclosure recorded on a 0 to 2 scale based on the importance of the disclosure. This approach is believed to present a better measure on the importance of disclosure than a simple binary (0 and 1) score of the firm disclose or non-disclose of an item. Then, a disclosure index was developed and used to capture the mandatory disclosure and compliance level for each firm in the sample. The disclosure index consists of all information that firms have to disclose in their annual report. The disclosure index has been widely employed by previous researchers to measure the extent of disclosure on requirements of accounting standards. This study also applies the disclosure index to measure the compliance level and disclosure quality of top 20 Shari'ah approved companies with the requirements of goodwill impairment. The purpose of developing disclosure index is to produce a ranking among the firms on compliance level and disclosure quality of FRS 136. The procedure to measure the extent of disclosure (i.e. to create disclosure index) is summarized as follows:

Developing of a Disclosure-scoring Sheet

The important step in developing a disclosure index is the selection of items to be included on a disclosure scoring sheet. As this study is concerns with the measurement of the firms' level of compliance and disclosure quality with the goodwill impairment requirements, the disclosure scoring sheet was designed on the basis of reviewing the requirements of FRS 136. We examine the notes to the accounts of firm's annual report in developing this index. Appendix A provides the disclosures required by FRS 136 from the disclosure scoring sheet protocol established for scoring disclosure items. The scoring sheet was constructed in a way that would permit this study to calculate compliance scores under the weighted method.

To fulfill the objective of this study, there are five important paragraphs in FRS 136 (2009). *First,* the disclosure requirement under paragraph 134(a) of FRS 136 requires entity to disclose the carrying amount of goodwill allocated to the cash generating

units (CGUs) to which goodwill acquired in a business combination is allocated and test for impairment.

Second, Paragraph 80(a) of FRS 136 requires that cash-generating units (CGUs) represent 'the lowest level within the entity at which the goodwill is monitored for internal management purpose. This will tend to lessen the burden in preparing the financial reporting under the new regime. However, to avoid against inappropriate aggregation, Paragraph 80(b) of FRS 136 states that the CGU should not be larger than an operating segment as defined by paragraph 5 of FRS 8 – *Operating Segments* before aggregation.

Third, Paragraph 90 of FRS 136 requires that cash generating unit to which goodwill has been allocated should be tested for impairment annually, and whenever there is an indication that the goodwill may be impaired, by comparing the carrying amount of the goodwill, with the recoverable amount of the goodwill.

Forth, under Paragraph 134 (c) of FRS 136, an entity shall disclose the basis on which the CGUs' recoverable amount has been determined (i.e. value in use or fair value less costs to sell). Fair value less costs to sell is defined as the amount obtainable from the sale of an asset or a CGU in an arm's length transaction between knowledgeable, willing parties less the costs of disposal. That is, market value less selling costs. On the other hand, Paragraph 6 of FRS 136 defines value in use as the present value of the future cash flows expected to be derived from an asset or CGU.

Fifth, under Paragraph 134 (d) of FRS 136, states that if the unit's (group of units') recoverable amount is based on value in use, an entity shall disclose the following:

i. *a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive;*
ii. *a description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information;*

iii. the period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit (group of units), an explanation of why that longer period is justified;

iv. the growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit (group of units) is dedicated;

v. the discount rate(s) applied to the cash flow projections.

Under paragraph 134 (e), if the unit's (group of units') recoverable amount is based on fair value less costs to sell, an entity shall disclose the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit (group of units), the following information shall also be presented:

i. A description of each key assumption on which management has based its determination of fair value less costs to sell. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.

ii. A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(or values) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.

If fair value less costs to sell is determined using discounted cash flow projections, the following information shall also be disclosed:

iii. the period over which management has projected cash flows.

iv. the growth rate used to extrapolate cash flow projections.

v. the discount rate(s) applied to the cash flow projections.

Scoring the Disclosure Items

As explained earlier, this study employs the disclosure weighted index as an effective measure of the level of compliance and disclosure quality among the top 20 Sha'riah approved companies in Bursa Malaysia. Our index identified criteria for 2 level of importance: extremely importance and importance depending on the degree of detail given for each item. Scores (value) were then allocated ranging from 2 (extremely importance) and 1 (importance). If the firm had not disclosed an item that was applicable to the firm, a 0 was recorded. The weights for particular firm was calculated by summing the integral values assigned to the firm and then dividing the total by number of required disclosed through the FRS 136. A mean (disclosure index) was used to summarize the firms' scores because it gave equal weight to each of the firm.

Thus, it is a starting point to assess the compliance level and quality of disclosure to which firms defined CGUs and allocate goodwill to them. The investigation process begins by first, comparing each firm's total goodwill balance with the total disclosed CGU goodwill allocation. If the total disclosed goodwill of the firm is less than the total value of goodwill allocated to CGUs, the quality and completeness of disclosure is classified as lower, and vice versa. Thus, firms score full mark of 2 if they successfully disclosed an allocation of goodwill into CGU into their annual report, otherwise it will mark 0. 1 mark is given for the firm with ostensibly compliant (95% of allocating goodwill to CGU).

The next step is comparing the number of CGUs and business segments for firms in the industry by industry basis. The important aspect in this process is to look at the level of aggregation of CGUs by those firms. As previously detailed discuss, this disclosure requirement is very importance aspect is impairment testing for firms to solve the inappropriate CGU aggregation issue. We believe that this particular disclosure is extremely importance and therefore, firms will score 2 if their disclosure as required in the standard, and 0 for non-disclose item.

The following step is scoring the disclosure item is score 1 for firms that has been allocated the goodwill to be tested for impairment annually, and whenever there is an indication that the goodwill may be impaired, by comparing the carrying amount of

the goodwill, with the recoverable amount of the goodwill and 0 for firms that not tested impairment annually. In addition, the same weighting scoring is also given for firms that disclose method used in estimating the recoverable amount either used value in use or fair value or combination both of them.

Further aspect that needs more attention in assessing the quality of FRS 136 requirements is on inspection of key assumptions that the recoverable amount of CGU assets has been estimated. Recoverable amount is defined as the higher of an asset's or a CGU's fair value less cost to sell and its value in use" (FRS 136, para. 6). Fair value less costs to sell is defined as "the amount obtainable from the sale of an asset or CGU in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal" while value in use is defined as the present value of the future cash flows expected to be derived from an asset or CGU (FRS 136 para. 6). This involves a selection of fair value or value in use and company is required to disclosure which method has been adopted.

As earlier elucidated, the key assumptions used in determining recoverable amount such as discount rate, growth rate and forecasting period are extremely important for users to understanding on the operation of goodwill impairment testing regime. Therefore, score of 2 is given to this particular disclosure items compared to other key assumptions in 134 (i) and (ii). In case where firms not disclose any of the key assumptions used in determining the recoverable amount, they will score 0.For the requirements on fair value method, the scoring of 2 is given if firms used observable market price to calculate its fair value. However, if the firms did not used observable market price, an equally score of 1 is given when reporting entity to use its own data and realistic assumption to develop unobservable inputs.

Creation of Disclosure Index

The disclosure index is a ratio computed by dividing the total actual score for each firm by the total maximum score that particular firm is expected to earn. However, firms are not penalized for not disclosing the information as required in the standard. The disclosure index score is measured using the equation below:

$$DI = \frac{\text{Firm's total actual score}}{\text{Firm's total maximum score}}$$

Ranking of Firms based on Degree of Compliance

The degree of compliance on disclosure requirement among the firms studied was based on Kantudu (2005). The research sample are groups into four categories which are strongly comply (80%-100%), semi strongly comply (60%-79%), weakly comply (40%-69%) and finally non-compliance (0%-39%) as shown in Table 2.

Table 2 – Grading Compliance System with Requirement of FRS 136 in Malaysia

Ranking	Percentage	Form	General Remarks
1	80%-100%	Strongly comply	Excellent
2	60%-79%	Semi strongly comply	Good
3	40%-69%	Weakly comply	Poor
4	0%-39%	Non compliance	Extremely poor

Source: Kantudu(2005).

Reliability and Validity of the Disclosure Index

Prior research revealed that disclosure index is a useful research tool. However, firm's compliance level and disclosure quality is not easily measured because the development and application of a disclosure index requires subjective assessments by the researcher applying the technique. As a result, it is important to assess the reliability and validity of the resulting measure.

In this study, the initial disclosure checklist was evaluated by the other two authors through a similar approach (Tsalavoutas et al., (2009), Camfferman and Cooke (2002), and Cooke (1992)). This process is important to measure the content validity and reliability of the items in the disclosure checklist which basically needs some evaluation and feedback by a group of experts. The other two authors also make some

comments and refining the research instrument (disclosure weighted index) to ensure the reliability and accuracy of the disclosure index.

Therefore, for the purpose of this study, the disclosure requirements regulated in the FRS 136 is assumed to be a "high quality, validity and reliability" disclosure standard since it is based on the standard issued by the IASB through IFRSs after through several intensive process from multi-layer groups of expertise and country of its members. According to Hassan(2004), this assumption is reasonable because of the extensive nature of its disclosure requirements of accounting standards are designed to overcome the lack of guidance with regards to recognition and measurement. Thus, firms have to pay attention and awareness when to report the goodwill impairment in their annual report by ensuring that they disclose all the requirements of the standard.

Data Analysis

The degree of compliance and the extent of firm disclosure will be used as a proxy of quality. With higher degree of compliance and more firm disclosure the requirements in the standard, it significantly viewed as better quality and provides more information usefulness to users. This relationship is proven in this section, through the results of this analysis. The findings set out in Table 3 clearly illustrates the degree of compliance and disclosure as measured through the weighted index (mean scores). Meanwhile, the range distribution of firms is demonstrates in Table 4.

Table 3 shows there are different level of compliance with the requirements of FRS 136 among the top 20 Shari'ah approved companies in Bursa for 2010. Seven firms which are KNM Group Berhad, MMC Corporation Berhad, NESTLE (MALAYSIA) Berhad, PPB Group Berhad, Sapuracrest Petroleum Berhad,STAR Publications (MALAYSIA) Berhad and Telekom Malaysia Berhad were fully complied with the disclosures requirement mandated under FRS 136. These firms employed the value in use method in determining the recoverable amount of goodwill. In other words, these firms had disclosed all the required information in their annual report and this assist the user groups in accessing the firm's financial performance. Consequently, these firms are transparent and fair in providing the detail information at each level of operations.

In comparison, both LAFARGE Malayan Cement Berhad and Parkson Holdings Berhad are ranked ninetieth because fail to comply with the requirements of FRS 136. We found that, although those firms have stated their goodwill amount in their balance sheet, a detail disclosure on impairment testing process are not provided in any paragraph of their notes to the account. Therefore, the rate of compliance with the provisions of FRS 136 for these firms was poor. This result give a good signal that the requirements of the standard in not easy and highly complexity to implement although several amendments have been done to the standard. For the investors, they will face a difficulty in their future investment decision because these firms did not offered transparency and information usefulness in the impairment testing process.

A further analysis in done by examining the analytical results relative to each firm for identification of the ten requirements as described in the disclosure index checklist. Our analysis found two general gaps between the requirements of the standard and the availability of information in firm's financial report. The first general gap between the compliance level and disclosure quality among the firms is related to allocation of goodwill to CGU. We believed that the goodwill allocation is difficult and complex in the impairment testing process. Our analysis showed that Kuala Lumpur Kepong Berhad do not complied with this requirement where they failed to give any meaningful information related to basic allocation of goodwill to CGU. This result correspond from the previous reported by Carlin et al., (2008); Wines et al., (2007); Lonergan (2007); Carlin et al, (2007) and Cearns (1999) mentioned that the requirement of standard on allocation of goodwill is very difficult to implement.

Furthermore, 15 out of 20 firms (75%) failed to fulfill the requirement of the standard in paragraph 80 (b) which stated that the CGU or group of CGUs should not be larger than the operating segment. This study reported that the disclosure by firms suggested a possibility that goodwill was being monitored at a higher level than the defined operating segment, consistent with a higher risk of inappropriate of CGU aggregation. This in turn heightens the risk that impairment losses may not be subject to recognition even where material value degradation has occurred. The results consistent with the previous studies by Carlin and Finch (2010a); Wines et al., (2007); Lonergan (2007); and Cearns (1999).

The second general gap is on the assumptions used in determining the recoverable amount and this study focus on firms used value in use method. As discussed in early section, the three key assumptions which are the discount rate, the growth rate and the period for projected cash flow very important in determining the recoverable amount of CGUs. These factors have strong relationship in influencing the discounted cash flow model in valuing firm's performance. Most of the firms especially firms with multiple numbers of CGUs failed to provide enough information related to these key assumptions and creates difficulty among the user groups to self-assess the firms' potential performance. For example, LaFarge Malayan Cement Berhad and Parkson Holdings Berhad has allocated goodwill to two CGUs, but, the management of these firms failed to provide any meaningful information related to key assumptions used in determining the recoverable amount of its two CGUs. Similarsituation occurred in MISC Berhad and Kuala Lumpur Kepong Berhad. Therefore, those firms are ranked low among the top 20 Shari'ah firms based on the calculation of weighted disclosure index.

In addition, same cases happen to Oriental Holdings Berhad and Proton Holdings Berhad, who ranked 15th and 16th respectively. Although they claimed they employed value in use method in determining the recoverable amount, those firms failed to disclose the details on key assumption used, which are growth rate and period forecasting in their note to the account of annual report. As a result, it is questionable on the level of compliance and disclosure quality among these firms that claimed successful in implementing the FRS 136.

Table 3: Weighted Index for top 20 Shari'ah Listed Firms in Malaysia

No.	Company Name	Weighted Index	Ranking
1	KNM GROUP BERHAD	100.00%	1
2	MMC CORPORATION BERHAD	100.00%	1
3	NESTLE (MALAYSIA) BERHAD	100.00%	1
4	PPB GROUP BERHAD	100.00%	1
5	SAPURACREST PETROLEUM BERHAD	100.00%	1
6	STAR PUBLICATIONS (MALAYSIA) BHD	100.00%	1
7	TELEKOM MALAYSIA BERHAD	100.00%	1
8	AIRASIA BERHAD	84.62%	8
9	AXIATA GROUP BERHAD	84.62%	8
10	BATU KAWAN BHD	84.62%	8
11	IOI CORPORATION BERHAD	84.62%	8
12	UMW HOLDINGS BERHAD	76.92%	12
13	YTL POWER INTERNATIONAL BERHAD	76.92%	12
14	IJM CORPORATION BERHAD	76.92%	12
15	PROTON HOLDINGS BERHAD	69.23%	15
16	ORIENTAL HOLDINGS BERHAD	53.85%	16
17	KUALA LUMPUR KEPONG BHD	46.15%	17
18	MISC BERHAD	38.46%	18
19	LAFARGE MALAYAN CEMENT BERHAD	30.77%	19
20	PARKSON HOLDINGS BERHAD	30.77%	19

Furthermore, the range of firm's distribution on 20 top Syari'ah approved companies in Bursa Malaysia is demonstrates in Table 4 below. Result from our grading and assessment indicates that, half of the sample fall between 80%-100% which represent of 55% of total research sample that are strongly comply. In comparison, 4 firms are categorized into the poor to extremely poor compliance (less than 50%) which we believed that this scenario to be inadequate, because we recognized that top 20 Shari'ah approved companies are able to complied with all disclosures requirement in FRS 136 and assumed that Malaysia as an advanced and economically significant economy and capital market in the heart of Asia, with a highly skilled professional workforce and strong institutional and financial infrastructure to support quality financial reporting

Based on the pattern results of the study, we acknowledged that the requirements of FRS 136 is highly complexity and problematic for firms to implement. For these reasons we believe there is plenty of scope for improvement in this area, in order to make the standard related to the goodwill impairment testing useful for all external users, first and foremost the investors and also for the accounting standards setters.

Table 4: Range of Firm Distribution

Weighted Index - Range (%)	No. of Firm	%
Between 90 and 100	7	35
Between 80 and 89	4	20
Between 70 and 79	3	15
Between 60 and 69	1	5
Between 50 and 59	1	5
Less than 50	4	20
Total	**20**	**100**

5. Conclusions and Recommendations

This study sets out to offer proof of several important questions relating to the quality of information disclosed on goodwill impairment process under the new requirements of FRS 136 (2009). This study investigated the compliance level and disclosure quality of the new requirement of FRS 136 by top 20 Shari'ah approved companies in Bursa Malaysia for the financial year 2010 which is a year after the amendment of FRS 136. The results revealed that the compliance level and disclosure quality of FRS 136 is still lacking in its implementation and that the real situations in Malaysia jurisdiction where we expect the compliance level and disclosure quality are high. This deficiency may result in a decreased in the ability of external analysts to completely self-assess firm's performance.

The results of this study offer the group users further insight on the systematic compliance and disclosure quality of the new standard as required in the goodwill impairment testing process. However, it is clearly from the present study, several critical issues should be focused especially on the identification and valuation of CGUs, and the numerous assumptions to be made in estimating the CGUs recoverable amount. These two issues need to be considered in developing more complete understanding of the causes that some firms failed in complying with the new goodwill reporting regime.

Our results should be of interest to practitioners in the area of accounting standard setting and regulation, as we argue that the adoption of new requirement of goodwill impairment testing, unaccompanied by full compliance of the disclosure requirements, limits the effectiveness of the standard. The issue of compliance continues to be a contentious issue, for instance, indicating that rigorous interpretation and application of the standard.

This study covers only the first year of the new FRS 136 amendment, and so is limited by the availability of information pertaining to IFRS implementation, as the first year of the implementation may not be an accurate representation of the true level of compliance and disclosure quality with regard to IFRS based reporting. The total impact of the FRS 136 amendment on companies' financial reports will take years to fully unfold, but given more years of financial statement data, it may be possible to look at the pattern of disclosure on the key assumption used for the purpose of

impairment testing and find different results.

Finally, it is also important to note that, the accounting related to goodwill especially in allocation of CGUs and key assumptions adopted in estimating the recoverable amount of CGUs need to be examined from time to time, to see if any new issues of goodwill have emerged and also to revise the standard to become more reliable and follow the current accounting needs.

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APPENDIX A: Disclosure Index and Weightings

Contents	References	Score
An entity shall disclose the carrying amount of goodwill allocated to the unit (group of units)	Para 134 (a)	2
Cash-generating units represent 'the lowest level within the entity at which the goodwill is monitored for internal management purpose and that the CGU should not be larger than an operating segment as defined by paragraph 5 of FRS 8 *Operating Segments* before aggregation.	Para 80 (a) (b)	2
Cash generating unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication that the goodwill may be impaired, by comparing the carrying amount of the goodwill, with the recoverable amount of the goodwill	Para 90	1
An entity shall disclose *the basis on which the unit's (group of units') recoverable amount has been determined (ie value in use or* fair value *less costs to sell)*.	Para 134 (c)	1
A description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.	Para 134 (d)(i)	1
A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information	Para 134 (d)(ii)	1
The period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit (group of units), an explanation of why that longer period is justified	Para 134 (d)(iii)	1
The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit (group of units) is dedicated.	Para 134 (d)(iv)	2
The discount rate(s) applied to the cash flow projections	Para 134 (d)(v)	2
If the unit's (group of units') recoverable amount is based on fair value less costs to sell, an entity shall disclose the methodology used to determine fair value less costs to sell.	Para 134 (e)	2
A description of each key assumption on which management has based its determination of fair value less costs to sell. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive.	Para 134 (e)(i)	2
A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information	Para 134 (e)(ii)	1

THE BENEFIT OF STATE AUDIT AND SIGNIFICANCE TO ENHANCINGTHE VALIDITY OF STATE BUDGET ACCOUNTING – THE CASE OF VIETNAM

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Abstract

For achievement common goals, state accounting is used and applied by Government for adjusting the activities of public organizations that are followed with the social-economic policies in the country. Indeed, public sector has been playing a pivotal role to run in supporting the Government's aspirations in the development in any countries. To conduct these responsibilities, public entities have to provide the valuable financial information for making the decisions. These figures will be extracted from accounting documents and reports because accounting is a financial resources measurement of any firms. As a result, public sector accounting, also known as budget accounting, is an important tool for reflecting the governmental transactions to general statements. However, there are some limitations or errors at the public sector accounting reports. Therefore, state audit is established for checking, monitoring and inspection figures that made from pubic accounting. Moreover, from the past to present, very little research has been conducted to define the usefulness of public auditing to general accounting. With causes and necessary, the main purposes of this paper is to identify the theory of state budget accounting, the activities, characteristics and tasks of State audit for improving the value of accounting data in the Vietnamese public sector.

Keywords: state audit, public sector accounting, state budget accounting, auditing

1. Introduction

Together with the operations of private companies, a number of public sector entities are also working with numerous activities. Organizations of all fields and sizes need to implement a streamlined accounting system in order to accurately record and report the transactions. Accounting, also known as accountancy, is as a company's tool for reflection and measurement of financial resources and account information. This information is posted in various financial accounts and disclosed to decision makers

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and other parties in a specific format. Most people say that the matters which occurred in public sector entities are different with the events happened in companies. Therefore, the firms need figures as effective as making decision about public sector accounting. In many countries, the state accounting regime has some differences about recording, summarizing, preparing reports, etc. Along with objectives purposes, the subjective reasons have been made many matters about the corruptions or embarrassments in government budget. As a result, the state audit has formed for controlling and inspecting the state figures and clearly making transparency report for whole nations (Laura, 2008).

In fact, there are a lot of researches in public sector accounting, such as accrual matters, cash basis accounting matters, the development of international public sector accounting standard in countries, financial management in public sector, etc. However, in the world, from the past to present, very little research has been conducted to examine the benefits of government auditing with public sector knowledge. With above reasons, the content of this paper will focus into five sections as following: (1) introduction, (2) literature review and research method about the public sector accounting and state auditing, (3) legal status, tasks, types, contents and audit process of Vietnamese state audit, (4) solutions for developing the value of state audit in Vietnam and other countries and (5) conclusions.

2. Literature Review and Research Method

Literature Review

There is no doubt that governmental finance is a foundation and an important part of state accounting (Le, 2009). State finance always represents the public interest of any country and having a close relationship with the interests of businesses, organizations, families, individuals and foreign countries as well. All subjects in the society have the obligation to contribute the cash that extracted from the part of their income to the state. Taxation is the main source of state finance and this is revenue that has compulsory item required by law. In addition, state also has some revenues, as following: revenues from the sale or lease of state assets; voluntary contributions of the people; aid, debt targets under sate agreement. The state expenditure has consisted of regular expenditure, expenditure for development and investment and other expenses.

The structure of expenditures will depend on the task of state and the ability of the economy in each period. As the mechanism for creating the fund, it can be divided state finance into the parts, such as the state budget; state financial funds outside the state. Moreover, Philip (2011) revealed that as assigned in accordance with the system of government, the state finance has-been included: governmental state finance and local level (province, district and commune).The concept of state finance is broader than the concept of the state budget. Hence, the decentralization of management state finance does not coincide completely with the decentralization of management government budget and the decentralization of management budget is the core of decentralized finance. For managing the state finance, the government must use its management tools as the environment and transmission of the impact of management entity (the state) to the managed object. The tools for control state finance can be cited as: law, estimation and accounting. Among three factors, state accounting is supposed as an instrument for reflecting the picture of state finance. Hoang (2008) said that the auditing in government has been executed an essential field for most area in the society.

The contents of state accounting are to record, process and provide information about the entire of situation and the movement of financial resources (in the form of taxes, debt, regular expenditures, development and investment spending, paying the debt, etc.), state property and from that to the inspection and control of economic contracts, state finance, helping the State to make the economic decisions, the measures of economic management, finance and more effective (Vaughan, 2012). State accounting is part of the general accounting in the national economy, therefore, must comply with generally accepted accounting principles and methods (Azlan and Susela, 2008). However, State accounting has certain independent position in the general accounting system, associated with the financial-economic cycle through the state budget and state finance besides the state budget funds. Although there are some controversies, it can be believed that state audit is an office which is significant to monitor the using and receive budget of any departments in any countries.

Research Method

The paper adopts content analysis approach. By using the quality researching method, through the analysis the current situation in Vietnam, the paper will provide the

limitations from operations, processing of auditing. In addition, author has also reviewed the legal documents from the past to the present and discovers some unsuitable clauses and gives some ideas for reform.

3. General Framework of Vietnamese State Audit

Definition

According to Thinh (2010) and Hoang (2009) Audit activities of the State Audit is considered the examination, evaluation and verification of the accuracy and truthfulness of financial statements, compliance with law, economic nature, efficiency and effectiveness in the management and use of state budget, money and property. Principles for audit activities of the State Audit are independence and compliance with law only as well as honesty, objectivity.

Legal Status, Functions, Tasks, Powers and Organization of State Audit

The State audit is a government body which has power function in a country, as details:

- *Legal status*: the State Audit is a professional agency specialized in state financial examination, set up by the National Assembly, operating independently and complying with the law only.
- *Functions*: the State Audit has the function of conducting financial audit, compliance audit or operational audit with respect to agencies and organizations managing and/or using state budget, money and property.
- *Tasks*: these are the some main duties that audit has to perform, such as:
    a. To decide and organize the implementation of annual audit plans as well as report them to the National Assembly and the Government before implementation.
    b. To submit the State Audit's opinions to the National Assembly for considering and deciding on the state budget estimates, deciding on the allocation of central budget, the national important projects and works, and approving final settlements of the state budget.

c. To join the National Assembly's Economic and Budget Committee and other National Assembly agencies as well as the Government in considering and verifying reports on state budget estimates, schemes on allocation of the central budget, adjustment of state budget estimates or on arrangement of budget for important national projects and works, which have been decided by the National Assembly, and final settlements of the state budget.

d. To report annual audit results and results of implementation of audit proposals to the National Assembly,; send audit reports to the Nationality Council and the National Assembly's Committees, the State President, the Government and the Prime Minister; supply audit results to the Finance Ministry, the People's Councils of localities where audits are conducted, and other agencies.

e. To publicize audit reports and transfer dossiers to investigation agencies and other State agencies competent to examine and handle cases, which show signs of law violations by organizations or individuals and are detected through audit activities.

f. To manage audit dossiers; keep secret accounting documents and figures as well as information on operations of audited entities.

- *Powers*: these are the some main rights that audit got, such as:

a. To request audited entities and relevant organizations and individuals to supply full, accurate and timely information and documents in service of audit.

b. To request audited entities to act in response to the State Audit's conclusions and proposals on their violations in financial statements and violations; propose measures to redress shortcomings in operations of entities which it has detected and proposed.

c. To propose competent State agencies to handle violations of law committed by organizations or individuals, which have already been clarified through audit activities.

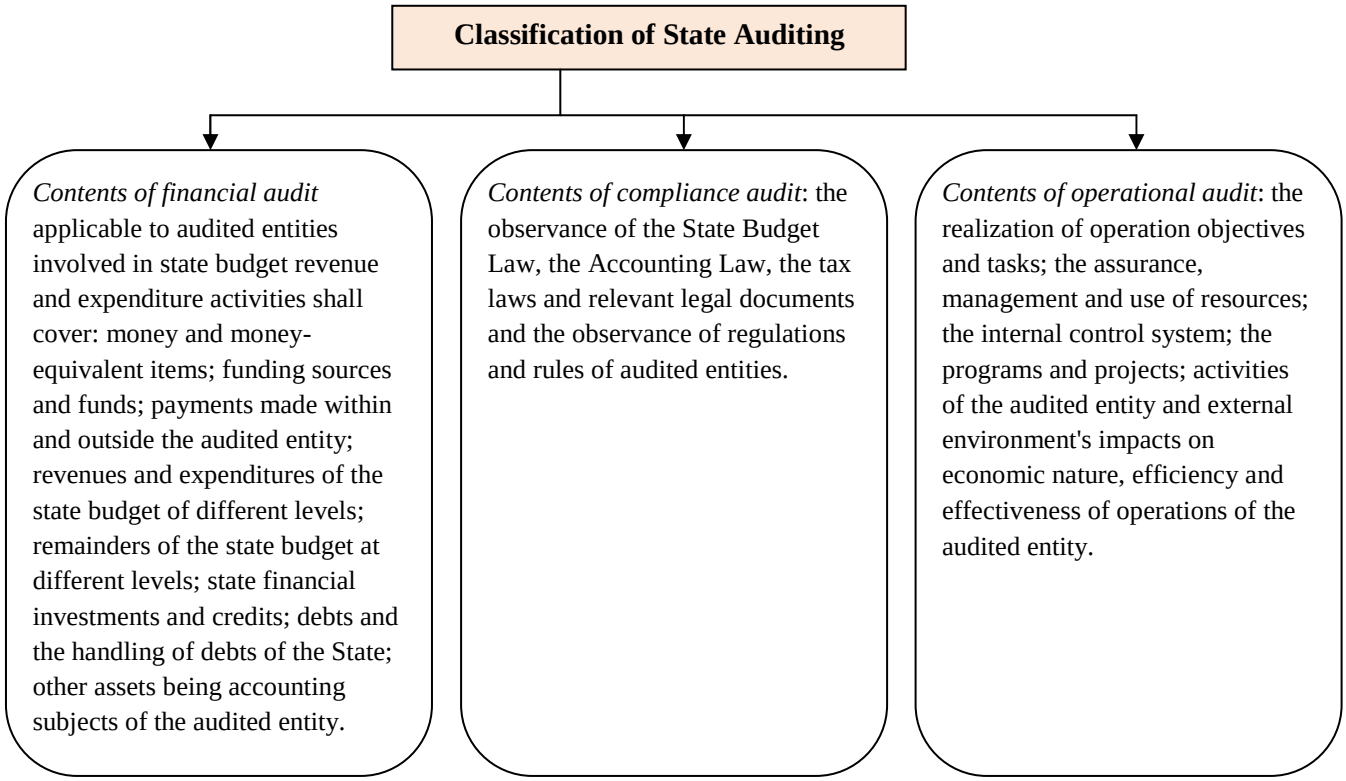
d. To request competent agencies to handle according to law organizations and individuals those obstruct its audit activities or supply untruthful information and documents to it and State auditors.

e. To entrust or hire audit enterprises to audit agencies or organizations managing and/or using the state budget, money and property; take responsibility for the accuracy of audit data, documents and conclusions provided by audit enterprises.

f. To propose the National Assembly, the National Assembly Standing Committee, the Government, the Prime Minister and other State agencies to amend and/or supplement mechanisms, laws and policies appropriately.

Types and Contents of Audit

Types of audit include financial audit, compliance audit and operational audit. The State Auditor General shall decide on the type of audit for each audit.



State Auditing Processes

Steps of the audit process are:

- *Preparing audit*: surveying, gathering and evaluating information on the internal control system, financial situation and other information related to the audited entity. From that, going to elaborating an audit plan.
- *Auditing*: by apply audit professional and operational approaches to gather and evaluate audit evidence; conduct examination, comparison and verification, an audit delegation must conduct the audit at the defined audited entity and comply with the audit objectives, contents, scope, venue and duration as stated in the audit decision of the State Auditor General.

- *Making and sending the audit report*: upon the end of an auditing year and an audit, the State Audit shall make an audit report, clearly stating its evaluations, verifications, conclusions and proposals on audited contents.
- *Inspecting the implementation of audit conclusions and proposals*: auditors must elaborate plans for and organize the inspection of audited entities in the complete and timely implementation of its conclusions and proposals regarding the latter's violations in financial statements and violations of law; the application of measures to redress shortcomings in their operations and results thereof, according to conclusions and proposals of the State Audit.

4. Results and Solutions for Enhancing the Value of State Audit

Viewpoints on Development of the State Audit

The strategy for development of the State Audit for long term purpose must demonstrate the following viewpoints:

- This body should be transferred to a main and efficient tool of the State in examining and controlling the management and use of the state budget, money and assets and of the National Assembly at all levels in supervising and deciding on important national and local issues.
- It should be expanded in line with the government’s points of view, guidelines and policies and accordance with the State’s legal system, and the independence of activities should be make sure that Audit can carry out all of its functions and tasks, better adapting all requirements of the management of the state budget, money and assets in the process of renewal.
- It should be growth in line with the objectives on administrative reform in general and public finance reform in particular, and its suitable scope should be determined in each period to meet requirements of assigned tasks. The state audit should be step built into a professional and modern agency with a reasonably developed quantity and improving quality and a neat apparatus that operates efficiently and effectively. Modern information technologies (IT) should be extensively utilized to audit management and operations.

- The State must adopt policies to prioritize necessary resources for the organizational structure and State Audit's operation, investment in the development of IT system in the sector and support for training the sector's personnel to cope with international integration requirements.
- It should be also operated to the needs of international economic integration and in accordance with international principles and practices and Vietnam's practical conditions.

Solutions for the Development of the State Audit

Major contents of the solution for development of the State Audit are five matters as details:

- ***First***, creation of complete and comprehensive legal grounds for the organization and operation of the state audit: studying and proposing the addition, at an appropriate time, to the Vietnamese Constitution of some articles or clauses; revising laws and relevant legal documents on the State Audit in order to ensure the consistency and uniformity of provisions of the legal system on the organization and operation of the State Audit.
- ***Second***, about the development of the organizational apparatus system of the audit office: to further develop and improve the organizational apparatus system of the State Audit after the current model of centralized and unified management, consisting of advisory units specialized state audit offices at the central level, regional state audit offices and non-business units. To strive to basically complete the organizational structure and build its organizational apparatus with a complete structure and sufficient personnel for proper operation.
- ***Third***, the development of human resources: developing the contingent of cadres, civil servants and public employees which is sufficient in quantity and rational in professional and rank structure. Furthermore, building a contingent of state audit cadres, civil servants and public employees who have a firm political stance, good professional ethics, sound professional skills and professionalism commensurate with requirements of the audit profession and the international integration.
- ***Forth***, the strategy for raising audit quality: comprehensively raising audit quality in the three aspects of capability, effectiveness and efficiency.

- ***Fifth***, the strategy for development of physical foundations, public information and propaganda and scientific and information technology development: formulating priority policy to vigorously mobilize resources for building special physical foundations for the entire system of the State Audit. Intensifying and diversifying forms of intensive and extensive public information and propaganda about the law on audit organization and operation as well as audit practices through formulation of specific plans combined with inspection and assessment of their implementation.

5. Conclusion

In the stage of development and management of the economy by the current trend of integration, especially when Vietnam joined the World Trade Organization, the development strategy of the State Audit of Vietnam for the long term period is set urgency, age, stem from the following reasons: firstly comes from the position, role and importance of state audit in general economic management and management of public asset in particular; secondly, from the practice in Vietnam's socio-economic status and the inevitable requirements of state audit in the trend of integration management; next, stem from reasons of economic integration international; last, stem from the current limitations of the Vietnamese budget state accounting. For the first three reasons, they have been mentioned a lot at the last time, and relatively unknown, here this paper would like to refer to the fourth reason, which is the current limit of the state accounting and auditing in Vietnam. State fields but has grown in many ways, has confirmed the location of its role in the past years but is not limited to the restrictions and exists as the quantity and quality of the state accountants do not meet the management requirements today. Facilities management facilities are poor, backward and needy. processes and building new audit approach in the first step; audit field must still popular is the field of auditing financial statements; audit focus areas, basic, key audit work yet to be done independently and completely.

With the efforts of government, there have a lot of solutions for improving the quality of state audit. Hence, in recent years the results of operations of the State Audit has achieved important results which are higher than the previous year; contributing to the reform of the financial system-the national budget, building up the nation's financial

transparency and efficiency; recovery for the state budget revenues that may not be obtained due to mistakes and errors in the process of budget and financial management and contribute anti-corruption, thrift practice and waste combat. Vietnam needs to orient to make the better environment of state audit. State audit is one of the factors that contribute to ensuring and maintaining the economy, the efficiency of economic activities. Through its activities, the state audit indicates the use of state funds in each sector, each field, each enterprise and the factors that hinder the effectiveness of activities in the economy. On the other hand, the state audit also provides an important basis of reliable data to make the distribution and operating a state budget effectively, consistent with the practical situation of each sector and industry areas and eliminate unreasonable expenses that cause losses to the budget. Over all the values and benefits, State audit have to be a tool for financial examination of the state to make the power of people in check and control. Certified comments by the state audit are to ensure the reliability of budget financial information and the general economic groups in particular.

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CORPORATE SOCIAL RESPONSIBILITY OF MALAYSIAN ISLAMIC BANKS: ARE THEY COMPLYING WITH THE *SHARI'AH* PRINCIPLES?

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Abstract

Corporate Social Responsibility (CSR) and ethical banking is of relevance especially for Islamic banks since they are based on religious foundations. Islamic banks are thus expected to potray a high level of CSR which would be evident in their CSR disclosure practices. However, several prominent studies in the related field have shown otherwise. This study examines the adequacy of the conventional CSR framework in guiding the CSR practices of Malaysian Islamic banks. Employing a sample comprising three full-fledged Islamic commercial banks over the years 2004-2010, the present study constructs the CSR Disclosure Index (CSRDI) to score the banks' disclosure level. It is revealed that Bank Islam score higher than their peers since 2006. Disclosure of the sample banks on some dimensions, such as corporate vision, employment and product is found to be strong, whilst disclosure on environment tends to be weak. The result of this study may have some important implications for the enhancement of CSR disclosure of Islamic banks.

Keywords: Corporate Social Responsibility, disclosure, Malaysia, Islamic banks, *Shari'ah*

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1. Introduction

Corporate Social Responsibility (CSR) has gained an unprecedented global focus and attention because it touches on many salient issues in the present business world. In general, CSR is essentially a concept whereby companies decide to contribute to a better society and a healthier environment. At present, a good number of companies are promoting their CSR strategies as a response to a variety of social, environmental and economic pressures. CSR framework sets standard of behaviour to which a company must subscribe in order to impact society in a positive and productive manner while abiding by values that exclude seeking profit at any cost (Dusuki & Abdullah, 2007).CSR has taken its stronghold in developed countries, especially amongst corporations across business sectors, in the United States, United Kingdom and European countries. However, the concept of CSR is still emerging and elusive for emerging markets and remains a continuously challenging issue for business managers.

In recent years there has been a considerable development of the Islamic banking sector within the emerging and or Middle-East countries. The main factor underlying the establishment of Islamic banks is the desire to run an economic system based on the values and principles of *Shariah*. The main difference between Islamic banks and conventional banks is that while the latter is based on the conventional interest-based principle, the former follows a principle of interest free and profit and loss sharing in performing their business as intermediaries (Ariff1988). Usmani (2000) states that the underlying philosophies of Islamic banks are to distribute justice that is free from all forms of exploitation. Despite the fact that Islamic banks are established on the desire to manage the banking sector on the values and principles of *Shariah*, the Islamic banking sector are using the conventional CSR framework and dimensions to guide their CSR strategies and practices. In an attempt to provide general guidance on disclosure for Islamic Financial Institutions, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) introduced the Financial Reporting and Governance Standard (1998, 2005), which provides guidance to Islamic banks/financial institutions in respect of reporting including the reporting of their CSR activities.

The aim of this study is to examine the current CSR practices and disclosure of Islamic banks operating in Malaysia. The current CSR framework offered today in mainstream economics which has been developed in isolation from Islamic input may not offer full guidance for Islamic banks in Malaysia which is operating in a dissimilar philosophy. Currently, Islamic banks in Malaysia are using the conventional CSR framework and dimensions to guide their CSR strategies and practices. Due to lack of a structured CSR framework for Islamic banks worldwide, Islamic banks are unsure of what kind of CSR is expected of them based on Islamic prescriptions other than to avoid *riba* and *gharar* (Farook, 2007). Furthermore, even if Islamic banks are conducting their social responsibility activities, they may not be informing the rest of society through disclosure, leading to an expectation gap.

This paper is organized into four sections. The subsequent section proceeds with the background of the research. The third section provides the literature review of the study whilst the fourth section discusses the methodology and this is followed by the results and discussion section. The final section offers the concluding comments.

Background of Research

Malaysia has the unique distinction of being the world's first to have full-fledged Islamic financial system operating in parallel to the conventional banking. Malaysia possesses one of the world's most advanced Islamic financial markets and have attracted foreign financial institutions to make Malaysia their destination of choice to conduct Islamic banking business which in turn has transformed Malaysia into one of the most viable Islamic banking market in the world.

Since Islamic banks are based on divine revelation, Dusuki (2006) argues that the concept of CSR should be naturally embedded and instilled in Islamic banking practices. In this context, there is an increasing challenge for Islamic banks to play a significant role in economic progression, environmental protection and social stewardship. Notably, Islamic banks have the dual ability to redistribute wealth and allocate wealth to selective investment that contributed to the betterment of society. It is this allocation of power that differentiates Islamic banks from the conventional banks and indeed bestows upon it special responsibilities. Currently, Islamic banks in

Malaysia are using the conventional CSR framework and dimensions to guide their CSR strategies and practices and the aim of this study is to examine the adequacy of such framework to guide the CSR practices of Malaysian Islamic banks.

2. Literature Review

CSR: An Islamic Perspective

Corporate Social Responsibility from an Islamic perspective derives itself from core principles in the Holy Qur'an. The major foundational principles for ICSR are Unity(*Tawhid*), Vicegerency (*Khalifah*), Accountability and Justice (Farook, 2007).

The concept of Unity is derived from the belief in one God. In light of God's ownership of everything, it is believed that God has entrusted mankind to the use of resources. Thus, in return for the use of the physical universe, mankind agrees to be accountable for how the universe is used (DeLorenzo 2002). Based on the axioms of Unity, the main objective of social responsibility should demonstrate responsibility not only to Allah (SWT), provide one single direction in guaranteeing a unified spirit in adhering to *Shari'ah* (Moten, 1990).

> *"Say: Truly, my prayer and my service of sacrifice, my life and my death are all for Allah, the Cherisher of the Worlds"* (Surah Al An'am: 62).

The concept of vicegerency denotes that mankind is the representative of Allah on earth and as such Allah has entrusted mankind with stewardship of Allah's possession. The concept of *khalifah* (vicegerency) envisages business corporations as stewards or caretakers, not just of shareholders' financial resources, but also of society's economic resources, holding their property in trust for the benefit of society as a whole and ultimately attaining the blessing of God. This implies an ineluctable need for firms to instill good CSR practices in their business conduct embracing issues such as good environmental practice, occupational safety, philanthropic contributions, and socially beneficial and harmless activities and initiatives. Failure to do so is tantamount to an affront to God's will, with all the attendant consequences

in this world and in the Hereafter (Dusuki, 2008). Allah states this principle in the Holy Qur'an*:*

"I will create a vicegerent on earth"(Surah Al Baqarah:30)
"It is He who hathmade you the inheritors of the earth"(Surah Al An'am:165)

The concept of divine accountability flows from vicegerency principle and denotes that individuals will be accountable to Allah for all of their actions on the Day of Judgement. This divine accountability is the basis for all actions of a Muslim, and in turn the representative organizations of Muslims (Farook, 2007). This principle is expounded in several verses of the Holy Qur'an:

" Allah takes careful account of everything" (Surah An Nisa':86)

"Then shall anyone who has done an atom's weight of good shall see it and anyone who has done an atom's weight of evil, shall see it" (Surah Al Zalzalah:7-8)

The concept of justice is a sense of balance among the various aspects of a man's life in order to produce the best social order. This sense of balance is achieved through conscience purpose. Justice includes the fulfillment of promises, pacts and contracts. Islam condemns cheating and lying and commands businessmen to be straightforward in all their dealings and transactions (Khan & Karim, 2007).

The principle of enjoining good and forbidden evil encapsulates the responsibilities that Allah places on Muslims as trustees and vicegerents (Farook, 2007). Allah says:

"The Believers, men and women, are protectors one of another; they enjoin what is just (accepted), and forbid what is unjust (rejected)..." (Surah Taubah:71)

"You are the best of peoples, evolved for mankind, enjoining what is just (accepted), forbidding what is unjust (rejected), and believing in Allah"(Surah Al Imran:110)

The manifestations of such social responsibility, particularly in institutional settings such as Islamic banks, therefore need an overwhelming *Shari'ah* paradigm.In fact, Islam lays down a moral framework by spelling out values and non-values, as well as what is and is not desirable from a moral, spiritual, and social perspective (Ahmad , 2003).

CSR Disclosure by Islamic Banks

The disclosure of CSR activities is expected to be vitally practiced by Islamic Financial Institutions (IFIs) since these institutions are described as "having a social face" (Mashhour, 1996). Maali et al. (2006) believe social role is very important for Islamic banks, and is specified or at least mentioned in many banks' articles of association and that it reflects the importance of Islamic principles and how banking operation and practices contribute to reducing social issues. Haniffa and Hudaib (2004) states that one opportunity to demonstrate responsibility and commitment in meeting the needs of the Muslim community and society in general is through the disclosure of information that is relevant and reliable in the annual report. Through the disclosure of social responsibility, Islamic banks can provide information on the extent to which it has fulfilled the function as a means to improve the welfare of the community.

According to AAOIFI guidelines some of the items concerning CSR activities in the Islamic perspective, which an Islamic bank is expected to disclose under CSR reporting standards, are:

1. Islamic ethical behaviour;
2. Good governance, including efficient board of directors and SSB;
3. Good customer relations;
4. Fair dealing with those in the supply chain;
5. A focus on protecting staff, encouraging talent, ensuring diversity, keeping international labour standards, and providing safety and security in the workplace;
6. Provision of *Zakah* (religious tax) and charity funds;
7. Fostering strong links with the community through public service announcements, sponsorships, etc;

8. To balance corporate goals with activities to enhance environmental protection, including investment in the environment friendly projects, developing *Shariah* complaint green products, etc; and
9. Research, development, and training (RD&T).

Both CSR-reporting literature in Islamic perspective and AAOIFI have recognised the importance of disclosing information relating to corporate social issues on financial statements.Haniff and Hudaip (2007)identified 5 distinctive features that differentiate Islamic banks from mainstream conventional banking; as follows:

1. Underlying philosophy and values
2. Provision of interest-free products and services
3. Restriction to Islamically acceptable deals
4. Focus on developmental and social goals and
5. Subjection to additional reviews by the SSB

Using Hanif and Hudaip (2007) methodology, Hasan and Harahap (2010) examine the CSR disclosure of Islamic banks based on the following eight dimensions:

1. Ethical behaviour, stakeholder engagement, and customer relations
2. Good governance
3. Interest-free, lawful products and services
4. Shariah Supervisory Board
5. Development and social goal
6. Employees
7. Environment and
8. Research and development

They argue that Islamic banks should disclose all the above-mentioned information under the CSR disclosure policies that would facilitate users in their evaluation and assessment of the financial position and performance of an Islamic bank. In fact, the Islamic banks should bear responsibility to disclose information that would enable users to make economic decision from their accounting reports.

3. Methodology

The research approach involves content analysis of annual reports of three full-fledged local Islamic banks operating in Malaysia. The reporting period of study covers seven years i.e. from 2004 – 2010.The seven-year window period enables an examination of the trends in the disclosure practices on CSR related activities amongst local Islamic banks from its early stage of establishment to the current state. Content analysis of companies' annual reports is one of the most reliable ways of obtaining meaningful measures of social and environmental activities (e.g. Hackson & Milne, 1996; Cormier et al., 2004; Zeng et al., 2010) and has gained acceptance from researchers as the data collected are objective, systematic and reliable (Gray et al., 1995b).

Drawing on AAOIFI guidelines (2005), Haniffa and Hudaib's (2007) five distinctive features of Islamic banks and Hasan and Harahap's (2010) eight dimensions of CSR disclosure, this study examine the disclosure of CSR activities of the Malaysian Islamic banks based on six key thematic measurement areas:

1. Strategy
2. Governance
3. Product
4. Community Development and Social Goals
5. Employee and
6. Environment

The six key areas used are in line with the Bursa Malaysia's requirements whereby Malaysian companies are to report their CSR activities based on four dimensions (i.e. Workplace, Marketplace, Community Involvement and Environment) and taking into consideration the move towards integrated reporting which requires companies to link their organizations' strategy, governance and financial performance with their social, environmental and economic context within which they operate.

The scoring of CSR disclosure in this study is assessed using an equal-weighted index, which means that a point is awarded for each CSR disclosure theme in relation to any of the key elements considered. Disclosure score for each company is totalled

and not given any specific percentage as it is considered that each item of disclosure is equally important. The CSR disclosure score indexes are constructed as follows:

$$\sum_{i=1}^{m_j} \frac{d_j}{N}$$

The index indicates the level of disclosure for a company, where N is the maximum number of relevant items a company may disclose and d_i is equal to 0 if there is no disclosure; score of 1 if there is disclosure. Table 1.0 presents the key elements for each of the six thematic measurements and the maximum score for each key element. In total 78 constructs were developed as indicators of the index.

Table 1: CSR Disclosure Index

KeyTheme	Key elements	Score
1. Strategy	• Corporate Vision	4
2. Governance	• Board of Directors &Top Management	15
	• *Shari'ah* Compliant	15
3. Product	• Product, Services, and Fair Dealing with Supply Chain	8
4. Community Development and Social Goals	• Strategic Social Development	13
	• Research, Development and Training	5
5. Employment	• Employees	10
6. Environment	• Environment	8
TOTAL SCORE		78

Table 2 below presents the detailed constructs developed for the CSR disclosure index. The use of the disclosure index was deemed relevant to study the CSR reporting practices as it allows for an objective measurement of disclosures, as well as the development of a systematic numerical basis for a further examination of disclosures (also Deegan & Gordon, 1996; Walden & Schwartz, 1997; Bewley & Li, 2000; Hughes et al., 2001; Patten, 2002).

Table 2: Detailed Constructs for the CSR Disclosure Index for Islamic Banks

Key Theme	Key elements	Items
1. Strategy	Corporate Vision	• Operates within *Shari'ah* principles • Focus on stakeholders and distribution of profit • Appreciation to shareholders and customers • Building long-lasting relationships with customers
2. Governance	Top Management	• Name of the board of directors • Position of the board members • Academic qualifications of board • Profile of the board of directors • Remuneration of the board of directors • Shareholding of the board of directors • Various subcommittee exists and number of meeting held • Audit committee exists • Multi-directorship exist among board of directors • Name and position of the management team • Member in the subcommittee of the management team members • Academic qualifications of the management team • Governance structure of the Islamic bank including committees under the highest governance body responsible for specific task, such as setting strategy or organizational oversight • Mechanism for shareholders and employees to provide recommendations or direction to the highest governance body and annual general body meeting • Risk management practices
	Shari'ah Compliant	• Name of Shariah Supervisory Board (SSB) members • Qualifications of SSB members • Number of SSB members • Remuneration of members • Report sign by all members • Number of meetings held • Examination of documents based on sample • Examination of all documents • No defects in products • Report defects in product • Report of SSB • Nature of unlawful transactions • Certification of distribution of profits/losses complying to *Shari'ah* • *Zakah* calculated according to *Shari'ah* • *Shari'ah* screening during investment
3. Product	Product,	• Introduction of SSB-approved new product

	Services, and Fair Dealing with Supply Chain	• Basis of *Shari'ah* concept on new products • Glossary/definition of new product • No investment in non-permissible activities • Nature of unlawful transaction • Fair dealing with those in supply chain • Promotion of Research and Development • Market survey and feasibility report
4. Community Development and Social Goals	Strategic Social Development	• Funding to organizations that provide benefits to community for social equity • Fostering strong links with the community/public service • Creating job opportunities • Amount spent in community activities • Participation in government-sponsored social activities • *Zakah* payment - monetary • *Zakah* payment - beneficiaries • Qardh-Hassan - monetary • Qardh-Hassan - beneficiaries • *Sadaqah* - monetary • *Sadaqah* - beneficiaries • Community cohesion • Debt policy and amount of debts written off
	Research, Development and Training	• Capacity building • Regular performance and career development report • Strategy formulation and decision making support to the top management • Standardize training curriculum • Database management
5. Employment	Employees	• Equal opportunities policy • Employees welfare • Ensuring diversity • Training: *Shari'ah* awareness • Training: professional skill • Encouraging talent • Keeping policy of international labor standard • Reward for employees • Employees appreciation • Focus on safety of staff
6. Environment	Environment	• Introduction of green product • Glossary/definition of green product • Investment in recycling bin project (recycling for nature) and other sustainable development project • Amount of donation in environmental awareness • Financing in any project which may lead to environmental damage

- Investment in sustainable development projects
- Initiatives to mitigate environmental impacts of product and services, and extent of impact mitigation
- Focus on risk-based corrective actions

4. Analysis and Results

Table 3 provides the total disclosure scores for the three full-fledged Islamic banks in Malaysia i.e. Bank Islam Malaysia (BIM), Bank Kerjasama Rakyat Malaysia (BKRM) and Bank Muamalat Malaysia (BMM).

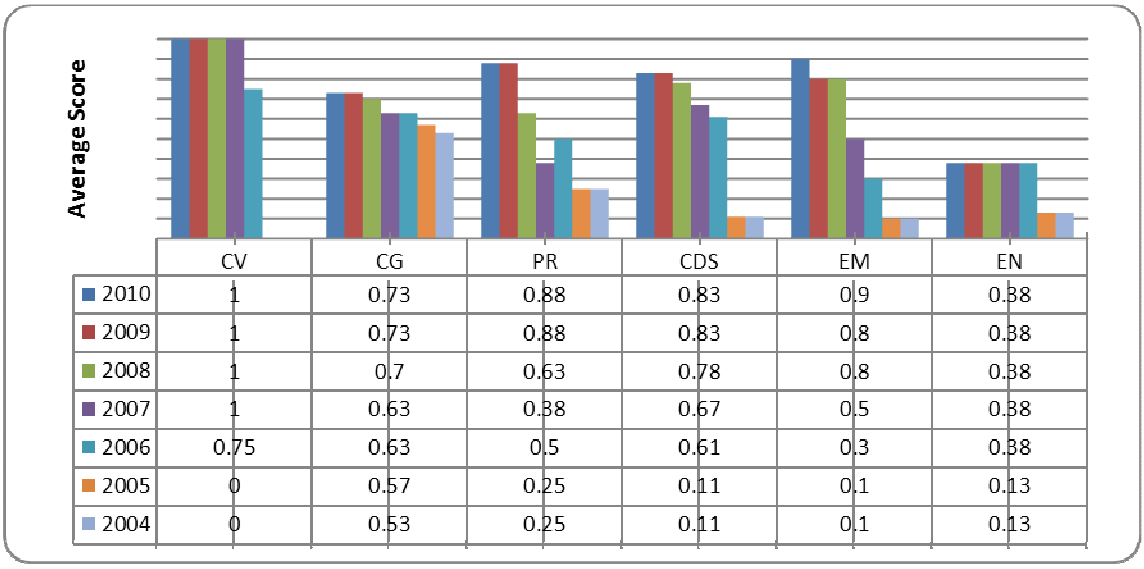
Table 3: Disclosure Scores of Full-Fledged Islamic Banks in Malaysia

Islamic Bank	Year						
	2010	2009	2008	2007	2006	2005	2004
Bank Islam Malaysia (BIM)							
Total Score	61/78	59/78	55/78	46/78	43/78	23/78	22/78
Percentage (%)	78	76	71	59	55	29	28
Ranking	1	2	3	4	5	6	7
Bank Kerjasama Rakyat Malaysia (BKRM)							
Total Score	51/78	44/78	40/78	36/78	29/78	29/78	27/78
Percentage (%)	65	56	51	46	37	37	35
Ranking	1	2	3	4	5	5	7
Bank Muamalat Malaysia (BMM)							
Total Score	48/78	46/78	40/78	36/78	34/78	31/78	24/78
Percentage (%)	62	59	51	46	44	40	31
Ranking	1	2	3	4	5	5	7

In general, it can be seen that i-CSR disclosures for all the three banks have gradually increased from 2004 to 2010. BIM however experienced a sharp increase between 2005 and 2006. Such an increase put forward a preliminary idea that the bank had an early positive reaction on the global and national calls for CSR reporting in Malaysia. Despite that BIM was the least i-CSR reporter in 2004, when compared to BKRM and BMM, the bank has emerged as the highest i-CSR reporter in 2010. All three banks have achieved scoring of more than 50 percent of the total 78 i-CSR items of disclosures.

Figure 1 demonstrates the average scores for i-CSR disclosures by BIM from 2004 till 2010 based on the six key themes investigated. It can be seen that the disclosure practice throughout the six years is generally of an upward trend. In the early years of study i.e. 2004 and 2005, disclosures pertaining to 'community development and social goals' and 'employment' were the least made available to the public; this was followed by disclosures on 'environment' and 'product'. Corporate vision was first disclosed only in 2006, but then maintained through 2007-2010. Among all themes, employment-related disclosures went through a sharp improvement over the years. In comparison, environmental-related disclosures showed the least progress; in which the scores had maintained from 2006 till 2010. Overall, 'corporate vision' scored the highest average score in 2010, followed by 'employment' and 'product'; whilst the least disclosed in that year was the information relating to 'environment'.

Figure 1: Average i-CSR Disclosure Score: Bank Islam Malaysia

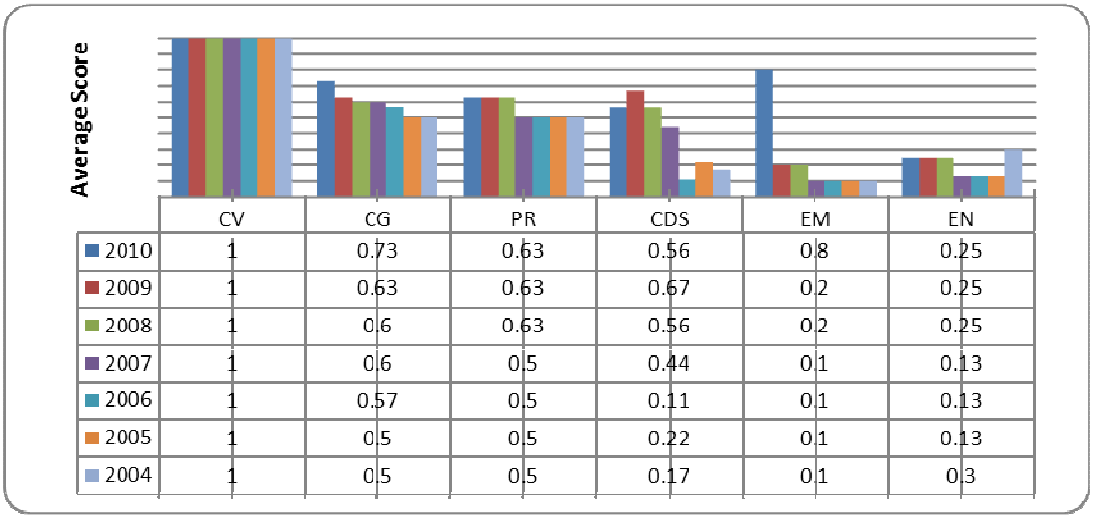


	CV	CG	PR	CDS	EM	EN
2010	1	0.73	0.88	0.83	0.9	0.38
2009	1	0.73	0.88	0.83	0.8	0.38
2008	1	0.7	0.63	0.78	0.8	0.38
2007	1	0.63	0.38	0.67	0.5	0.38
2006	0.75	0.63	0.5	0.61	0.3	0.38
2005	0	0.57	0.25	0.11	0.1	0.13
2004	0	0.53	0.25	0.11	0.1	0.13

Figure 2 exhibits the average scores for i-CSR disclosures by BKRM from 2004 till 2010. 'Corporate vision' scored the highest average scores throughout the years studied when compared to other key i-CSR disclosure themes. 'Corporate governance' experienced rather a steady increment over 2004-2010; nevertheless, 'product'-related i-CSR disclosures had a-two stable trend in which the average scores were similar from 2004-2007, increased in 2008 and maintained throughout till 2010.

'Community development and social goals' and 'environment' type of i-CSR showed an inconsistent trend. Drastic improvement however is seen in the 'employment'-related i-CSR disclosure between 2009 and 2010. This disclosure theme began as the least reported one in 2004 and became the second most reported i-CSR disclosures in 2009 and 2010. In comparison with the i-CSR disclosures by BIM, it is rather interesting to view that 'environment' is the least disclosures as well for BKRM especially in the recent 2010 publication.

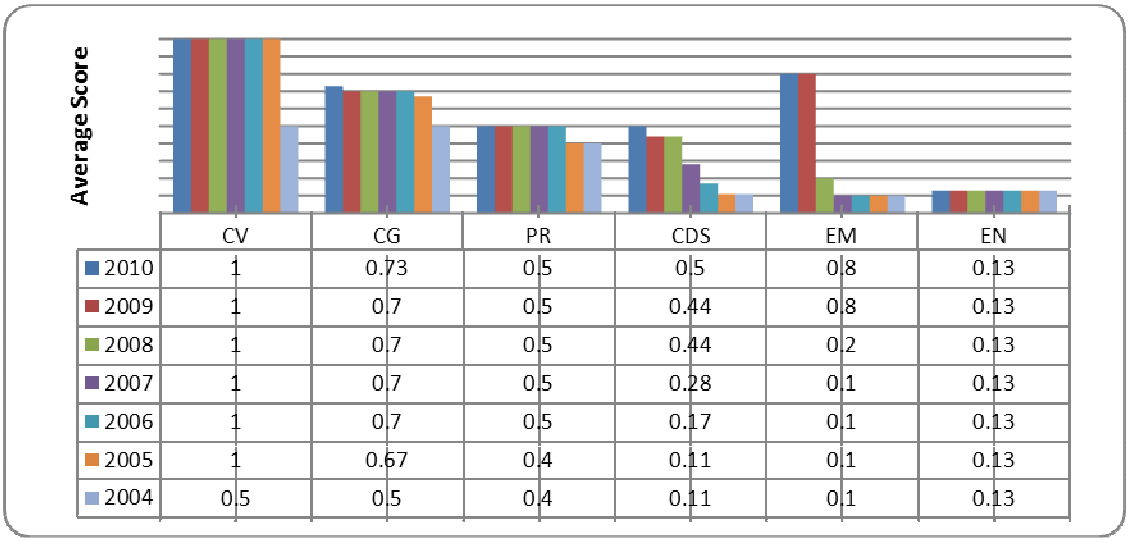
Figure 2: Average i-CSR Disclosure Score: Bank Kerjasama Rakyat Malaysia



	CV	CG	PR	CDS	EM	EN
2010	1	0.73	0.63	0.56	0.8	0.25
2009	1	0.63	0.63	0.67	0.2	0.25
2008	1	0.6	0.63	0.56	0.2	0.25
2007	1	0.6	0.5	0.44	0.1	0.13
2006	1	0.57	0.5	0.11	0.1	0.13
2005	1	0.5	0.5	0.22	0.1	0.13
2004	1	0.5	0.5	0.17	0.1	0.3

BMM's trend of average scores for all six key themes of i-CSR disclosures, in general, is rather similar to BKRM (refer Figure 3 below). 'Corporate vision' obtained the highest scores since 2005 whilst 'employment' was the second highest disclosures made by the bank.

Figure 3: Average i-CSR Disclosure Score: Bank Muamalat Malaysia

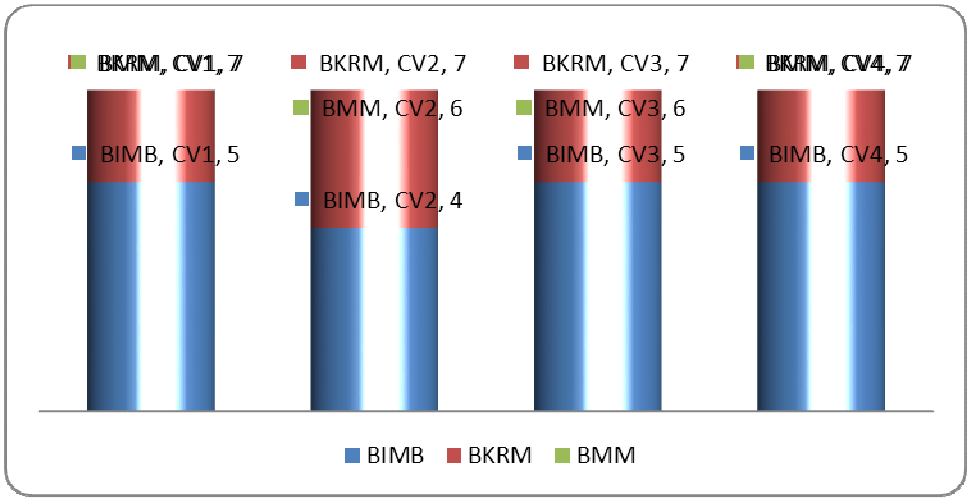


	CV	CG	PR	CDS	EM	EN
2010	1	0.73	0.5	0.5	0.8	0.13
2009	1	0.7	0.5	0.44	0.8	0.13
2008	1	0.7	0.5	0.44	0.2	0.13
2007	1	0.7	0.5	0.28	0.1	0.13
2006	1	0.7	0.5	0.17	0.1	0.13
2005	1	0.67	0.4	0.11	0.1	0.13
2004	0.5	0.5	0.4	0.11	0.1	0.13

Figure 4 shows the average scores for i-CSR disclosure on theme 1 (Strategy). Among the three banks, BKRM scored the highest average score over the seven years, followed by BMM and BIM. Nevertheless, item no.1 "Operate within *Shari'ah* principles" and item no.4 "Building long-lasting relationships with customers" dominates, over the last five years for the three banks. Item no.3 "Appreciation to shareholders and customers" was the second most disclosed item for the three banks. However, a huge difference of average score for item no.2

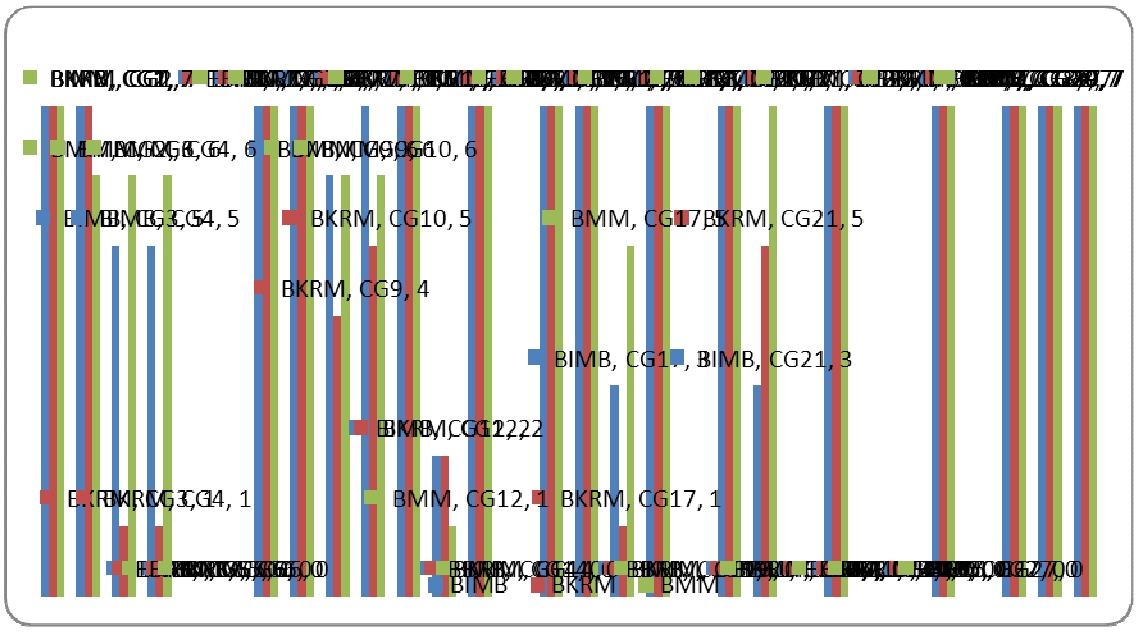
"Focus on stakeholders and distribution of profit" between BIM and BKRM with BIM scored the least disclosed information. This may be attributed to a lack of pressure from and an indifferent attitude of stakeholders.

Figure 4: Average Scores for i-CSR Disclosures on Theme 1 (Strategy)



Under the second theme (Governance), "Board of Directors and Top Management" element, all of the three banks disclosed more than half required items, experiencing a steady increment over the seven years (refer Figure 5). From the results, it seems that good corporate governance practice exist among the three Islamic banks. Hence, credentials of those entrusted in operating the business would enable users of annual reports to make their judgement. Under the element of S*hari'ah* compliant, the highest disclosed information is found to be in relation to the background of *Shari'ah* Supervisory Board(SSB) members, number of SSB members, the report signed by all members, examination of all documents, report by SSB, certification of profit and losses distribution complying to *Shari'ah*, zakat calculated according to *Shari'ah* and *Shari'ah* investment screening. However, overall results indicate that the level of disclosure on S*hari'ah* compliant for the three banks was still below the desirable level. *Shari'ah* compliance procedures should be disclosed comprehensively because it highlights the procedures taken to achieve S*hari'ah* compliance on each product or transaction.

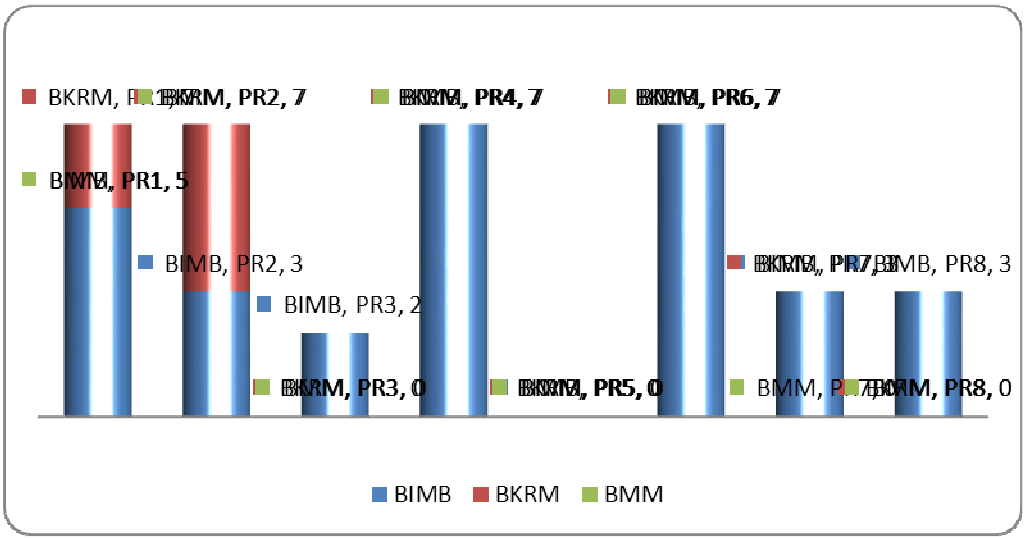
Figure 5: Average Scores for i-CSR Disclosures on Theme 2 (Governance)



The three banks disclosed up to half of the required items for the reporting of the third theme (i.e. Product) (refer Figure 6 below). The most item being disclosed by the three banks were item no.4 - "No investment in non-permissible activities" and no.6 "Fair dealing with those in supply chain". This information demonstrated that all of

the three banks disclosed details of their investment and financial activities. One possible explanation for the three banks addressing this theme may be due to close monitoring by Bank Negara Malaysia. For the item no.5 “Nature of unlawful transactions”, none of the three banks disclosed the related information, whilst only BIM disclosed item no.3 “Glossary/definition of new product” in the report to familiarize non-Arabic speaking to the product. As an Islamic bank, it needs to be transparent to give full and accurate information about their products and services, and to keep interested parties well informed. The three banks ranged with the highest scored disclosure for BIM and the lowest for BMM.

Figure 6: Average Scores for i-CSR Disclosures on Theme 3 (Product)



Referring to Figure 7, the highest score for disclosure under the theme ‘Community Development & Social Goals’ for seven consecutive years, has been achieved by BIM. Overall, BIM disclosed most of the required items as compared to BKRM and BM and that it was the only bank that provided attestation with regard to the financial reports in their SSB report. The SSB should provide an opinion on the disclosure of Islamic banks annual reports. However, BKRM and BMM scored the highest disclosure for item no.2 “Fostering strong links with the community/public service” and item no.12 “Community cohesion”.

All of the banks however failed to disclose items no.8 "*Qardh-Hassan*-monetary", item no.9 "*Qardh-Hassan*-beneficiaries" and item no.13 "Debt policy and amount of debts written off". One unique feature of Islamic banks is the provision of *qardh al hassan* (benevolent funds), that is, providing loans without expecting any extra payout over and above repayment of sources and uses of benevolent. Therefore, the less advantaged in society should be given priority in accessing such funds if social justice is to be upheld by the Islamic banks. Unfortunately, such activities were not reflected and communicated by the three banks. In addition, the three banks did not disclose their debt policy and provide details on type of lending activities.

Figure 7: Average Scores for i-CSR Disclosures on Theme 4 (Community Development & Social Goals)

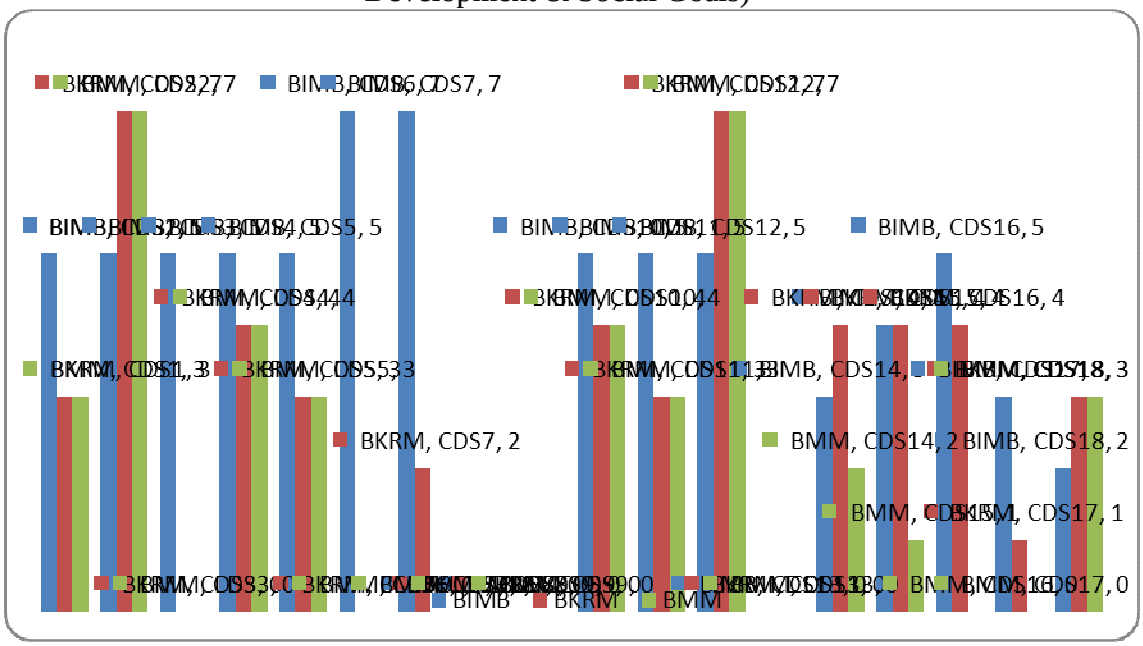
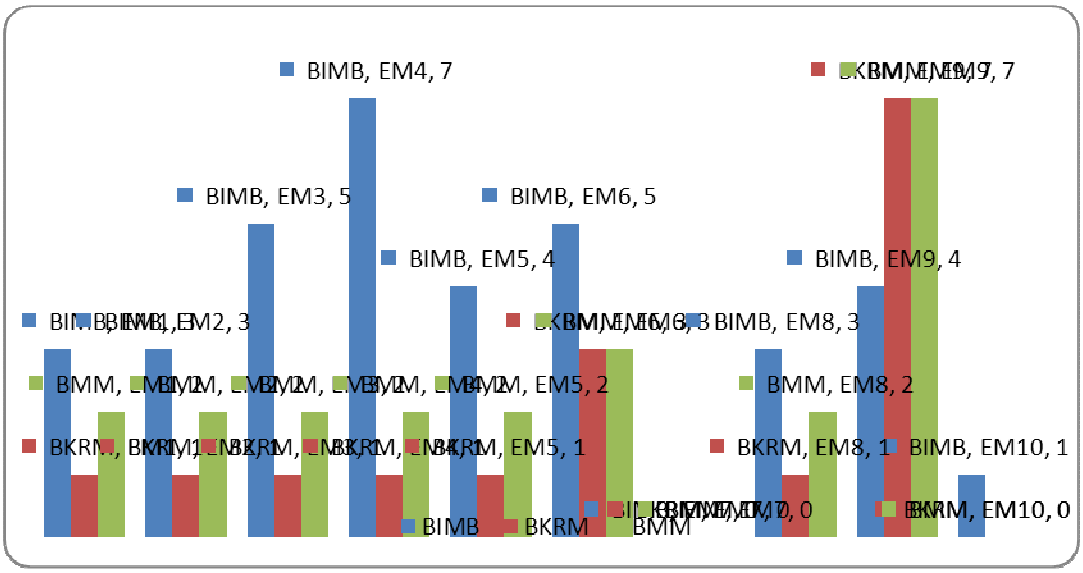


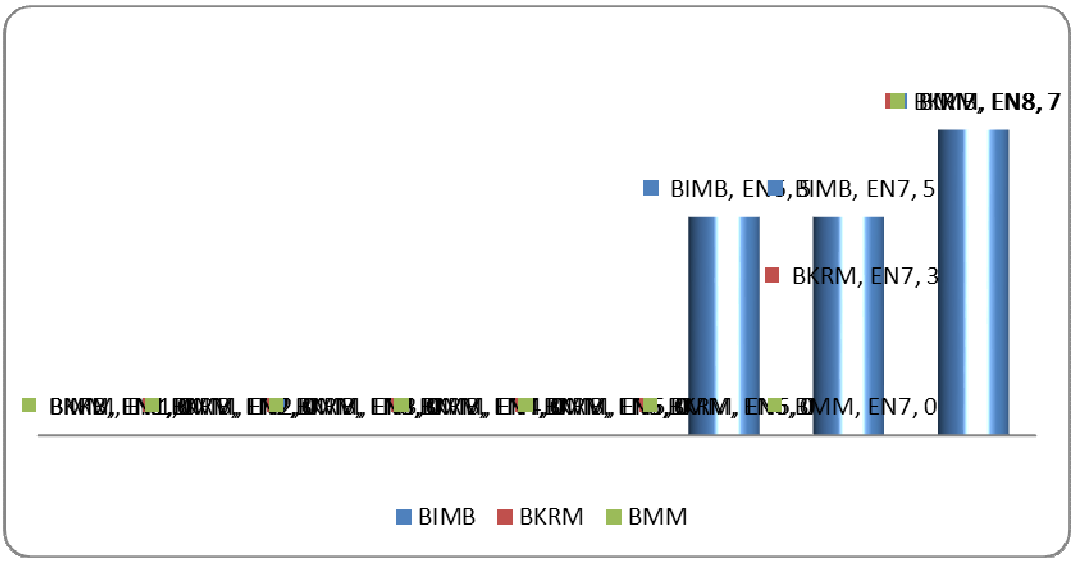
Figure 8 demonstrates that for the disclosures relating to the 5th theme i.e. employee, all the banks disclosed almost all of the items except for item no.7 "Keeping policy of international labor standard", that is, none of the three banks disclosed the related information. For item no.10, only BIM disclosed "Focus on safety of staff". This effort is commendable and staff safety is equally vital.

Figure 8: Average Scores for i-CSR Disclosures on Theme 5 (Employee)



Environment theme was the least disclosed by the three banks. All banks disclosed very minimal information, that is, less than half of the required items. This would reflect their little effort to demonstrate ethical identity and ultimate goal of betterment of society as the tag they claim of being Islamic. Nevertheless, the three banks disclosed information on item no.8 "Focus on risk-based corrective actions".

Figure 9: Average Scores for i-CSR Disclosures on Theme 6 (Environment)



5. Conclusion and Limitations

Results of the analysis indicated that of the six themes, the theme demonstrating the "Corporate Vision" was the most disclosed, while the theme dealing with banks' activities as regards the environment was the least disclosed. The finding on S*hari'ah* compliant element indicated that disclosures were still limited and it lacks the depth of providing assurance. It was observed that there is no disclosure made on the detailed computation of the derivation of zakat. It is merely an endorsement of the bank's *shari'ah* compliance in general without any emphasize on the actual operational or conduct of the respective banks. It needs more development and disclosure to provide a deeper assurance to the stakeholders on the *shari'ah* compliance. Moving towards a more transparent disclosure would require more proactive involvement of the regulators as it seems that the respective banks will only abide with the minimum requirement as provided by the regulators. In addition, minimal zakat disclosure observed might be due to the lack of guidelines on zakat in the financial reporting framework of Islamic banks in Malaysia.

However, there is a positive step in the current undertaking of the three Islamic banks in the development of the *shari'ah* review, that is, embedding *shari'ah* compliance in the audit program is view as a feasible way to conduct *shari'ah* review and will give a long run benefit for these banks.

Results on the disclosures relating to environment theme was rather surprising because Islamic banks, as social and economic institutions, are expected to disclose more on environment to reflect accountability and justice not only to society, but also ultimately to God. Therefore, what can be gathered is that Islamic banks in Malaysia have to realign their activities and priorities to ensure that they reflect the Islamic principles which they claim to follow. This is vital as to retain their credibility and reputation not only from an ethical point of view, but more importantly, from the perspective of religion, Islam.

Our study focused only on corporate annual reports even though it is known that management utilizes other mass communication mechanisms. In addition, future research may consider other methodological approaches, for instance, survey work

involving interviews with management and stakeholders may help to enhance our understanding of the phenomenon.

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HARMONISATION OF *IJARAH* ACCOUNTING STANDARDS FOR ISLAMIC BANKS

NurazaliaZakaria[1]

Abstract

The wave of International Financial Reporting Standards (IFRS) convergence is very distinct. IFRS is used by more than 100 countries worldwide. Other countries such as Korea, Argentina and Canada have converged to IFRS since 2011. Malaysia's convergence to IFRS has been effective as from January 1, 2012. Among the entities that will be affected by such convergence are Islamic banks. In relation to Islamic financial transactions, the key challenge has been to find a relevant accounting framework that will allow for comparability with conventional finance as well as international comparability without affecting the Shariah compliance. It is questioned as to whether IFRS could adequately address the reporting of Islamic financial transactions, or whether the transactions are so unique that some other form of accounting framework would be required. The development of an Islamic accounting standards issuing body, the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), makes possible a comparison between conventional Western and Islamic accounting standards. This paper presents a comparison of one contentious accounting issue, the recognition, measurement and disclosure of *Ijarah*. The objective is to outline the issues, not necessarily to resolve them, and to consider the implications they have for pursuing IFRS convergence in the context of Islamic financial service industry.

Keywords: Harmonisation, accounting standards, Islamic banks, *Ijarah*

1. Introduction

Over the last two decades, rapid globalisation has helped to facilitate international business and eliminate barriers to capital flows and this does not exclude the Islamic banking industry. As a result of globalization also Bank Negara Malaysia has opened up the possibilities for foreign owned Islamic bank to be operating in Malaysia such as Kuwait Finance House and Al-Rajhi. From the perspective of accounting, standard setters have struggled to keep pace with the development of commerce that is unique to the Islamic banking industry.

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The implementation of International Financial Reporting Standards (IFRS) in many of the world's major markets is providing a foundation that enables investors to make accurate cross-border comparisons of companies (Lopez, 2012; Gomes, 2012). Additionally, IFRS also allows companies to better communicate their strategy to shareholders.

The spread of IFRS has reached countries across the European Union, to Hong Kong, Singapore, Australia, Canada, the Gulf States, Russia, Pakistan, Turkey and South Africa (Lopez, 2012). Beginning 2012, Malaysia has joined this long list of countries to be IFRS-compliant. Malaysian businesses have had ample time to comply towards the IFRS with direction from the Malaysian Accounting Standards Board (MASB), which unveiled in 2011 the Malaysian Financial Reporting Standards (MFRS) Framework that is fully IFRS-compliant.

According Mohammad Faiz (2012), MFRS also applies to Islamic banks in the same way they apply to conventional financial institutions. Historically, MASB had considered separate Islamic standards, but they decided otherwise as there are potential for undesirable arbitrage opportunities. Additionally, after much research conducted by MASB, they believe that applying IFRS to Islamic finance is possible and it helps the industry to be more internationally accepted. MASB is of the opinion that there are problems in trying to fit Islamic finance within an IFRS framework. However, these problems or issues such as applicability of lease standard for *Ijarah*, insurance contracts for *takaful*, etc were seen as not insurmountable and does not need to lead to a repudiation of IFRS principles.

However, there are group such as the Asian-Oceanian Standard Setters Group (AOSSG) that highlighted certain issues in applying IFRs to Islamic financial transactions and events. This group consists of accounting standard setters in the Asian-Oceanian region which discusses issues and shares experiences on the adoption of IFRS-appointed the MASB as the Leader for AOSSG Islamic Finance Working Group. The Working Group issued a Research Paper entitled *Financial Reporting Issues relating to Islamic Finance* on 30 June 2010, which discussed the accounting issues related to Islamic financial transactions within the IFRS framework. Within the perspective of addressing the important issue of financial reporting harmonisation, the

AOSSG's study sampled the opinions of working group members – consisting of accountants from the Islamic financial industry in various jurisdictions including Indonesia, Pakistan, Saudi Arabia and Malaysia – on issues relating to financial reporting in Islamic finance. According to the AOSSG (2010), two main approaches could be adopted when accounting for Islamic financial transactions: (i) through a separate set of Islamic accounting standards; or (ii) by adapting IFRS with some modifications to accommodate for Shariah principles.

Therefore, this paper seeks to examine the harmonization effort by international accounting standard setters in reconciling issues and accommodating Shariah principles within IFRS with a special focus on *Ijarah* and conventional leases. The objective is to outline the issues, not necessarily to resolve them, and to consider the implications they have for pursuing IFRS convergence in the context of Islamic financial service industry.

2. Literature Review

Financial Reporting Standards

At the international level, The International Accounting Standards Board (IASB) was established on April 1, 2001 to replace the International Accounting Standards Committee (IASC). The IASB is expected to develop International Financial Reporting Standards (IFRS), which are accounting standards promulgated after 2001, and to enforce the use of each standard. Many of the standards forming part of IFRS are known by the older name of International Accounting Standards (IAS). The IASs were issued between 1973 and 2001 by the Board of the International Accounting Standards Committee (IASC). As from April 1, 2001 the IASB took over the responsibility for setting IAS from the IASC. During its first meeting the IASB adopted existing IAS and Standing Interpretations Committee standards (SICs). The IASB has continued developing accounting standards, henceforth called IFRS. IFRS therefore comprise:

- International Financial Reporting Standards (IFRS) – standards issued after 2001;
- International Accounting Standards (IAS) – standards issued before 2001;

- Standing Interpretations Committee standards (SICs) – standards issued before 2001; and
- Conceptual Framework for the Preparation and Presentation of Financial Statements (2010).

Initial efforts by the standard setters mainly focused on *harmonization*—reducing differences among the accounting principles used in major capital markets around the world. By the 1990s, the notion of harmonization was replaced by the concept of *convergence*—the development of a single set of high-quality, international accounting standards that would be used in at least all major capital markets (Lukenda and Scannella, 2009).

The accounting standard setting in Malaysia is spearheaded by Malaysian Accounting Standards Board (MASB). Malaysia has had a comparatively easy journey towards convergence since it has been incorporating the provisions of (International Accounting Standards) IAS into local accounting standards since 1978 (Zainal Abidin, 2008). The current Financial Reporting Standards (FRSs) issued by the Malaysian Accounting Standards Board (MASB) are already compliant with IFRS.

On 19 November 2011, the MASB has issued a newly approved accounting framework, the Malaysian Financial Reporting Standards (MFRS) Framework. This issuance, which was made in conjunction with the MASB's plan to converge with IFRS in 2012, has finalised the MASB Exposure Draft 75 *IFRS-compliant Financial Reporting Standards* released in June 2011. The MFRS Framework comprises standards as issued by the IASB which are effective as from 1 January 2012. It also comprises new/revised standards recently issued by the IASB that will be effective after 1 January 2012 such as Standards on financial instruments, consolidation, joint arrangements, and fair value measurement and employee benefits, among others.

Another international accounting standard setting body, Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI) was established in 1990 in order to cater for Islamic financial institutions (IFIs). The accounting standards are specific in nature as it focuses on the financial instruments used by IFIs, such as *Ijarah* and *IjarahMuntahiaBittamleek*, *Murabaha*, *Salam*, etc.. Countries such as

Bahrain, Dubai, Jordan, Lebanon, Qatar, Sudan and Syria have adopted AAOIFI's standards. It is difficult to say that AAOIFI has gain popularity and acceptance at the global arena as most of the countries that adopt are middle-eastern countries where IFIs are mostly located. Further, the proponents of AAOIFI opines that AAOIFI's accounting standards are more relevant for the use by IFIs rather than adopting IFRS that may not portray the true nature of Islamic financial instruments.

Challenges in Adopting IFRS for Islamic Financial Transactions

In relation to Islamic financial transactions, the key challenge has been to find a relevant accounting framework that will allow for comparability with conventional finance as well as international comparability without affecting the Shariah compliance of Islamic financial transactions. However, if IFRS are to be implemented by IFIs, there are a number of reporting issues that may arise. Generally, it is questioned as to whether the existing accounting standards or IFRS could adequately address the reporting of Islamic financial transactions, or whether the transactions are so unique that some other form of accounting framework would be required.

Smith (2004) reported that IFIs are faced with the challenge between adhering to the distinctive characteristics of their operations and expanding business through deeper integration into the global financial markets. While IFIs are eager to truly comply with and conduct their businesses in accordance with Islamic principles, they also have to ascertain that there is international accounting and financial standardisation in order to be part of the global financial markets (Ratna, 2011).

As such, in order to be competitive in the global markets, Islamic banks in Malaysia are required by Bank Negara Malaysia to comply with IFRS. In the Circular on the Application of FRS and Revised Financial Reporting Requirements for Islamic Banks made effective on 1 January 2010, Islamic banks are required to prepare financial statements in accordance to financial reporting standards approved by MASB to the extent that the standards are consistent with Shariah principles.

Ijarah and Conventional Lease

Ijarah is defined by Shariah Advisory Council (SAC) of Bank Negara Malaysia (BNM) as a "*lease or commission contract that involves an exchange of usufruct or benefits of an assets or a service for rent or commission for an agreed period."*(Bank Negara Malaysia, 2010). Normally, *Ijarah* concept is applicable in financing contracts such as in real property financing, vehicle financing, project financing and personal financing.

The basic feature of *Ijarah* is that one party is given the right to use the services of a person or a given asset from another party for a consideration. This contract does not involve the transfer of ownership to the other party because there is no intention to purchase or to own the *Ijarah* object by the interested party. This is also termed as operating *Ijarah* by AAOIFI or merely rental.There are also financing products that provides the option to the lessee to lease assets from Islamic financial institutions with an option to acquire the leased assets at the end of the lease tenure based on the concept of *IjarahMuntahia bi al-tamlik*or *Ijarahthumma al-bai'*.The main differentiation between an *Ijarah* and conventional lease is it is riba'-free, and represent the cooperation of rights and obligations of lessor (*mu'ajir*) and lessee (*musta'jir*) according to Shariah (Abdul Rahim, 2010).

Such definition and principles give implications to the recognition and reporting of *Ijarah* in both the lessee and lessor's account. According to AAOIFI's FAS 8 on *Ijarah* and *IjarahMuntahiaBittamleek*, operating *Ijarah*, the asset on rental is only recorded in the lessor's books. The lessee only recognises the lease/rental expense in its income statement. As for *IjarahMuntahiabial-tamlik* or *Ijarahthumma la-bai'*, the asset is also recorded in the lessor's account until the legal ownership passes over to the lessee at the end of the lease term.

Conventional lease according to the MFRS 117 Leases in paragraph 4 defines it as "*an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use and asset for an agreed period of time*. It then distinguishes between finance and operating lease. The standard defines finance lease as a "*lease that transfers substantially all the risks and rewards incidental to*

ownership of an asset. Title may or may not eventually be transferred." Operating lease as defined in paragraph 8 of MFRS 117 is "*it does not transfer substantially all the risks and rewards incidental to ownership*."

These definitions give major impact to the way Islamic bank recognises and disclose *Ijarah* or conventional lease in its financial statement. The AOSSG Research Report (2010) highlighted the concern of standard setters on the classification of *Ijarah* as operating lease and whether such classification is appropriate as in classical *fiqh* texts, the usufruct (i.e. right to use) is deemed to be an asset (*mal*) for the lessee. Therefore, it can be argued that *Ijarah* should also be reported as asset in the lessee's books of account as well.

In 2006, MASB issued TR *i*-2 *Ijarah* which affirmed that IAS 17 Leases (i.e similar to MFRS 117) would apply to *Ijarah*, MASB has included in the Basis for Conclusions its disagreement with the principle in IAS 17 and stated its belief that *Ijarah* gives rise to assets for both the lessor and the lessee, which ought to be recognise as separate assets. The view is consistent with *fiqh* texts which expound that *Ijarah* although the lessor retains ownership of the underlying asset, the usufruct of that assets is transferred to the lessee (Abdullah, 2011). Furthermore, majority of *fuqaha* recognise that the right to an asset is in itself an asset, or *mal*. Thus, if *fiqh* essentially recognises that all *Ijarah* confers an asset on the lessee, it may not be tenable to insist *Ijarah* be treated as operating leases, under which the lessee would not recognise any asset at all (AOSSG, 2010). It may be noted that similar view is held by IASB in its proposed exposure draft on lease issued in September 2010.

The IASB proposed exposure draft on lease basically is suggesting the use of a new accounting model termed as "the right-of-use" asset. Under this model, the lessee would have to record right-of-use asset in its balance sheet together with corresponding liability to make lease payments regardless of whether it is operating or finance lease. This means that no distinction is made on whether the lease is operating or finance but emphasis is given to disclosing the rights and obligations of both lessee and lessor to shareholders and investors.

3. Research Method

Library search was conducted to analyse the similarities and differences between the standards on *Ijarah*as issued by AAOIFI, MASB and IASB. These standards were chosen as it provides an indication as to the accounting principles or stand that each standard setter upholds and believes. For instance, standards issued by AAOIFI are based on Shariah principles and advocate contractual obligations or legal form over economic substance. On the other hand, MASB and IASB accounting standards are similarly supporting the accounting principles of economic substance over form where economic substance of a transaction is deemed as more true and fair in reflecting rights and obligations of the reporting entity rather than the legal form or contractual obligations.

The accounting standards analyzed covers FAS 8 *Ijarah* and *IjarahMuntahiaBittamleek*, MFRS 117 Leases and IASB proposed Exposure Draft on Lease that was issued in year 2010.The area for comparison comprises of classification, recognition, measurement and disclosure of each of the mentioned standards.

4. Results

Based on the content analysis of standards and exposure draft issued by AAOIFI, MASB and IASB, Table 1 summarizes the salient point of divergence and similarities.

Table 1: Comparison of accounting standards on *Ijarah* and Conventional Lease

	AAOFIFI: FAS 8 *Ijarah*	MFRS 117 Leases (IFRS-compliant)	IASB Proposed Exposure Draft on Leases
Classification of *Ijarah* or Lease	• *Ijarah* is defined as operating lease or rental. • *IjarahMuntahiaBittamleek* is defined as lease ending with sale.	• Classifies lease into operating and finance lease.	• Does not distinguish between operating and finance lease. Proposed a new accounting model – "right-of-use" assets
Recognition	• Lessee recognises the lease expense or rental under operating *Ijarah.* • Lessor recognises leased asset in the balance sheet.	• For operating lease, the lessee records lease expense in the income	• The lessee needs to record the "right-of-use" asset and liability to make lease

	If there is a promise by lessee to buy the leased asset, only then the leased asset is derecognized from the balance sheet.	statement. No asset is recorded in balance sheet if it is operating lease. cord the leased asset as part of its asset in the balance sheet including depreciation expense and finance expense in the income statement. • For both type of lease, the lessor records the leased asset in the balance sheet as part of its assets. For finance lease, the lessor records finance income and lease income for operating lease.	payments separately in its balance sheet. • The lessor has an option to either use performance obligation approach or derecognition approach depending on its exposure to risks or benefits associatedwith the underlying asset
Measurement	• Lessor recognizes using historical costs upon acquisition of leased assets for either operating *Ijarah* or *IjarahMuntahiaBittamleek*.	• For lessee in recording finance lease - fair value of leased assets or present value of minimum lease payments (use of interest rate to calculate) • For lessor in recording finance lease – net investment in the lease.	• Lessee initially measure lease using present value of lease payments and initial direct costs.Amortisation of leased assets and revaluation of “right-of-use” is required. • Lessor measures using sum of present value of lease payments.
Disclosure& Presentation	• Lessee discloses only the lease rental expense/*Ijarah*instalment payables in income statement for operating *Ijarah*.	• Lessee disclose lease rental for operating lease. • Lessee and lessor both	• Both lessee and lessor discloses leased asset in the balance sheet (i.e “right-of-use”, residual asset,

	• Lessor discloses both operating *Ijarah*and*Ijarah*ending with sale or transfer of ownership as asset in its balance sheet.	records the asset in their financial statement for finance lease.	underlying asset respectively) and income statement (i.e. lease expense or lease income)

Source: AAOIFI (2010), MASB (2012) and IASB (2010)

From the above analysis, it is evident that AAOIFI and MFRS 117 classification and disclosure seemed to be similar in nature where both classifies lease into operating and finance lease. However, AAOIFI advocates that *IjarahMuntahiaBittamleek* be recorded based on legal form meaning that first there is a transaction on lease and at the end of the lease term, the lessor has to record the sale of leased asset to the lessee. As for MFRS 117, finance lease is recognized as leased asset using one-time accounting treatment in the lessee and lessor's account.

AAOIFI in its Financial Accounting Standard No. 8 (FAS 8) on *Ijarah* and *IjarahMuntahiaBittamleek* refers to *Ijarah* as an operating lease where there is no promise that legal title of the leased asset will be transferred to the lessee. In this case, the recording of the *Ijarah*asset remains with the lessor. On the other hand, if there is a promise that legal title will be transferred to the lessee, this is referred to as *IjarahMuntahiaBittamleek*. According to the AAOIFI, *IjarahMuntahiaBittamleek* will involve two transactions, one on leasing and another at the end of the contract to reflect the sale of the asset to the lessee. The accounting treatment of *IjarahMuntahiaBittamleek* should accordingly reflect these two transactions. Such recording follows the legal form of the Islamic financial transaction.

If the principle of substance over form as practiced under IFRS is applied to *IjarahMuntahiaBittamleek,* only one transaction will be recorded pertaining to the transfer of legal title of the asset to the lessee so as to reflect the economic reality of the financial transaction. This will result in the asset being recorded in the lessee's book. However, Abdul Rahim (2010) emphasizes that the promise of the lessor to transfer the ownership of the leased asset to the lessee under *IjarahMuntahiaBittamleek* is not the same as the substance over form rule under IAS

17: Leases. This is because the risk and reward incidental to ownership of the leased asset under the conventional finance lease is being compared to *Ijarah*.

Under *Ijarah*,the lessor holds the ownership rights and obligations pertaining to the asset from the beginning till the end of the contract. According to Abdul Rahim (2010), the ownership rights and usufructary rights (right to use) are treated differently in an *ijarah* agreement as they are detachable according to Islamic commercial law. However, under IAS 17: Leases, there is no distinction between ownership rights and usufructary rights. Therefore, Abdul Rahim (2010) concluded that there can never be a transfer of ownership risk in *Ijarah*as it deals only with the transfer of usufruct (right to use). He further elaborated that in the case of *IjarahMuntahiaBittamleek*, transfer of ownership only takes place when both parties enter into a contract separate from the *Ijarah* contract. The second contract – that of sale – is drawn up when the promise to purchase is fulfilled by the lessee at the end of the term. Based on this discussion, it seems that the accounting treatment would result in recording the *IjarahMuntahiaBittamleek* in two transactions – the *Ijarah* contract and the sale contract. However, in Malaysia, the practice of accounting for *Ijarah*ending with sale is based on substance over form, that is the leased asset would appear as asset of the lessee and the bank, on the other hand, will recognise it as receivable.

Nonetheless, Abdul Rahim (2010) argued that there are several implications if the legal form over substance is adopted. First, the bank will have to bear the entire costs incident to the ownership of the *Ijarah* asset which would result in assuming greater costs and risks in relation to the maintenance cost of the asset. Secondly, since recording of the *Ijarah* transaction will reflect two transactions, it may lead to higher costs in terms of double taxation, stricter regulatory requirements, and other legal implications. Thirdly, the balance sheet of an Islamic bank would reflect more fixed assets and may expose IFIs to greater risks and capital requirements.

MFRS 117 on Leases strongly support the accounting principle of substance over form, thus this is reflected in the accounting treatment and disclosure of finance lease as its asset for the lessee. The lessee does not have legal ownership rights but the risks and rewards incidental to ownership has been transferred to the lessee when there is

an indication that the leased asset will be purchased by the lessee at the end of the lease term.

The question then arises as to whether the IASB proposal on leases would be more in line with Shariah or not. When analysed using the classical *fiqh* on usufruct rights being treated as asset (i.e. *mal*), it seemed that this proposal supports such statement whereby the lessee who has "right-of-use" of the asset records it as part of its assets. According to Abdullah (2011), usufruct according to majority of scholars (i.e. *jumhur*) can be considered as property (*mal*). According to these scholars, *mal* has certain attributes which one of it is the object (i.e. property) must have beneficial usage (usufruct). Further, ownership to property can be classified into complete and partial ownership, whereby usufruct is one form of partial ownership and one party can have ownership of the usufruct only but not the corpus. There are several contracts in Islamic jurisprudence that transfer the usufruct ownership or give permission to use it and this includes *Ijarah*. Based on this reasoning, it seemed that the new lease proposal better reflect Shari'ah principles for *Ijarah* in terms of being more accountable by disclosing what are the beneficial rights and related lease payment obligations clearly in the balance sheet.

The new lease proposal would greatly affect the accounting treatment for Islamic financial transactions that is based on AAOIFI because it does not distinguish between operating and finance lease. Both lessee and lessor need to record the lease as assets in their balance sheet and the respective liabilities i.e. lease payments or lease obligations regardless of ownership rights. A stark difference is noted as AAOIFI's approach would deem transfer of rights is not similar to transfer of ownership and strongly advocates the legal form whereby only legally owned assets are recorded.

KPMG (2010) and Ernst & Young (2010) agreed that IASB exposure draft provide the advantage of clearer picture of an entity's assets and payment obligations be it the entity is a lessee or lessor. At this point, the SAC of BNM does not disallow the use of IFRS as long as it does not contradict with Shariah principles. Further, SAC of BNM in MASB Statement of Principle (SOP*i*-1) issued in 2009 supports the accounting

principle of substance over form in recording and disclosing Islamic financial transactions. As such, it seemed that the new proposal from IASB would not be in contradiction to this principle but provides encourages greater transparency to investors about the reporting entity's economic condition as either lessee or lessor.

5. Conclusion

This study implied that there are harmonization efforts by international standard setters to reconcile differences in the accounting treatment of conventional leases and *Ijarah*. Even though, the exposure draft differs significantly from AAOIFI's existing FAS 8 standard, nonetheless it seemed that IASB is trying to foster more transparency in disclosure requirements for reporting entity. Therefore, Islamic banks, respective Shariah advisors and academician should take this opportunity to provide comments and feedback on the exposure draft so that Shariah point of view would also be taken into consideration when IASB issue respective accounting standards in the future. This is much espoused by MASB in providing inputs and feedback so that the voice of the Islamic finance industry can also be heard by the IASB. Without strong support and cooperation, the needs and requirement of the Islamic finance industry will never be reflected in future accounting standards issued by IASB.

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VOLUNTARY AND MANDATORY DISCLOSURES OF INTELLECTUAL CAPITAL: A COMPARATIVE STUDY OF PUBLIC VERSUS PRIVATE COMPANIES IN MALAYSIA

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Abstract

This study determines the extent of voluntary and mandatory intellectual capital reporting in public and private companies in Malaysia. The disclosures signify the extent a company acknowledge the importance of intellectual capital resources and implement them in business operation. This study also addresses the gap on lack of study in comparative public and private companies despite of their significant existence and contribution to the economy of the country. The companies reporting needs and scrutiny differ despite of administer by the same accounting standards. The sample study matches 50 public listed and 50 privately held companies during 2002 until 2007; results in 600 firm-year observations. Voluntary intellectual capital disclosures content analysis is based on studies such as Petty and Guthrie (2000) and Guthrie, Petty and Ricceri (2006). Mandatory intellectual capital compliance is developed based on the relevant Financial Reporting Standards (FRS) applicable to intellectual capital items. The findings support the theoretical expectation that public companies have higher reportingfor both voluntary and mandatory intellectual information disclosures.

Keywords: Intellectual capital, reporting, public and private companies

1. Introduction

This study examines the extent of voluntary and mandatory compliance of intellectual capital information disclosures in private and public companies in Malaysia. Intellectual capital information disclosureis the arising importance resources[1] during the current knowledge-based economy. The knowledge-based economy utilizes resources which contribute towards company innovativeness and developments which

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[1] Survey by Brooking Institute (2003) noted market perception on company value has changed over the years. The survey in the U.S. noted in 1982, 62% of company market value was contributed by tangible assets such as machines, products and facilities. By 2002, 80% of market value is instead contributed by intangible assets/intellectual capital such as brand name, intellectual property and quality of workforce (cited in Ow, 2006).

enhances company productivity, competitiveness, performance and value (Shapira, Youtie, Yogeesvaran and Jaafar, 2006; Lev, Radhakrishnan and Zhang, 2009). The resources are human capital such as human capabilities, leadership and experiences, relational capital such as collaborative relationships and structural capital such as intellectual property, technological and information stocks and capabilities for shared learning and utilization (Shapira et al., 2006).

However, the extent of information disclosure may vary on corporate management's interest and utilization of such resources in their business operation. In addition, not every intellectual capital resources are presentable in corporate financial statement due to lack in meeting the criteria as the corporate assets. As such, this study focuses on both voluntary and compliance on mandatory intellectual capital reporting.

Private company reporting has predominance existence and contribution in the economy[2].Its reporting is subject to substantially equivalent regulatory provisions as the public company[3], despite of the markets for private and public financial reporting are substantially different. Hence, this study provides opportunity to examine the interaction between the market and regulatory effects. It is argue that demands and supply of private company reporting is lower than the public company;

[2] 99% of registered Malaysian companies are private companies. Based on data on the first quarter of 2008, there are 805,910 registered companies in Malaysia (source: Companies Commission of Malaysia website; www.ssm.com.my) of which 855 companies are listed in the main and second board of Bursa Malaysia (source: Bursa Malaysia website; www.bursamalaysia.com). In addition, 70% companies from the list of Malaysian top 1000 corporate directory in 2007/2008 were private companies.

[3]Private companyis to comply either with Private Entity Reporting Standards (PERS) or Financial Reporting Standards (FRS) in their entirety. For instance, a private company should adopt PERS in entirety if the company has no other intangible assets other than research and development costs (which cover in the PERS's MASB 4, Research and development costs) and provides no other employee benefits other than staff costs (which cover in the PERS's MASB 1, Presentation of Financial Statements). Such private company is normally relatively small in size and business operation. Other private company that has sufficient information on intangible assets and employees' information that cover in the FRS 119 Employee Benefits, FRS 126 Accounting and Reporting for Retirement Benefits Plan and FRS 138 Intangible Assets should comply with the FRS standards; similar to the other public listed companies. Such companies normally have similar and competitive business operation as the public listed companies.

notwithstanding the accounting regulations. The result of this studyenhances the understanding of the economic role of accounting standards, particularly in Malaysia.

The next section 2 reviews prior studies on intellectual capital and its reporting in public and private companies. Section 3 presents research sample and methodology of the study. The results and its discussion are describes in section 4, whilst section 5 concludes the study.

2. Literature Review

Intellectual capital

Prior studies noted agency conflict as one of the important factor in corporate disclosures. Agency issuearises from separation between management and shareholders (Jensen and Meckling, 1976). The management may make a business decision which is not consistent with the interest of the shareholders (as the corporate owner). Hence, financial statements disclosures are use as a method in monitoring the managers'action in addressing the agency conflicts (Cooke, 1989; Healy and Palepu, 2001; The American Accounting Association's Financial Accounting Standards Committee chaired by Botosan, 2006).The reporting addresses information asymmetry between the management and shareholders, hence enhances its decision usefulness (Walker 2003, Botosan et al., 2006, Yaari, 2008).

Current or potential shareholders demand such disclosures in evaluating corporate performance and value. The management may also supply greater information disclosures in attracting greater capital investment. In fact company from certain industry such as pharmaceutical is more incline to disclose intellectual capital resources as enhances its corporate value (van, der Meer-Kooistra and Zijlstra, 2001; Guthrie, Petty, Yongvanich and Ricceri, 2004; Mouritsen, Bukh and Marr, 2004).

The reporting also addresses accountability/stewardship (Walkers, 2003; Botosan et al., 2006). The reporting represents a medium which company's management discharges their fiduciary duties towards the shareholders and stakeholders on the

company resources entrusted to them during the business period and legitimizes the action of the company.

Despite of the theoretical financial statements reporting importance as discussed above, lack of reporting framework on intellectual capital reporting, particularly prior to 2003, lead to low disclosures and mostly in qualitative rather than quantitative form (Guthrie et al., 2006). Some countries such as U.K (as noted by Striukova et al. 2008), Hong Kong and Australia (as noted by Guthrie et al., 2006) report mostly external capital as it is more value by the users. Reporting by the developing countries such as Sri Lanka and Malaysia has improve over the period as companies and government are proactive in reporting intellectual capital resources to regain investors' confidence subsequent to the economic recession in 1997/1998 (Abeysekera 2008; Goh and Lim 2004 and Yau, Chun and Balaraman2009).The limitation of voluntary intellectual capital reporting may address by the accounting recognition and reporting framework as mandated by the accounting regulatory body.

Public versus private companies financial reporting

Despite of both public and private companies are govern by the same accounting regulatory body, their reporting needs and demands are differ.

Public and private companies have different demand and supply of accounting information disclosures. Public company trades its shares in the securities market hence have more than 50 shareholders. Such of diverse shareholders are normally not involved in the business operation. The shareholders demand sufficient accounting information disclosures in reducing information asymmetry with the corporate management. The disclosuresaddress the accountability/stewardship of corporate management on usage of corporate resources entrusted by the shareholders. In addition, public company financial reporting is widely used as communication tools to supply corporate information to attract potential investors for capital financing (Ball and Shivakumar, 2005; Givoly, Hayn and Katz, 2010).

Public company financial statements' significant usage in evaluating corporate performance and value leads to significance monitoring by the legislative body (Burgstahler, Hail and Leuz, 2006). The legislative bodies that highly monitor the accounting reporting compliance of public companies in Malaysia are Bursa Malaysia and Securities Exchange Malaysia.

Private companies' members are limited to 50 shareholders and they are normally involved in corporate business operation. There is less information asymmetry issue as it is normally resolved through informal communication during the business operation. Hence there is less demand on formal accounting reporting by the shareholders of private companies (Ball and Shivakumar, 2006; Givoly et al., 2010).

The primary external user of private companies accounting reporting is bank lender (American Accounting Association, 2006). The banks use accounting information to evaluate the company's credit payment ability besides debt covenants requirements in their debt capital financing (Peek, Cuijpers and Buijink, 2010).

3. Research Method

Sample

This study matches 50 public and 50 private companies of a similar size and within the same type of industry. Company size and type of industry influence information reporting (Penno and Simon, 1986) particularly on the intellectual capital information disclosure (Tayles et al.,2007). In addition, it allows better estimation on the effect of public and private companies (Penno and Simon, 1986). The method ensures consistency and comparability of two groups has been widely adopted in comparative public and private companies' studies such as Penno and Simon (1986), Ball and Shivakumar (2005) and Givoly et al. (2008).

Controlling for the company size, only companies with at least RM1 million sales is cover in the sample study. Then, public and private companies are matched-pair using

a factor of 3[4]. The matched-pair companies are group on their respective industries as certain type of industry has higher influence on intellectual capital reporting compare to the others[5](Ho and Williams, 2003; Tayles, et al., 2007). The disclosure of such resources in corporate financial statements represents high reliance on intellectual capital. The list of the sample companies is obtained from the Malaysian 1000 Top Corporate Directory[6].

The period of study is 2002 until 2007 (6 years) enable comparative reporting practices for period before and after the implementation of the accounting standards related to intellectual capital. The relevant accounting standards are FRS 119, Employee Benefits and FRS 126, Accounting and Reporting of Retirement Benefits Plan are implemented on 1 January 2003 and FRS 138, Intangible Assets is implemented on 1 January 2006 as reflects in table 1. The practice is consistent with other study such as Kadri, Abdul-Aziz and Ibrahim (2009). The sample method results in 600 firm-years observation as reflects in table 2.

[4]The factor of 3 reflects sales ratio between the two matched-pair group of companies is not less than one-third nor greater than three from each other (Penno and Simon, 1986).

[5]Industries of high reliance on intellectual capital are technology, consumer product, trading and services as well as finance (Edvinsson and Malone, 1997).

[6] The method is consistent with Penno and Simon (1986). Penno and Simon obtained their sample company listing using the 1983 edition of Dun and Bradstreet's Million-Dollar Directory. The directory provides a comprehensive listing of public and private companies with at least $1 million in revenue (that is similar in size) and of the same industry group.

Table 1: Time-line of study period

	2002	2003	2004	2005	2006	2007
Employee information	Year before adoption of employee information standards	Adoption of: i) FRS 119 Employee Benefits ii) FRS 126 Accounting and Reporting of Retirement Benefit Plans	Years after adoption of employee information standards			
Intangible assets	Years before adoption of intangible assets standard				Adoption of FRS 138 Intangible Assets	Year after adoption of intangible assets standard

Table 2: Distribution of sample companies

	Public company	Private company	Total
Total of sample companies	50 companies	50 companies	
Year of observation	6 years (2002-2007)	6 years (2002-2007)	
Total firm-years observation	300 (50 companies x 6 years)	300 (50 companies x 6 years)	600 firm-years observation

Voluntary intellectual capital information disclosures index

Disclosure index of voluntary intellectual capital studies is developed based on various studies such as Guthrie, Petty, Ricceri and Wells (1999), Petty and Guthrie (2000), Guthrie (2001), Goh and Lim (2004), Abeysekera and Guthrie (2005), Guthrie, Petty, Yongvanich and Ricceri (2004) and Guthrie, Petty and Ricceri (2006). The studies use content analysis by developing a list of items relating to intellectual capital of human, relational (external) and structural (internal) capital. Examples of human capital items are employee, education, training, work related competencies and entrepreneurial spirit. Examples of relational (external) capital items are corporate brands, customers, customer satisfaction, company names, distribution channels, business collaborations and licensing agreements. Structural (internal) capital items are intellectual property, management philosophy, corporate culture, management processes, systems and financial relations. Following the studies above, a check list of intellectual capital themes is developed. There are five (5) themes on human capital,

seven (7) themes on relational (external) capital and four (4) themes on structural (internal) capital. The themes classifications and descriptions of this study voluntary disclosure index are appended in Appendix 1.

Mandatory intellectual capital information disclosures index

Mandatory information disclosure is based on the relevant Financial Reporting Standards (FRS) applicable to intellectual capital items. They are FRS 119 Employee Information, FRS 126 Accounting and Reporting by Retirement Benefits Plan and FRS 138 Intangible Assets. FRS 119 and FRS 126 are adopted as they relate to human capital whilst FRS 138 relates to structural (internal) and some on relational (external) capital.

There are 21, 8 and 18 disclosures items requirements by the FRS 119, FRS 126 and FRS 138 respectively, which the themes are presented in Appendix 2.

Scoring voluntary and mandatory intellectual capital disclosures

The results of voluntary and mandatory intellectual capital disclosures score are converted into disclosure ratio. The voluntary and mandatory disclosures ratios are developed by diving the disclosed items with the total applicable items; as follows.

$$\text{Disclosure index} = {}^{i,j} \frac{\Sigma \text{ Disclose items}}{\Sigma \text{ Applicable items}}$$

^{i,j}

The formula is widely used in disclosure studies such as Haniffa and Cooke (2005), Li, Pike and Haniffa (2008) and Singh and Vander Zahn (2008).

4. Results

The descriptive results address the extent of voluntary and mandatory intellectual capital disclosures in public and private companies in Malaysia are show on the following table 3 and 4.

Table 3: Mean of voluntary intellectual capital disclosure in public versus private companies

	2002		2003		2004		2005		2006		2007	
	Public	**Private**	**Public**	**Private**	**Public**	**Private**	**Public**	**Private**	**Public**	**Private**	**Public**	**Private**
Human capital	0.696	0.587	0.704	0.667	0.722	0.673	0.727	0.644	0.616	0.596	0.593	0.544
Relational capital	0.463	0.397	0.474	0.417	0.509	0.440	0.520	0.431	0.483	0.434	0.486	0.397
Structural capital	0.404	0.228	0.440	0.216	0.440	0.236	0.444	0.232	0.424	0.228	0.412	0.228
Total voluntary IC disclosure	0.596	0.487	0.614	0.532	0.633	0.548	0.635	0.529	0.567	0.508	0.564	0.470

Table 4: Mean of mandatory intellectual capital related accounting standards disclosure of public and private company

	2002		2003		2004		2005		2006		2007	
	Public	**Private**	**Public**	**Private**	**Public**	**Private**	**Public**	**Private**	**Public**	**Private**	**Public**	**Private**
Human capital												
Employee benefits (FRS119)	0.960	0.960	0.901	0.797	0.896	0.727	0.904	0.719	0.910	0.750	0.894	0.738
Retirement benefits (FRS126)	0.180	0.080	0.240	0.098	0.273	0.155	0.268	0.165	0.270	0.165	0.283	0.165
Structural capital												
Intangible assets (FRS138)	0.720	0.425	0.815	0.445	0.855	0.444	0.855	0.472	0.754	0.448	0.752	0.414
Total mandatory IC disclosure	0.620	0.488	0.647	0.446	0.668	0.442	0.669	0.452	0.639	0.452	0.637	0.439

Table 3shows the individual category of human, relational, structural and total intellectual capital disclosures for period 2002 until 2007 for public and private companies. Table 4 shows individual accounting standards related to intellectual capital (FRS 119, FRS 126 and FRS 138) and overall mandatory intellectual capital disclosures. The mean results of each voluntary and mandatory disclosure on human, relational, structural and total intellectual capital are graph into the respective figure 1 and 2 as appended in Appendix 3.

The descriptive results in the appendices and figures show public company has greater voluntary and mandatory intellectual capital disclosures compares to private company in Malaysia during the period of study. Further test on mean differences between

public and private companies show significant results in almost all of respective voluntary and mandatory intellectual capital for each period of study .

Discussion of the findings

The findings support the expectation of lower demand and supply of intellectual capital information in private companies financial statements as compares to public companies. Private companies concerntrated ownership among the shareholders results in less agency issueas they normally directly involve in the business operation. Any information asymmetry is resolves through informal communication during the course of business operation, hence less information reflects in corporate financial statements (Ball and Shivakumar, 2005). Lower agency issue, more concerntrated ownership result in lower demand of information in private companies financial statements subject to less scrutiny by securities exchange(Bursa Malaysia), although there is still monitoring by the accounting body (that is the MASB). This lead to lower reporting in private companies financial statementsas compares to the public companies.

Public company, on the other hand, has diversed shareholders. Public company capital financing normally derives from corporate investors and shareholders. Current and potential investors and shareholders normally use corporate financial information inevaluating the company performance and value in making inform-investment decision. This results in greater demand by investors and shareholders besides the company's managementmore willingness to supply enhanceinformation in its financial reporting (Ball and Shivakumar, 2005; Bursgstahler et al., 2006). In addition, diverse shareholders in public company are normally not involve in business operation. This results higher agency issue and information asymmetry between corporate managemnet and shareholders of public company. The financial statements of public company is use inreducinginformation asymmetry and evaluatingaccountability/stewardship of the corporate managementson the use of corporate resources entrusted to them (Botosan et al., 2006).

The findings alsosupport Lev and Zarowin (1999) and Botosan et al. (2006) that mandatory reporting provides reporting framework on intellectual capital reporting henceenhances information disclosure in corporate financial statements. The results

also noted lower voluntary intellectual capital disclosure subsequent to the implementation of mandatory intellectual capital accounting standards. This is because some of the information which was voluntary in nature has becomecompulsory by the accounting standards requirements. In addition, corporate management may shift their focus to fulfill the mandatory reporting compliance requirements.

Private companies's compliance on accounting standards addresses its capital financing for the creditors and financial providers such as banks. This rejects Peek et al.(2010) suggestion that private company relies on personal and long term relationship with loan providers, hence information on private company is obtains through "soft" proprietary information rather than "hard" financial information of corporate financial statements. The finding reflects financial reporting is important for both public and private companies capital financing. Whilst public company financial reporting addresses information needs for the shareholders and investors, private company addresses information needs for the loan providers.

Other than that, similar compliance of both private and public companies in Malaysian especially inview ofemployee benefits and intangible assets accounting standards may suggest that having the same accounting standards is cost-benefit effective for accounting bodies of the Malaysian Accounting Standards Board (MASB), accounting practitioners (such as the accountants and auditors) as well as monitoring bodies in Malaysia (such as Securities Commission of Malaysia and Bursa Malaysia). This is consistent with recommendation by the American Accounting Association Financial Accounting Standards (AAA FAS) committee study chaired by Botosan in 2006 of similar or separate accounting standards between public and private companies depends on each company legal and institutional environment and need to be justified within appropriate cost-benefit measures.

5. Conclusion

Intellectual capital (of human, relational and structural capital) enhances company future competitive advantage and performance; particularly during the current knowledge-based economy. Public and private companies are identified as the engine

towards the mobilisation of the intellectual capital components (Economic Planning Unit, 2001). Hence, this study addresses the gap in the area of comparative public and private companies reporting of intellectual capital resources.

Voluntary intellectual capital disclosures reflect public and private companies acknowledges the importance of intellectual capital creation and utilisation, hence fairly disclose the information in their financial statements. Compliance on mandatory intellectual capital enhances intellectual capital disclosures as the standardsprovide reporting guidelines and framework for uniformity and comparability across companies. Voluntary and mandatory compliance of intellectual capital reporting is noted as higher in public than private companies. This supports demand and supply information hypotheses as suggested by Ball and Shivakumar (2005) and Burgstahler et al. (2006) as well as higher monitoring by regulatory bodies (Givoly et al., 2010).

The results also assist in understanding the economic role of accounting standards where, although not absolute, its application is subject to market demand and supply of information. The focus of this study is comparative between public and private companies. Future study may extend towards examining company that switch organizational types.

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Appendix 1

Dependent variable of voluntary intellectual capital disclosures themes, measurement and descriptions

No	Intellectual capital theme		Measurement	Justification of measurement
HUMAN CAPITAL				
1	Employee measurement			
	1.1	Number of staff	1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of basic information on employee in the financial statements.
	1.2	Staff cost	1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of basic information on employee in the financial statements.
	1.3	Employee turnover	Change in staff cost divide by change in revenue. 1 for value more than zero, otherwise 0.	Value more than zero represents the investments in employees (in term of staff costs) generate income to the company.
	1.4	Employee profitability	Revenue divide by staff cost. 1 for value more than zero, otherwise 0.	Value more than zero represents that investment in staff cost generates revenue to the company.
	1.5	Employee growth	i) Change in staff cost ii) Change in number of employee 1 for increase in value, otherwise 0.	Increase in number of staff and staff cost represents growth in investment in employees in the company.
	1.6	Employee productivity	Staff cost divide by net profit. 1 for value more than zero, otherwise 0.	This represents the employee is efficient in producing profit to the company.
2	Education, know-how, qualification, competencies		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of information on the level of qualification and competencies of the employees.
3	Safety		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of safety information for the employees in the financial statements.
4	Training and development		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of information on employees' training and development in the financial statements.
5	Welfare, incentives program, compensation		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of

	scheme, employee benefits, share option, employee provident funds			information on employees' welfare in the financial statements.
RELATIONAL (EXTERNAL) CAPITAL				
1	Market: presence/ leadership / share		Company sales divide by total sales in the industry. 1 if result more than 1%, otherwise 0.	1% or more market share represents relatively significant of the company's presence in the industry.
2	Business partnership/ collaboration		1 for company having jointly controlled entity or business partnership, otherwise 0.	This information reflects that the company does not operate alone. The company has external/relational business cooperation.
3	Marketing expenditure		1 for disclosure, otherwise 0.	This reflects the company invests in marketing expenditure to improve its relational/external capital.
4	Research collaboration/research expenditure		1 for disclosure, otherwise 0.	This reflects the company's relationship in research activities collaboration.
5	Growth in business or service volume		Change in revenue. 1 for increase in revenue, otherwise 0.	Increase in revenue as compared to the previous year represents growth in business from relation with customers.
6	Brand building/ corporate image/ goodwill		1 for disclosure, otherwise 0.	Company that portrays good image, branding and goodwill in financial statements reflects strong external capital in the company.
7	Distribution cost		1 for disclosure, otherwise 0.	Disclosure of distribution cost reflects the company acknowledges the importance of effective distribution channel with the suppliers.
STRUCTURAL (INTERNAL) CAPITAL				
1	Intangible assets			
	1.1	Capitalized Examples: brand name, goodwill, research and development cost, innovation, patent, copy right, trademark, marketing right, technical know-how, development expenditure, rights	1 for disclosure, otherwise 0.	Information on capitalized intangible assets reflects the company's strong ownership on its intellectual property which will generate consistent future economic benefits for the company.
	1.2	Expensed off Examples: research	1 for disclosure, otherwise 0.	Information on expensed off intangible assets represents the

		and development costs expenditure, royalties expenditure		company's year-to-year investment in intangibles/ intellectual property which eventually improve its business operations.
2	Financial relation: bank loan, hire purchase, borrowings		1 for disclosure, otherwise 0.	Bank loan etc represents the company's financial relationship/support to enhance its business operation.
4	Systems: information systems		1 for disclosure, otherwise 0.	Information systems represents the company has strong systems in its business operation; hence reflects efficient structural business operation.

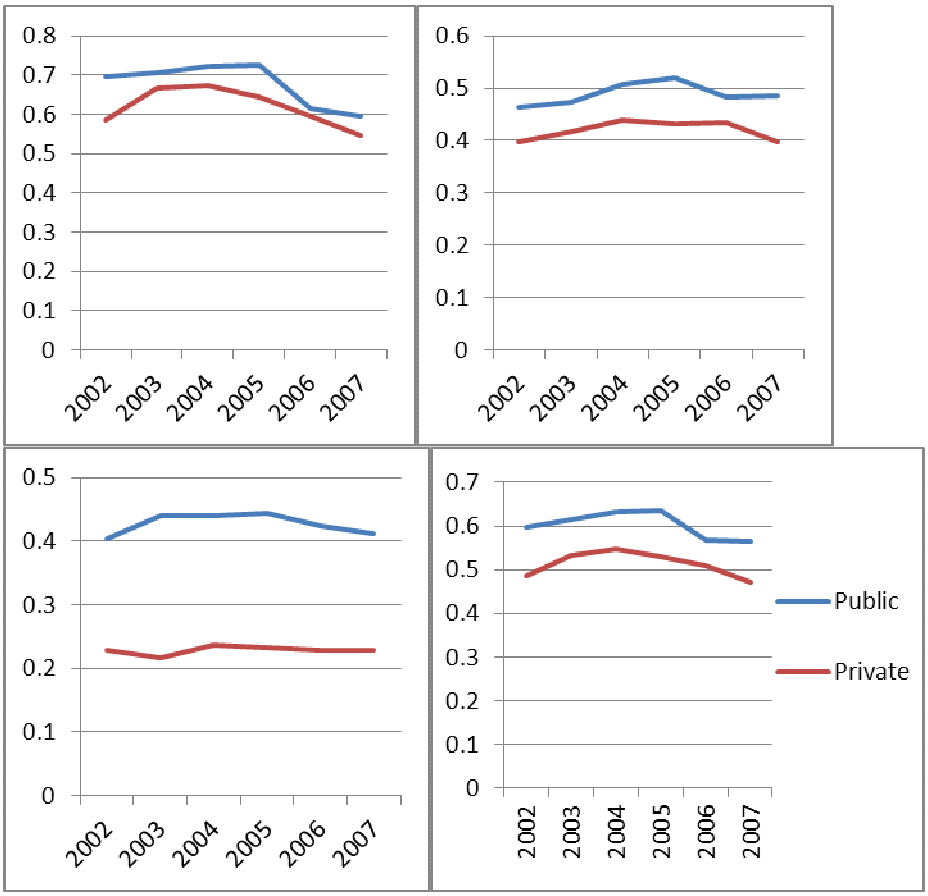
APPENDIX 2

Dependent variable of mandatory intellectual capital disclosures checklist based on relevant Financial Reporting Standards (FRS 119, FRS 126 and FRS 138)

No	Classification:		Applicable items:
FRS 119 EMPLOYEE BENEFITS			
1	Staff cost		1
2	Post-employment benefits		1
3	Pension/retirement		16
4	Other long term employee benefits		1
5	Termination benefits		2
	Total FRS 119 applicable items		**21**
FRS 126 ACCOUNTING AND REPORING OF RETIREMENT BENEFIT PLAN			
1	Summary in significant accounting policies		1
2	Description of the plan		2
3	Description of funding policy		1
4	Statements of net assets/ changes in net assets		2
5	Defined benefit plan: actuarial assumption, benefits, present value of retirement benefits		2
	Total FRS 126 applicable items		**8**
FRS 138 INTANGIBLE ASSETS			
1	Description of intangible assets		1
2	Capitalized – class of intangible assets		1
	2.1	Finite useful lives	6
	2.2	Indefinite useful lives	2
3	Expensed off intangible assets		3
4	Others		5
	Total FRS 138 applicable items		**18**

APPENDIX 4

pectively

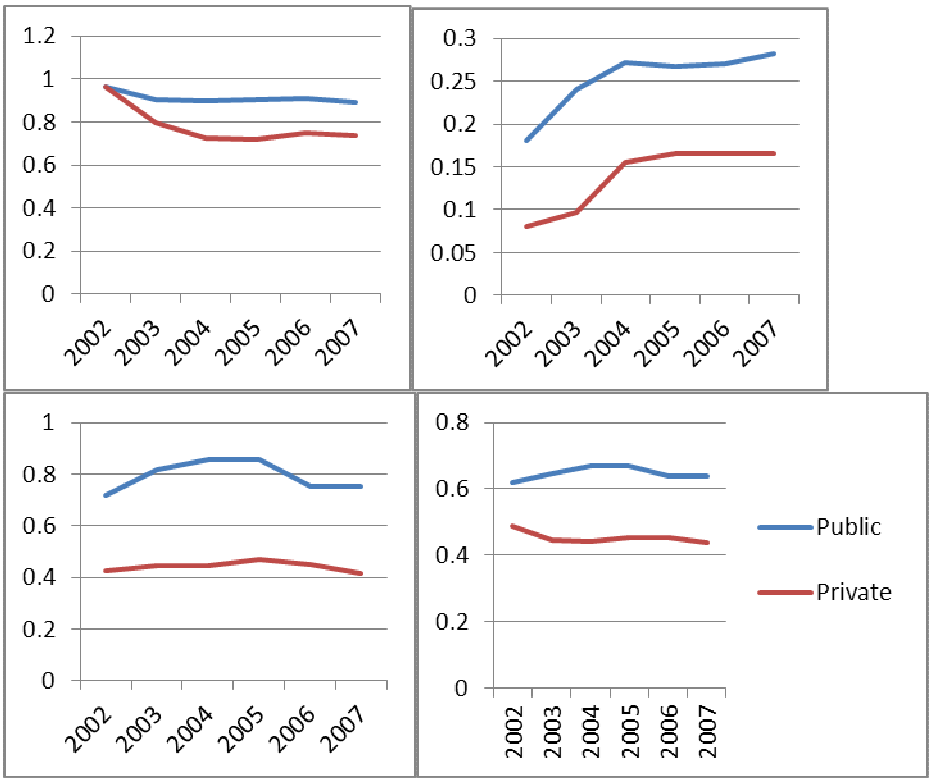


Human capital Relational capital Structural capital

Total voluntary intellectual capital

Figure 2: Graph of mean results of public versus private companies:

Compliance on mandatory human, relational, structural and total intellectual capital disclosures respectively.



FRS 119 FRS 126 FRS 138

Total mandatory intellectual capital

VOLUNTARY INTELLECTUAL CAPITAL DISCLOSURE AND EARNINGS QUALITY OF PRIVATE AND PUBLIC FIRMS: EVIDENCE FROM MALAYSIA

AmiliaSyuhada Abdul Majid*

Abstract

This study reviews the extent of voluntary intellectual capital information disclosure influence on earnings quality in both public and private companies. Intellectual capital recognition may attract higher discretionary accruals recognition hence affect the quality of corporate earnings. Such of recognition may differ between public listed and privately held companies due **to their different information needs.The sample study covers 50 public listed and 50** privately held companies for the period 2002 until 2007; results in 600 firm-year observations. Voluntary intellectual capital disclosure content analysis is based on studies such as Petty and Guthrie (2000) and Guthrie, Petty and Ricceri (2006). Earnings quality is proxy by discretionary accruals using Dechow and Dichev (2002) for the modified Jones (1991). The findings support the prediction that public companies disclose greater voluntary intellectual capital disclosure and better earnings quality compare to private companies. However, the results unable to significantly support the proposition that voluntary intellectual capital information disclosure influences for better earnings quality in both public and private companies in Malaysia.

Keywords: Voluntary intellectual capital, earnings quality, public and private companies

1. Introduction

This study examines the extent of voluntary intellectual capital information disclosures, earnings quality and their influences in private and public companies in Malaysia. Intellectual capital information disclosure is the arising importance resources[1] during the

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[1] Survey by Brooking Institute (2003) noted market perception on company value has changed over the years. The survey in the U.S. noted in 1982, 62% of company market value was contributed by tangible assets such as machines, products and facilities. By 2002, 80% of market value is instead contributed by intangible assets/intellectual capital such as brand name, intellectual property and quality of workforce (cited in Ow, 2007).

current knowledge-based economy. The knowledge-based economy utilizes resources which contribute towards company innovativeness and developments which enhances company productivity, competitiveness, performance and value (Shapira, Youtie, Yogeesvaran and Jaafar, 2006; Lev, Radhakrishnan and Zhang, 2009). The resources are human capital such as human capabilities, leadership and experiences, relational capital such as collaborative relationships and structural capital such as intellectual property, technological and information stocks and capabilities for shared learning and utilization (Shapira et al., 2006).

Public and private companies are identified as the engine towards mobilisation of intellectual capital components (Economic Planning Unit, 2001). In addition, significance presence and contribution of private company towards the economy[2] of the country raises the needs to study the adequacy, effectiveness and quality of its financial statements reporting (Lev and Zarowin, 1999; Healy and Palepu, 2001). Despite of the importance, the companies' information needs and application of reporting towards company value varies. The widely adopted market share price information in valuing corporate value is not available for private company; hence the alternative measure of earnings quality is adopted.

In view of the above, section 2 discusses the importance of earnings quality, the implication and limitation of its accounting and intellectual capital recognition as well as their differences in public and private companies' recognition. Section 3 presents research sample and methodology of the study. The results and discussions are describes in section 4, whilst section 5 concludes the study.

[2]99% of registered Malaysian companies are private companies. Based on data on the first quarter of 2008, there are 805,910 registered companies in Malaysia (source: Companies Commission of Malaysia website; www.ssm.com.my) of which 855 companies are listed in the main and second board of Bursa Malaysia (source: Bursa Malaysia website; www.bursamalaysia.com). In addition, 70% companies from the list of Malaysian top 1000 corporate directory in 2007/2008 were private companies.

2. Literature review

Earnings are widely used and highly ranked as the most important measures to corporate outsiders (Grahams, Harvey and Rajgopal., 2005). Investors, institutional owners, analysts and regulators rely on the quality of reported earnings in making inform decision on the company performance and value. Earnings reflect company's current operating performance and predict its future performance and value (Dechow, 1994; Dechow and Schrand, 2004; Ball and Sivakumar, 2005).

Earnings are produced under accrual basis of accounting. It arises from timing and matching principles in recognizing accounting transactions which eventually requires discretionary assumption and estimation made by corporate managements (Dechow, 1994; Dechow and Dichev, 2002). This may influence corporate management to opportunistically manage and manipulate the recognition and match between earnings and its expenditure. This raises reliability concern on accounting numbers as they may contain estimation errors made by corporate management. Such of accounting estimation errors would consequently reduces the persistence of accounting numbers, hence may become less relevant for company's valuation (Dechow, 1994; Dechow and Schrand, 2004; Givoly, Hayn and Katz; 2007). This is because any estimation errors would affect true corporate value during the accounting period and hence need to be corrected using the future earnings. These results in corporate earnings become less reliable in measuring the company performance.

In reference to intellectual capital, employees' information (human capital) in balance sheet may trigger accruals estimation error through recognition of pension liabilities and post-retirement benefits. In order to recognize such employee benefits in balance sheet, manager must forecast expected return of plan assets and obtain actuarial assumptions on the employees' life expectancies (Dechow and Schrand, 2004). Thus, the employee information accounting recognition and disclosure through the implementation of FRS 126, Accounting and Reporting of Retirement Benefits Plan on 1 January 2003 may results in higher accruals recognition (Dechow and Schrand, 2004).

Intangible assets capitalization, on the other hand, is more stringent on its recognition implementation. Intangible assets is capitalize in company balance sheet when it meets the requirements of separately identifiable resources with contractual or legal rights (FRS 138 Intangible Assets, paragraph 12) that a company has control over the assets to obtain future economic benefits (FRS 138 Intangible Assets, paragraph 13 and 17) and the cost could be measured reliably (FRS 101 Presentation of Financial Statements, paragraph 20 b). However, intangible assets may involve managements' discretionary accruals in judging its yearly amortization period/value and impairment loss recognition.

Earnings quality relation towards the extent of corporate voluntary disclosure may be viewed from two perspectives; which are substitutive or complementary relation (Francis, Nanda and Olsson, 2008).

Substitutive relation arises where poor corporate earnings quality lead to enhance voluntary disclosure in corporate annual report. The condition arises as the management has more incentive to educate the readers of corporate financial statements in reducing information asymmetry. Poor earnings quality may perceive as bad news by the investors without proper knowledge on the company business operation. This would discount the value of the company's share price (Francis et al., 2008). Voluntary disclosure enhances investors' confidence by providing information in making informed decision on corporate performance (Dechow and Schrand, 2004). However, Dechow and Schrand (2004) also indicate increase voluntary public disclosure may reduce investors' incentive to gather and interpret of such information. This would lead to reduce market value of the company. The substitutive relation may also arise where good earnings quality lead to lower voluntary information disclosures. This may arise where corporate management has lack of motivation to reduce information asymmetry and further explain the corporate operation.

On the other hand, complementary relation suggests company with good (poor) earnings quality enhance (lower) its voluntary disclosures (Dye, 1985). Corporate management has more incentive (disincentive) to disclosure more (less) voluntary information on

corporate operation as investors may treat such disclosure as more (less) credible. Good earnings quality reflects good news to the investors. Market responds positively, hence increase share price, when good news are further supplement in corporate reporting. Conversely, company with poor earnings quality may lower its voluntary disclosure. This is because company that faces earnings disappointments is more likely to lead to greater disappointment with greater disclosure on the poor corporate earnings. This would consequently further hamper the company's share prices. Hence, the company may not make further voluntary disclosure on such earnings performance and value.

Francis et al., (2008) examine the relations between voluntary disclosures in 677 U.S. companies for the period 2001 towards the extent of corporate voluntary reporting. They find complementary relation between earnings quality and voluntary disclosure. Company with good earnings quality has higher voluntary disclosure than companies with poor earnings quality. Company having good earnings quality make more voluntary disclosures to facilitate corporate investors to better infer the information disclosures, which may not possible from other sources.

Quality of earnings information in financial statements may differ between public listed and privately held companies. Among the studies that compare earnings quality of public and private companies are Ball and Shivakumar (2005), Burgstahler, Hail and Leuz (2006) and Givoly, Hayn and Katz (2010). They highlight the issue of earnings quality in public and private companies based on demand and supply of information as well as opportunistic behavior hypotheses.

Public company's greater separation between corporate management and shareholders results in greater information asymmetry between them. This leads to greater demand on quality information disclosure in public company reporting (Ball and Shivakumar, 2005; Givoly et al., 2007). The information is highly use by investors in making inform decision on company performance and value in deriving investment decision on the corporate share capital trading activities. Public company management also willing to supply such quality of information reflecting corporate performance and value, hence

attracting greater capital financing for the company (Ball and Shivakumar, 2005; Burgstahler et al., 2006; American Accounting Association's Financial Accounting Standards Committee chaired by Botosan, 2006). Corporate shareholders also demand greater information disclosures from the management as a medium to monitor their performance and accountability on the resources entrust to them (Botosan et al., 2006). This relates to opportunistic behavior hypothesis. The hypothesis suggests public company is scrutinized by corporate investors and shareholders. This pressures the management of public company to opportunistically adopt certain accounting method to generate the expected corporate performance results in meeting investors and shareholders expectation and forecasts (Givoly et al., 2007). Givoly et al. indicate the examples are management has the incentive managing stock prices to meet analysts' forecasts, avoiding reporting losses and avoiding earnings decreases. In addition, public company trading its share in securities market for capital financing results in demand of information by potential investors in making inform decision on company performance and value (Ball and Shivakumar, 2005; Burgstahler et al., 2006; Botosan et al., 2006). These result in greater demand on quality information disclosure in public company.

Private company, on the other hand, is normally manages by the owners and it is a common practices in Malaysia (Claessens, Djankov and Lang; 2000). The private's owner-managed companies has less information asymmetry issue (Arunnada, 2010) as it is quickly resolves through informal private communication during the course of business operation (Ball and Shivakumar, 2005). This also leads to less likely for private company adopting opportunistic behavior in its accounting practices and reporting. As such, there is lower demand on high quality information disclosures in private company (Givoly et al., 2007).

A summary of demand and opportunistic behavior hypotheses predict quality of public and private companies financial reporting are indicated in following table 1.

	Demand hypothesis	Predicted quality of financial reporting	Opportunistic behavior hypothesis	Predicted quality of financial reporting
Public listed company	Strong demand for quality financial reporting	High	Strong incentives to manage accounting numbers	Low
Privately held company	Weak demand for quality financial reporting	Low	No incentive to manage accounting numbers	High

Source:Givoly et al., 2010

Higher demand and supply of financial information and potential opportunistic behavior of management in public company results in its information disclosures faces stringent monitoring by the regulatory governing bodies (Givoly et al., 2007). High scrutiny of public company financial reporting is because their financial information has significant impact to investors and potential shareholders on the security trading activities decision making.

3. Research Method

3.1 Sample companies

This study matches 50 public and 50 private companies of a similar size and within the same type of industry. Company size and type of industry influence information reporting (Penno and Simon, 1986) particularly on the intellectual capital information disclosure (Tayles, Pike and Sofian, 2007). In addition, it allows better estimation on the effect of public and private companies (Penno and Simon, 1986). The method ensures consistency and comparability of two groups has been widely adopted in comparative public and private companies' studies such as Penno and Simon (1986), Ball and Shivakumar (2005) and Givoly et al. (2008).

Controlling for the company size, only companies with at least RM1 million sales is cover in the sample study. Then, public and private companies are matched-pair using a

factor of 3[3]. The matched-pair companies are group on their respective industries as certain type of industry has higher influence on intellectual capital reporting compare to the others[4] (Ho and Williams, 2003; Tayles, et al., 2007). The disclosure of such resourcesin corporate financial statements represents high reliance on intellectual capital. The list of the sample companies is obtained from the Malaysian 1000 Top Corporate Directory[5].The period of study covers from 2002 until 2007 (6 years); results in 600 firm-years observation.

3.2 Voluntary intellectual capital information disclosures index

Disclosure index of voluntary intellectual capital studies is developed based on various studies such as Guthrie, Petty, Ricceri and Wells (1999), Petty and Guthrie (2000), Guthrie (2001), Goh and Lim (2004), Abeysekera and Guthrie (2005), Guthrie, Petty, Yongvanich and Ricceri (2004) and Guthrie, Petty and Ricceri (2006). The studies use content analysis by developing a list of items relating to intellectual capital of human, relational (external) and structural (internal) capital. Examples of human capital items are employee, education, training, work related competencies and entrepreneurial spirit. Examples of relational (external) capital items are corporate brands, customers, customer satisfaction, company names, distribution channels, business collaborations and licensing agreements. Structural (internal) capital items are intellectual property, management philosophy, corporate culture, management processes, systems and financial relations. Following the studies above, a check list of intellectual capital themes is developed. There are five (5) themes on human capital, seven (7) themes on relational (external) capital and four (4) themes on structural (internal) capital. The themes classifications and descriptions of this study voluntary disclosure index are appended in Appendix 1.

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[3]The factor of 3 reflects sales ratio between the two matched-pair group of companies is not less than one-third nor greater than three from each other (Penno and Simon, 1986).

[4]Industries of high reliance on intellectual capital are technology, consumer product, trading and services as well as finance (Edvinsson and Malone, 1997).

[5] The method is consistent with Penno and Simon (1986). Penno and Simon obtained their sample company listing using the 1983 edition of Dun and Bradstreet's Million-Dollar Directory. The directory provides a comprehensive listing of public and private companies with at least $1 million in revenue (that is similar in size) and of the same industry group.

The results of voluntary intellectual capital disclosures score are converted into disclosure ratio. The disclosures ratios are developed by diving the disclosed items with the total applicable items; as follows.

$$\text{Disclosure index} = \frac{\Sigma \text{ Disclose items}}{\Sigma \text{ Applicable items}}$$

$_{i,j}$

The formula is widely used in disclosure studies such as Haniffa and Cooke (2002), Li, Pike and Haniffa (2008) and Singh and Zahn (2008).

3.3 Earnings quality

This study uses discretionary accruals (DA)[6] as a measure of earnings quality as the method has been widely adopt to measure corporate earnings quality (Hashim, 2009). Discretionary accruals (DA) arise on accounting transactions made in managing earnings recognition. Jones (1991), based on De Angelo (1986), proposed non-discretionary accruals are constant from period to period. Hence, the difference between current and prior period accruals is solely due to changes in discretionary accruals. As such, discretionary accruals (DA) reflect the absolute value from the result of residual value of the total accruals (TA). The model is adopted in various earnings quality study such as Dechow, Sloan and Sweeney 1995, Dechow and Dichev 2002, Ball and Shivakumar

[6]Accruals (total accruals; TA) can be divided into discretionary (DA) and non discretionary accruals (NDA) (Jones 1991, Dechow, Sloan and Sweeney 1995), hence reflects as*TA = DA + NDA*. Non-discretionary accruals (NDA) are accounting transaction that arises from normal business operations (Ronen and Yaari, 2008). Discretionary accruals (DA) are accounting transactions made in managing earnings recognitions.

2006, Burgstahler et al., 2006, Francis et al., 2008, Givoly et al., 2010) using modified Jones (1991)[7] approach as follows.

$$TA_{i,t}/Assets_{i,t-1} = \alpha_0+\beta_1(1/Assets_{i,t-1}) +\alpha_2 [\Delta Rev_{i,t}/Assets_{i,t-1}]+\alpha_3 [PPE_{i,t}/Assets_{i,t-1}]+\varepsilon_{i,t}$$

Where:

$TA_{i,t}$ = total accruals in year *t* for firm*i*

$\Delta Rev_{i,t}$= revenue in year *t* less revenue in year *t-1* for firm *i*

$PPE_{i,t}$ = gross property plan and equipment in year *t* for firm*i*

$Assets_{i,t-1}$= total assets in year *t-1* for firm*i*

$\varepsilon_{i,t}$= error term in year *t* for firm*i*

3.4 Regression model

Regression model measures voluntary disclosure of intellectual capital influence towards better corporate earnings quality of public and private companies. Corporate governance and company characteristics are also included in the study as they are expectto influence the extent of corporate earnings quality. The model is as follows.

$$DA_{i,t}= \alpha_0 + \alpha_1 Pvt_{i,t} + \alpha_2 VOLDIS_{i,t} + \alpha_3 BSIZE_{i,t} + \alpha_4 INDDIR_{i,t} + \alpha_5 DUALITY_{i,t} + \alpha_6 CHAIRIND_{i,t} + \alpha_7 Pvt*VOLDIS_{i,t} + \alpha_8 Pvt*BSIZE_{i,t} + \alpha_9 Pvt*INDDIR_{i,t} + \alpha_{10} Pvt*DUALITY_{i,t} + \alpha_{11} Pvt*CHAIRIND_{i,t} + \alpha_{12} SIZE_{i,t} + \alpha_{13} PROFIT_{i,t} + \alpha_{14} GROWTH_{i,t} + \alpha_{15} LEV_{i,t} + \alpha_{16} INDUSTRY_{i,t} + \alpha_{17} PERIOD_{i,t} + \alpha_{18} INTAN_{i,t} + \varepsilon_{i,t}$$

[7]Jones (1991) model developed a linear regression, controlling for non discretionary components, between total accruals (TA) and changes in revenue and property, plant and equity, scaled by lagged on prior year total assets (Dechow et al., 1995).Dechow et al., (1995) modified the Jones (1991) model by including changes in net receivables to adjust for changes in revenues. Both Jones (1991) and modified Jones models outperformed other models (such as Healy, DeAngelo and Industry models) in detecting induced earnings manipulation (Dechow et al., 1995; Guay et al., 1996). The modified Jones model reflects higher test in detecting management discretion on accruals/earnings management as compared to the original Jones model (Dechow et al., 1995; Bowman and Navissi, 2003). However, this study is unable to perform modified Jones model due to unavailability of net receivables data.

Where:

$DA_{i,t}$ = Discretionary accruals of company *i* at year *t*

$VOLDIS_{i,t}$ = company *i* score of voluntary disclosure of intellectual capital items

$BSIZE_{i,t}$ = Number of board of directors, of company *i* at year *t*. Board size more than 8 members is score as 1, otherwise 0.

$INDDIR_{i,t}$= Proportion of independent director over total board directors of company *i* at year *t.* Independent directors consist of one-third of the board member score as 1, otherwise 0.

$DUALITY_{i,t}$= Separate CEO-chairman duality position of company *i* at year *t*, score as 1 otherwise 0.

$CHAIRIND_{i,t}$= Independent board chairman of company *i* at year *t*, score as 1 otherwise 0.

$SIZE_{i,t}$= Log of total assets of company *i* in year *t.*

$PROFIT_{i,t}$= Return on assets (ROA) of company *i* in year *t.* ROA is measured by ratio of net income divided by total assets during the year.

$GROWTH_{i,t}$= Ratio of changes in sales of company *i* in year *t* and *t-1*.

$LEV_{i,t}$= Ratio of total liabilities over total assets of company *i* in year *t* .

$INDUSTRY_{i,t}$= Industry that company *i* operates in, 1 is score for industry that sensitive on intellectual capital development (manufacturing, trading and services) and 0 otherwise (infrastructure, construction and transportation).

$PERIOD_{i,t}$= Period after the adoption of the FRS accounting standards related to intellectual capital (2006-2007) applicable to company *i*is score as 1, otherwise (2002-2005) 0.

$INTAN_{i,t}$= Log of intangible assets capitalized of company *i* in year *t.*

Pvt = dummy variable of 1 for privately held company and 0 public listed company.

$\varepsilon_{i,t}$= Error term.

4. Results

The descriptive mean results of discretionary accruals (in reflecting the extent of earning quality) and voluntary intellectual capital disclosure is present in the following table 2.

Table 2: Mean of discretionary accruals (proxy of earning quality) and respective voluntary intellectual capital disclosuresin public and private companies

	2002		2003		2004		2005		2006		2007	
	Public	Private	Public	Private	Public	Private	Public	Private	Public	Private	Public	Private
Discretionary accruals	0.051	0.097	0.057	0.079	0.055	0.070	0.056	0.070	0.050	0.077	0.065	0.100
Human capital	0.696	0.587	0.704	0.667	0.722	0.673	0.727	0.644	0.616	0.596	0.593	0.544
Relational capital	0.463	0.397	0.474	0.417	0.509	0.440	0.520	0.431	0.483	0.434	0.486	0.397
Relational capital	0.463	0.397	0.474	0.417	0.509	0.440	0.520	0.431	0.483	0.434	0.486	0.397
Structural capital	0.404	0.228	0.440	0.216	0.440	0.236	0.444	0.232	0.424	0.228	0.412	0.228
Total voluntary IC disclosure	0.596	0.487	0.614	0.532	0.633	0.548	0.635	0.529	0.567	0.508	0.564	0.470

As translated into the following figure 1, descriptive results mean of discretionary accruals show lower results in public compares to private companies. It reflects better earnings quality in public company financial statements as compares to private companies.

Figure 1: Graph of means of discretionary accrualsin public versus private companies

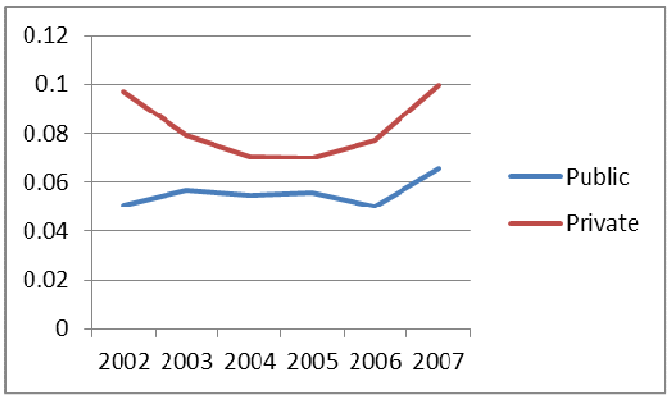
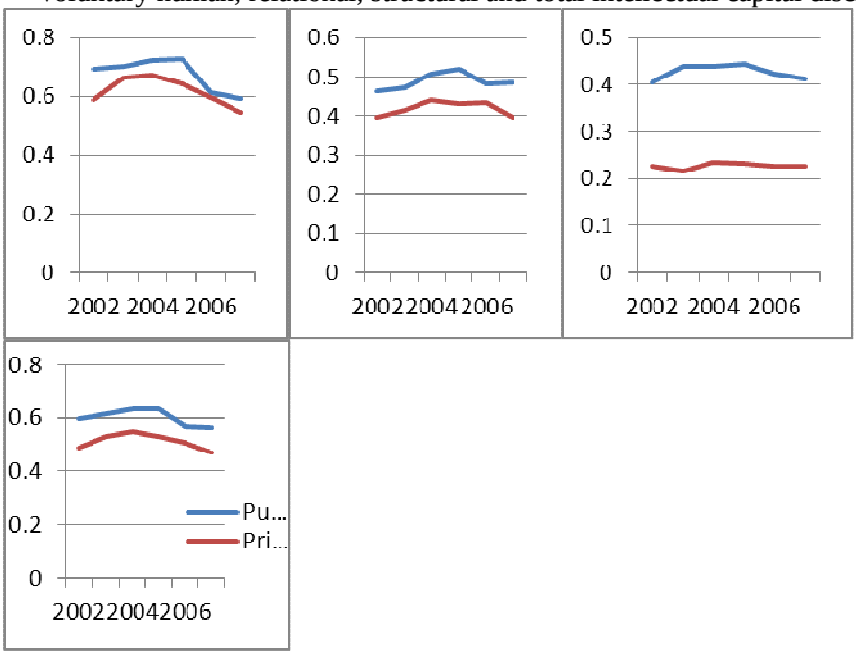


Figure 2 shows the graph of means results of public and private companies' disclosures of the respective voluntary intellectual capital resources and its total voluntary disclosure. As expected, the results show higher voluntary intellectual capital disclosures in public compares to private companies during the period of the study.

Figure 2: Graph of mean results of public versus private companies:
voluntary human, relational, structural and total intellectual capital disclosures respectively.



Human capital Relational capital Structural capital Total voluntary intellectual capital

Further test on mean differences between public and private companies shows significant results in almost all of earnings quality and the respective voluntary intellectual capital disclosures for each period of study. The descriptive results support the proposition by public company stakeholders demand higher quality of information disclosures helping them making inform decision on the company performance and value. Public company also willing to supply enhance quality of information in respond of the demand for higher capital financing by the potential and current shareholders (Ball and Shivakumar, 2005; Burgstahler et al., 2006). The utilization of public company reporting by the current and potential shareholders in reaching their investment decision, results in high monitoring by regulatory bodies. This leads to greater monitoring by the regulatory bodies, hence

results in higher disclosures and better earnings quality in public as compares to the private companies (Givoly et al., 2010).

The following table 3 presents the regression results of the total voluntary intellectual capital disclosures influence towards corporate earnings quality.

Table 3: Regression results

$$DA_{i,t} = \alpha_0 + \alpha_1 Pvt_{i,t} + \alpha_2 VOLDIS_{i,t} + \alpha_3 Pvt*VOLDIS_{i,t} + \alpha_4 BSIZE_{i,t} + \alpha_5 INDDIR_{i,t} + \alpha_6 NON\text{-}DUALITY_{i,t} + \alpha_7 CHAIRIND_{i,t} + \alpha_8 Pvt*BSIZE_{i,t} + \alpha_9 Pvt*INDDIR_{i,t} + \alpha_{10} Pvt*NON\text{-}DUALITY_{i,t} + \alpha_{11} Pvt*CHAIRIND_{i,t} + \alpha_{12} SIZE_{i,t} + \alpha_{13} PROFIT_{i,t} + \alpha_{14} GROWTH_{i,t} + \alpha_{15} LEV_{i,t} + \alpha_{16} INDUSTRY_{i,t} + \alpha_{17} PERIOD_{i,t} + \alpha_{18} INTAN_{i,t} + \varepsilon_{i,t}$$

Variable	Coefficient	t-statistic	Prob.
C	0.121	2.679	0.008
Pvt	0.042	1.196	0.232
VOLDIS	-0.031	-0.751	0.453
Pvt*VOLDIS	-0.073	-1.359	0.175
BSIZE	0.003	0.310	0.757
INDDIR	0.003	0.272	0.786
NON- DUALITY	0.002	0.164	0.870
CHAIRIND	-0.007	-0.736	0.462
Pvt*BSIZE	-0.001	-0.051	0.959
Pvt*INDDIR	0.017	1.019	0.309
Pvt*NON -DUALITY	-0.015	-0.832	0.406
Pvt*CHAIRIND	0.007	0.421	0.674
SIZE	-0.010	-1.516	0.130

PROFIT	0.097	2.420	0.016
GROWTH	0.001	0.094	0.925
LEV	0.028	1.907	0.057
INDUSTRY	-0.017	-1.876	0.061
PERIOD	0.004	0.632	0.528
INTAN	0.035	0.557	0.577
R-squared	0.073		
Adjusted R-squared	0.044		
F-statistic	2.532		
Prob(F-statistic)	0.000		

Dependent variable DA of discretionary accruals to represents the extent of corporate earnings quality. Pvt represents private companies in the regression analysis. Independent variable VOLDIS represents the overall results of voluntary human, relational and structural capital information disclosures. Corporate governance items under study are dummy variable 1 for board size (BSIZE) more than 8 members, otherwise 0, dummy variable 1 for one-third proportion of independent director over total board directors (INDDIR) otherwise 0, dummy variable 1 for separate CEO and chairman position (NON-DUALITY) otherwise 0 and dummy variable 1 for of independent board chairman (CHAIRIND) otherwise 0. INDUSTRY under reviews are manufacturing and trading (M), infrastructure (I), construction (C), transportation (T) and services (S). M and S industries represent industries sensitive towards intellectual capital developments, hence coded as 1, whilst the other industries are coded as 0. Company size (SIZE) is measured by log of total assets during the period. Profitability is represented by return on assets (ROA) is measured by net income over total assets during the period. Company GROWTH is measured by ratio of changes in sales during the period. Leverage (LEV) is

measured by equity divided by total assets during the period. INTAN is measured as total intangibles capitalized divided by total assets during the period.

The regression result shows voluntary intellectual capital information disclosures influence lower discretionary accruals recognition with coefficient -0.031 in the overall results and -0.073 in the private company results. The results reflect complement relation where more disclosure of voluntary intellectual capital information reduces the management's discretion on accounting figures (as measured by lower discretionary accruals) hence reflect better corporate earnings quality (Francis et al., 2008). Information asymmetry between corporate management and shareholders creates a demand for voluntary information disclosure apart from the mandatory disclosure requirements by the regulatory body of MASB. Voluntary information disclosures on human resources, organizational structure and relationships with other parties lead to better management of corporate financial figures; hence lower discretionary accruals recognize by company management. Shareholders treat such voluntary disclosure as credible information which enhances perceives corporate value (Francis et al., 2008). However, the results of both public and private companies reflect lack of significant coefficient, hence unable to significantly support the above proposition.

Lack of significant results may reflect limitation of intellectual capital recognition and reporting in corporate financial statements. Firstly, stringent intellectual capital recognition as promulgated by the accounting standards, which may limits the management voluntary information disclosures. Secondly, it may reflect the management hesitation on enhance voluntary intellectual capital recognition and disclosures due to uncertainty of perceive value of such of voluntary intellectual capital information by the stakeholders. Thirdly, the management may focus its incentives in fulfilling the mandated reporting of the accounting standards as failure of compliance may result in revoke of public company listing status.

5. Conclusion

Intellectual capital recognition and disclosureare seen as the emerging resources which enhance company value. Public and private companies are identified as the engine towards mobilisation of intellectual capital components (Economic Planning Unit, 2001). Although there is high existence and contribution of the private company towards the economy of the country; there is limited study on this area. In addition, both public and private companies use similar accounting standards; yet their application is subject to the market demand and supply of information. In addressing the gapsin these areas, this study adopts the alternative measure of company value that is earnings quality due to non-existence of market share price by the private company.

The results meet the expectation of higher voluntary intellectual capital reporting and better earnings quality in public company compare to private company. It relates to higher demand and supply of information as well as greater monitoring by the regulatory bodies in public compares the private companies (Ball and Shivakumar, 2005; Burgstahler et al., 2006; Givoly et al., 2010). Yet, the results unable to significantly support the proposition of higher voluntary intellectual capital disclosures compliment for better corporate earnings quality in both public and private companies in Malaysia.

This study contributes towards identifying the extent of voluntary intellectual capital disclosures, earnings quality and their influences in public and private companies in Malaysia. The study raises several avenue for future research. Other models of earnings quality may be adopted in future study such as modified Jones, cash flows and balance sheet approach in testing their implication on towards the reporting.

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APPENDIX 1

Dependent variable of voluntary intellectual capital disclosures themes, measurement and descriptions

No	Intellectual capital theme		Measurement	Justification of measurement
HUMAN CAPITAL				
1	Employee measurement			
	1.1	Number of staff	1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of basic information on employee in the financial statements.
	1.2	Staff cost	1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of basic information on employee in the financial statements.
	1.3	Employee turnover	Change in staff cost divide by change in revenue. 1 for value more than zero, otherwise 0.	Value more than zero represents the investments in employees (in term of staff costs) generate income to the company.
	1.4	Employee profitability	Revenue divide by staff cost. 1 for value more than zero, otherwise 0.	Value more than zero represents that investment in staff cost generates revenue to the company.
	1.5	Employee growth	iii) Change in staff cost iv) Change in number of employee 1 for increase in value, otherwise 0.	Increase in number of staff and staff cost represents growth in investment in employees in the company.
	1.6	Employee productivity	Staff cost divide by net profit. 1 for value more than zero, otherwise 0.	This represents the employee is efficient in producing profit to the company.
2	Education, know-how, qualification, competencies		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of information on the level of qualification and competencies of the employees.
3	Safety		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of safety information for the employees in the financial statements.
4	Training and development		1 for disclosure, otherwise 0.	This represents the company acknowledge the importance of information on employees' training and development in the financial statements.
5	Welfare, incentives program,		1 for disclosure, otherwise 0.	This represents the company

	compensation scheme, employee benefits, share option, employee provident funds			acknowledge the importance of information on employees' welfare in the financial statements.
RELATIONAL (EXTERNAL) CAPITAL				
1	Market: presence/ leadership / share		Company sales divide by total sales in the industry. 1 if result more than 1%, otherwise 0.	1% or more market share represents relatively significant of the company's presence in the industry.
2	Business partnership/ collaboration		1 for company having jointly controlled entity or business partnership, otherwise 0.	This information reflects that the company does not operate alone. The company has external/relational business cooperation.
3	Marketing expenditure		1 for disclosure, otherwise 0.	This reflects the company invests in marketing expenditure to improve its relational/external capital.
4	Research collaboration/research expenditure		1 for disclosure, otherwise 0.	This reflects the company's relationship in research activities collaboration.
5	Growth in business or service volume		Change in revenue. 1 for increase in revenue, otherwise 0.	Increase in revenue as compared to the previous year represents growth in business from relation with customers.
6	Brand building/ corporate image/ goodwill		1 for disclosure, otherwise 0.	Company that portrays good image, branding and goodwill in financial statements reflects strong external capital in the company.
7	Distribution cost		1 for disclosure, otherwise 0.	Disclosure of distribution cost reflects the company acknowledges the importance of effective distribution channel with the suppliers.
STRUCTURAL (INTERNAL) CAPITAL				
1	Intangible assets			
	1.1	Capitalized Examples: brand name, goodwill, research and development cost, innovation, patent, copy right, trademark, marketing right, technical know-how, development expenditure, rights	1 for disclosure, otherwise 0.	Information on capitalized intangible assets reflects the company's strong ownership on its intellectual property which will generate consistent future economic benefits for the company.
	1.2	Expensed off Examples: research	1 for disclosure, otherwise 0.	Information on expensed off intangible assets represents the

		and development costs expenditure, royalties expenditure		company's year-to-year investment in intangibles/ intellectual property which eventually improve its business operations.
2	Financial relation: bank loan, hire purchase, borrowings		1 for disclosure, otherwise 0.	Bank loan etc represents the company's financial relationship/support to enhance its business operation.
4	Systems: information systems		1 for disclosure, otherwise 0.	Information systems represents the company has strong systems in its business operation; hence reflects efficient structural business operation.

MILITARY EXPENDITURES AND ECONOMIC GROWTH IN SELECTED OIC COUNTRIES: CAUSALITY ANALYSIS USING PANEL ERROR-CORRECTION APPROACH

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Abstract

This paper examines the causality between military expenditures and economic growth for selected 20 Organization of Islamic Countries (OIC). In this paper we test for *Granger* long-run causality employing the Panel Error-Correction Model (ECM) framework using annual data for the period 1970 to 2005. Military expenditure is measured using the logarithm of the ratio of military expenditures to gross domestic product (*milex*); while economic growth is proxy by the logarithm of real GDP per capita (*rgdppc*). Causation (as well as cointegration) is inferred from *milex* to *rgdppc*, in a panel setting using the Pooled Mean Group (PMG) estimator proposed by Pesaran et al. (1999) when the Error-Correction (ECM) term is significant in an equation with *rgdppc* as dependent variable. On the other hand, *Granger* causality is said to run from *rgdppc* to *milex*, when the ECM term is significant in an equation with *milex* as dependent variable. However, before testing for cointegration or causality, the order of integration of both time-series in a panel setting was tested using the three standard panel unit root tests (Levin et al., 2002; Im et al., 1997; Maddala and Wu, 1999). Our PMG results suggest that the ECM term is significantly different from zero in a model when *milex* is the dependent variable but not otherwise. The result implies that there is cointegration between military expenditures and economic growth, on average, for all the selected OIC countries. The result thus suggests that there is one-way *Granger* causality running from economic growth to military expenditure for the selected OIC countries under study for the period 1970-2005.

Keywords: Military expenditures, economic growth, causality, Pooled Mean Group, OIC.

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1. Introduction

Is defense spending related to economic growth? This question has important implication for policy makers and researchers. From the viewpoint of the researchers, the question of whether military spending causes economic growth or otherwise has important implication for empirical work. Nevertheless, the direction of causation between the defense spending and economic growth has no specific prediction. In general, studies have found that defense spending can influence an economy both negatively or positively. Defense spending can affect economic growth through a number of channels. For example, defense spending can affect an economy either positively as per the finding of Hassan et al. (2003), through an expansion of aggregate demand or through increase security, and negatively (Deger, 1986) through a crowding out of investment. On top of that, there are findings showing no meaningful relationship as found by Galvin (2003) and Yildirim et al. (2005). In some cases, the results are mixed as found by Kollias et al. (2004b) and Dakurah et al. (2000).

For the policy makers, the impact of military expenditure on economic growth which can be positive or negative can have different ramification with respect to what strategy to take to foster growth. A positive relationship between defense spending and growth and the line of causation that runs from defense spending to economic growth implies that defense spending stimulate economic growth. In this respect defense spending enhances aggregate demand by increasing purchasing power and produces positive spin-off effect. DeGrasse (1993) argues that defense spending generates contract awards which generate jobs and increase purchasing power of workers. The increased purchasing power will lead to more demand. Thus, through this process of increasing aggregate demand and employment, defense spending helps economic growth. On the other hand, Deger (1986) points out that in the less developing countries (LDCs), military may help in creating a socioeconomic structure conducive to growth. In this aspect, military may engage in research and development, provide technical skills, educational training and create an infrastructure necessary for economic development. With respect to negative impact of military expenditure on growth, economists focus on the opportunity cost of military spending, that is military expenditures hinder economic development by reducing savings and

misallocating resources away from more productive use in the public or private sector (see Deger, 1986; Deger and Smith, 1983).

The purpose of the present paper is to determine empirically whether military spending is related to economic growth in twenty (20) selected Organization of Islamic Countries (OIC). The OIC economies selected are Algeria, Benin, Burkina Faso, Cameroon, Egypt, Indonesia, Iran, Kuwait, Malaysia, Mauritania, Morocco, Nigeria, Pakistan, Saudi Arabia, Senegal Sudan, Syria, Togo, Tunisia, and Turkey. Our paper contributes to the present literature on defense spending-economic growth by applying the panel error-correction model proposed by Pesaran et al. (1999) to concur causality in a panel data framework between military expenditure and economic growth. The plan of the paper is as follow. In the next section we review related empirical work on the defense spending-economic growth nexus. In section 3, we provide the method of estimation and in section 4, we discuss the empirical results. The last section contains our conclusion.

2. Review of Related Literature

Since the early 1970s, numerous studies on causality between military spending and economic growth have been conducted. Benoit (1973, 1978) pioneered the empirical work on this issue. The author found that there is a positive correlation between military expenditure and economic growth in 44 less-developed countries that he studied. Since then, there are many studies attempting to evaluate the impact of military expenditure on economic growth, and most the results are often mixed and ambiguous.

It cannot be denied that the result on how military spending influences growth lack of consensus. Empirical evidence tends to vary across countries and over time, and the results are sensitive to the underlying theoretical framework. Most common findings are that military spending has no significant impact, either positive or negative, on economic growth.

Galvin (2003) and Dakurah et al. (2000) examine the case for developing countries. There are also other numerous studies concerning different regions and countries, for example study concerning Middle Eastern countries by Yildirim et al. (2005), European Union (EU) by Kollias et al. (2004a), and SAARC by Hassan et al. (2003).

A new explanation of the Benoit hypothesis on endogenous growth and military expenditure is provided by Shieh et al. (2002). They develop an endogenous model to examine the linkage between economic growth and military expenditure. They implement the modeling strategy where both the demand side and supply side effects of national military are taken into consideration. They found that an increase in military expenditure has a tendency to stimulate the continuous growth rate and it is conforming to Benoit's famous empirical finding.

Deger (1986) found negative relationship between military expenditure and growth in the least developed countries (LDCs), citing that military expenditure takes resources away from productive investments and fails to mobilize and create additional savings. Other empirical studies that found insignificant relationship as well as the adverse effects of military spending on the economy include studies by Faini et al. (1986), Deger and Sen (1983) and Deger and Smith (1983).

Dakurah et al. (2000) studied 62 LDCs and found those 10 cases causality runs from growth to military; 7 countries suggesting bidirectional causality, 13 countries showed unidirectional causality from military expenditure to growth and 18 countries showing independencies. Studies by Kollias et al. (2004a) on 15 EU countries suggest mixed results in term of causal direction. Most of the countries in EU showed unidirectional causality from growth to spending expenditure. They conclude that an EU government derives military expenditure based on the economic performance. Another study by Kollias et al. (2004a) suggest the presence of instantaneous bi-directional causality between military expenditure and growth for the case of Cyprus from 1964 – 1999. They used cointegration and causality test to analyze the causal relationship between the variables involved.

Galvin (2003) studies the defense and growth relationship using cross-section data for 64 developing countries. The author examines the impact of military expenditure on economic growth with a supply and demand side model. The author used simultaneous equation methodologies (2SLS and 3 SLS)in order to test the robustness of the results. The author intends to replicate the results of these conclusions to changes in model specifications and samples size that were found previously. With three simultaneous equation models - the growth equation, the saving equation and the defense equation, their results show that, when taking all interdependent effect together, the impact of increases military burden reduce the growth rate within both income groups. The author concluded that wealthier countries have less to gain from the military because those countries have a more productive worker and have more developed infrastructure in terms of communications and domestic markets.

Hassan et al. (2003) examine the impact of the military expenditure on economic growth and FDI covering five of seven South Asian Regional Cooperation Council (SAARC) nations using a panel data over the 1980-1999 periods. The result suggests that there is a positive relationship between military expenditure and economic growth, which support the view that military expenditure can bring positive impact on growth.

By extending Barro and Sala-i-Martin model to account for the impact of military expenditure on growth for a cross section of countries, Aizenman and Glick (2006) study the long-run impact of military expenditure on growth. They suggest that military expenditure induced by external threats should increase growth, while military expenditure induced by rent seeking and corruption should reduce growth.

India and Pakistan have been in constant conflict with each other since their separation in 1974. In 1974 the division of the country was mainly due to religious differences, breakdown in the political system, economic and social of the country. Yildirim and Ocal (2006) studies the issue of arms race between Pakistan and India and their relations to each country's economic growth. The author found that there is a unidirectional causal relationship between economic growth and military expenditure for Pakistan and India. Reitchuler and Loening (2005) study on Guatemala using Feder-Ram model to investigate between linear versus non-linear

function. The authors propose that the linear model show insignificant effect on growth. However the results were changes using non-linear model. They also found that at low threshold there is positive effect on growth and beyond the threshold, it turns negative. However, military is less productive than the civilian sector.

The intrinsic value of national security is perhaps the most important argument for military spending. Definitely, national security allows for productive economic activities to be carried out without fear of foreign appropriation. Thus, military spending is expected to provide national security and subsequently enhance economic growth in the long-run (Ram, 1996). Bader et al. (2003) found negative effect between military burden and economic growth in Egypt, Israel and Syria. They also found that civilian expenditure caused positive economic growth in Israel and Syria.

In the context of Asia, Moon and Hyun (1992) found through disaggregated analysis the effect of heavy military to have entailed negative implications for growth, distribution and economic stability. Chan (1992) suggests that military spending has not been the direct determinant of Taiwan's economic growth despite heavy burden on military. The study by Chowdhury (1991) on causal relationship between economic growth and military spending which covers 55 developing countries and by using the Granger causality test, found out that the relationships between military spending and economic growth cannot be generalized across the 55 developing countries.

Al-Yousif (2002) apply Granger causality test within a multivariate error-correction model to investigate the existence and direction of causality between economic growth and defense spending. The author investigate these two variables in six Gulf countries namely; Kuwait, Saudi Arabia, Bahrain, United Arab Emirates, Oman and Iran, covering the period from 1975 – 1998. The author's empirical results show that neither growth nor military expenditure can be considered exogenous. The author also argues that the relationship between economic growth and military expenditure cannot be generalized across countries. The author states that there are two implications, one is the need for more studies, especially from developing countries using the time – series data. The second is that military expenditure should be based on each country's socio-economic circumstances.

Narayan et al. (2007) select Fiji Islands to examine the nexus between military expenditure and GDP. They investigate Fiji Island because Fiji's is unique for a numbers of reasons: (1) Fiji have a small open economy with0.8 million of population; and (2) despite facing minimum threat from external military forces Fiji has the largest military force in the South Pacific Island region. Their study covers the period from 1970 and 2001. In this study, they use several estimators; (1) the ordinary least squares, the autoregressive distributed lag (ARDL); (2) the dynamic ordinary least squares (DOLS) and fully modified (FMOLS) ordinary least squares approach to determine the robustness of the long-run results. They predict that military expenditure might enhance Fiji's economic growth. When using the bound test, they found one cointegrating relationship between variables when GDP was the endogenous variable. Based on the long-run elasticities results both military expenditure and exports had a positive impact on Fiji's GDP. They also found that exports Granger cause GDP and military expenditure Granger cause export positively. They further suggest three policy implications in their findings. First, they found different results compared with the volume of the literature on developing countries which military expenditure has positive impact on economic growth, the results are consistent with the Keynesian school of thought. Second, they found in the short-run, military expenditure Granger cause exports positively. Which in turn positively Granger cause GDP, implies that Fiji provides significant military services at overseas missions given that defense spending makes upon only 2.3% of GDP. Third, they found that both export and military expenditure Granger-cause GDP implies that increasing Fiji's export and securing overseas missions will enhance economic growth in the long-run.

Lee and Chen (2007) re-investigate the long-run co-movements and the causality between military expenditure and GDP in a multivariate model with real military expenditure per capita (ME), real GDP per capita (GDP) and real capital stock per capita (K). They were using data for 27 OECD countries and 62 non-OECD countries for the period of 1988 - 2003. Using aggregate production function, they create the empirical model and combined the cross-sectional and time-series data to re-examine the relationship between military expenditure and GDP. Their result suggests positive relationship between GDP and military expenditure for OECD countries, where a negative relationship from military expenditure to GDP exist in non-OECD countries

under examination. They also determine that military expenditure and GDP need short-run causality but do show long-run bidirectional causalities in both OECD and non-OECD countries by employing the dynamic panel-based error correction model.

Before 1980s, the long separation of Taiwan from China bred hostility, which led to a significant increase in military expenditure to GDP. Lai et al. (2005) examine the relationship between national military expenditure and economic growth for China and Taiwan by employing both non-linear and linear models. They were using data from 1953 to 2000 on GDP, capital, military expenditure, GDP, import and export. They found that the results of the linear models shows1) China's spending growth leads economic growth, 2) Economic growth and Taiwan's spending display feedback relations and 3) Granger cause was found from China's spending growth to Taiwan's spending. They also use rival's spending growth as the threshold variable to look at the causal relationship. They found that there exists feedback relation (an arms race) when China's spending growth exceed the 3% threshold values.

Stroup and Heckelman (2001) estimate the influence of military expenditure on growth in African and Latin American countries. They employed panel data analysis for 44 countries in African and Latin American countries from 1975 to 1989. They found low levels of military expenditure increasing economic growth but higher levels of military expenditure decreasing growth, the defense burden on economic growth is non-linear, and found empirical evidence that the defense burden in these two country has a non-linear influence on economic growth, changing from positive to negative as military expenditure represent an ever-higher proportion of GNP. They also found that the influence of military labor use on growth is similarly non-linear and depends upon the level of male education attainment in a country. They used Barro's neoclassical model to economic growth as a starting point because the model on growth specification includes variables designed to control for differences in institutional influences across countries.

Study by Cuaresma and Reitschuler (2003), discuss the impact of military expenditure on GDP growth in the US by estimating two fairly general models that had been discussed in Deger (1986) and Biswas and Ram (1986). They present evidence of a level dependent effect of military expenditure on growth using longitudinal data for

the US economy. They used yearly frequency data and spanning from 1929-1999 for all variables. The variables are growth rate of saving, growth rate of the labor force, growth rate of export and the growth rate of military expenditure. There is a positive externality effect and a negative size effect for low levels (relative to the estimated threshold) of defense spending based on the non-linear generalization results and they indicated that there is a positive externality effect, and the externality effect sign and the size effect disappears for high levels. Using linear methods tends to show exclusively one distorted "side of the coin" of the defense-growth nexus based on the quantitative results. The data strongly rejected the linear specification, taking account the lack of uniformity of the effect of military expenditure on GDP growth and approaching the problem using non-linear methods.

Yildirim et al. (2005) investigate the effects of military expenditures on economic growth for Turkey and Middle Eastern for the time period, 1989 to 1999. They used cross-sectional and dynamic panel estimation techniques to investigate the relationship between military expenditure and economic growth. They also investigated the income growth-military expenditure relationship for low, middle and high income countries to see if this relationship differs with the income level of the countries.

Their analysis indicated that military expenditure boost economic growth in the Middle Eastern countries and Turkey. They also suggest that the factor productivity differentials are positive, that means it implies that the military sector is more productive than the civilian sector. Thisis because the military sector uses high technology compared with the rest of economies in the Middle East. Overall, their conclusions are consistent with the related literature which uses the Feder model, finding no effect of military expenditure on economic growth or positive effect.

3. Methodology

Since the annual data available in our study ranges from 1970 to 2005 (35 observations), the short time dimension of the available data on a country level hinders robust estimates with classical time-series econometrics. Panel econometrics are said to allow a substantial gain in power and furthermore, panel estimators are

proven to deal better with the problem of measurement bias (Baltagi et al., 1995). Pesaran et al. (1999) propose the Pool Mean Group (PMG) estimator which is essentially a dynamic error-correction model that allows the short-run parameters to vary across countries (Groups), while restricting long-run elasticities to be identical across countries. An alternative technique, the Mean group (MG) estimator, also discussed in Pesaran et al. (1999) involves simply the estimation of separate equations for each country and the computation of the mean estimates, without imposing any constraint on the parameters. However, if some parameters are the same across groups, efficiency gains are made by taking this into account.

To illustrate the method, we start with the following long-run relationship with say, $rgdppc_t$ denotes economic growth and $milex_t$ denotes military expenditures

$$rgdppc_{it} = \theta_{0i} + \theta_{1i}\, milex_{it} + \mu_{it} \tag{1}$$

For simplicity, assuming a maximum lag order of one, we can re-write Equation (1) as an autoregressive distributed lag (ARDL) (1,1) as follows

$$rgdppc_{it} = \mu_{it} + \delta_{10i}\, milex_{it} + \delta_{11i}\, milex_{i,t-1} + \lambda_i\, rgdppc_{i,t-1} + \varepsilon_{it} \tag{2}$$

The subscripts $i = 1, 2, ..., 20$ stand for 20 OIC countries, the subscripts $t = 1970, 1971, ..., 2005$ for the years 1970 to 2005, μ_i represent the fixed effects due to the parameter θ_{0i}, and δ_i are the coefficients of the explanatory variables and λ_i the coefficients of the lagged dependent variable.

Rewriting Equation (2) in an error-correction form yields

$$\Delta rgdppc_{it} = \phi_i\,(rgdppc_{i,t-1} - \theta_{0i} - \theta_{1i}\, milex_{it}) - \delta_{11}\,\Delta milex_{it} + \varepsilon_{it} \tag{3}$$

where $\theta_{0i} = \dfrac{\mu_i}{1-\lambda_i}$, $\theta_{1i} = \dfrac{\delta_{10i} + \delta_{11i}}{1-\lambda_i}$, and $\phi_i = -(1-\lambda_i)$.

Imposing the same long-run coefficients in Equation (1) implies that in the long-run the elasticities of economic growth with respect to military expenditures will be the same across countries. The long-run causality between defense spending and economic growth can be infer from the sign and the significant of the error-correction term ϕ_i. A significant and negative sign of ϕ_i suggest that military expenditures causal effect economic growth. Country heterogeneity is accounted for by allowing different short-run dynamics in each cross sectional unit.

Pesaran et al. (1999) point out that three econometric techniques seem to be suitable to estimate ARDL models such as Equation (2): Mean Group (MG), Pooled Mean Group (PMG) and Dynamic Fixed effects (DFE). With both T, the number of time-series observations, and N, the number of groups, quite large, all three methods produce consistent estimates of the coefficients, though these estimates will be inefficient (and biased) when specific homogeneity assumptions hold. The MG estimator is consistent and imposes no restrictions at all, and thus provides a standard of comparison. The traditional pooled estimators such as the DFE constraint the coefficients and the error variances to be the same across groups. Only the intercepts are allowed to differ from group to group. These estimators may cause substantial efficiency losses when only long-run homogeneity assumptions are valid. The PMG has the advantage over the DFE and the MG model in that the short-run dynamics (and the error variances) are allowed to differ freely while the long-run slope coefficients are assumed to be equal across groups.

The test of the homogeneity of the long-run coefficients is provided by a Hausman test. This is based on the null hypothesis that the two set of coefficients generated by the PMG and MG estimators are not statistically different. Under the null hypothesis this statistic is asymptotically distributed as a $\chi^2(p)$, where p is the number of parameters. The lag order of the ARDL model for each country covered is selected by the Schwarz Bayesian Criterion (SBC) subject to a maximum lag of two. Based on these SBC determined lag orders long-run homogeneity is imposed.

Sources of Data

In this study we use annual data that span from 1970 to 2005. The OIC countries included in the study are Algeria, Benin, Burkina Faso, Cameroon, Egypt, Indonesia, Iran, Kuwait, Malaysia, Mauritania, Morocco, Nigeria, Pakistan, Saudi Arabia, Senegal Sudan, Syria, Togo, Tunisia, and Turkey. Data on the share of military expenditure to gross domestic product and real gross domestic product per capita are collected from various issues of the Stockholm International Pearce Research Institute (SIPRI, 1975, 1977, 1985, 1990, 2006, 2008) Yearbook published by Oxford University Press. All variables were transformed into natural logarithm.

4. Discussion of Empirical Results

Test for Panel Unit Root

Before testing for causality between economic growth and military expenditure using the panel error-correction approach, it is essential to determine the order of integration for each of the series. The popular single equation standard ADF tests used to test for the presence of unit roots has been criticised for lack of power. Some authors recognised that the power could be significantly improved if panel data are used instead of a univariate time-series (Levin et al., 2002; Im et al., 1997). Furthermore, the panel approach appears extremely appealing because the inclusion of a limited amount of cross-sectional information induces significant improvement in term of power. For the panel unit root test procedures, Levin et al. (2002) proposed to perform the augmented Dickey-Fuller tests based on the following regression model. For a sample of N groups observed over T time periods, the panel unit root regression of the ADF test is written as

$$\Delta y_{it} = \alpha_i + \beta_i y_{it-1} + \sum_{j=1}^{p_i} \gamma_{ij} \Delta y_{it-j} + \varepsilon_{it}, \qquad i = 1,...,N, \qquad t = 1,...,T \tag{4}$$

where $\alpha_i, \beta_i \text{ and } \gamma_{ij}$ are parameters and the error terms ε_{it} are uncorrelated across regions. The Levin-Lin-Chu tests for the $H_0 : \beta_i = 0$ against $H_a : \beta_i < 0$. Under the

null hypothesis, they show that the test statistics, t^* is asymptotically distributed according to the standard normal distribution.

On the other hand, Im et al. (1997) extent the work of Levin et al. (2002) to allow for heterogeneity in the value of β_i in Equation (4). Im et al. (1997) proposed a $t-$bar statistic, which is based on the average of the individual ADF $t-$statistics.

The null hypothesis of a unit root in the panel data is defined as

$$\beta_i = 0, \text{for all } i \tag{5}$$

against the alternatives that all series are stationary processes

$$\beta_i < 0,\ i = 1,2,...,N_1;\ \beta_i = 0,\ i = N_1 + 1, N_2 + 2,...,N\,. \tag{6}$$

This equation of the alternative hypothesis allows for $\beta_i = \beta < 0$ for all $i.$To test the hypothesis, Im et al. (1997) propose a standardised $t-$bar statistic given by

$$\Psi_{\bar{t}} = \frac{\sqrt{N}\left\{\bar{t}_{NT} - (1/N)\sum_{i=1}^{N} E\left[t_{i,T}(p_i,0)\middle|\,\beta_i = 0\right]\right\}}{\sqrt{(1/N)\sum_{i=1}^{N} Var\left[t_{i,T}(p_i,0)\middle|\,\beta_i = 0\right]}} \tag{7}$$

where

$$\bar{t}_{NT} = \frac{1}{N}\sum t_{i,T}(p_i, \beta_i) \tag{8}$$

And $t_{i,T}(p_i, \beta_i)$ is the individual $t-$statistic for testing $\beta_i = 0$ for all $i.\ E\left[t_{i,T}(p_i,0)\middle|\,\beta_i = 0\right]$ and $Var\left[t_{i,T}(p_i,0)\,\middle|\beta i = 0\right]$ are reported in Table 1 of Im et al. (1997). Under the null hypothesis, the standardised $t-$bar statistic $\Psi_{\bar{t}}$ is asymptotically distributed as a standard normal distribution ($\Psi_{\bar{t}} \sim N(0,1)$). The Im et al. (1997) panel unit root test is derived assuming that the series are independently

generated, and they suggested subtracting cross-sectional means to remove common time specific effects. This assumes the error term in Equation (8) consists of two random components, $\varepsilon_{it} = \delta_t + \nu_{it}$ where ν_{it} is the idiosyncratic random component, and δ_t is a stationary time-specific effect that accounts for correlation in the errors across economies.

Another commonly used panel unit root test is the one based on Fisher (1932). Maddala and Wu (1999) propose the test statistic which is based on combining the *p*-values of the test statistics (of β_i) of *N* independent ADF regressions. The test statistic (the Fisher test $P(\lambda)$) is as follows

$$P(\lambda) = -2\sum_{i=1}^{N} \log(\pi_i) \tag{9}$$

where π_i is the *p*-value of the test statistic for unit *i*. The Fisher test statistic $P(\lambda)$ is distributed as a chi-squared distribution with $2N$ degree of freedom.

The results of the panel unit root tests for $rgdppc_t$ and $milex_t$ are presented in Table 1. We report the estimated *t-star* statistics of the Levin-Lin-Chu (LLC) test, $t-$bar statistics for the Im-Pesaran-Shin (IPS) test and λ-values for the Fisher $P(\lambda)$ test with their accompanying *p*-values. Despite study by Im et al. (1997) that have demonstrated by Monte Carlo simulations that their panel test suggest better finite sample performance of the $\psi_{\bar{t}}$ over Levin-Lin-Chu's t^*, and a study by Breitung (1999) that has showed the Maddala and Wu (1999) panel unit root tests have considerable more power relative to the IPS test, in all cases the three panel unit root test results are consistent indicating that real GDP per capita and military expenditures are $I(1)$ as a group. The null hypothesis of unit root in level cannot be reject at the 5 percent level of significance, while the null hypothesis of a unit root in first difference can be reject at the 5 percent level of significance.

Table 1: Results of Panel Unit Root Tests

Series	Levin-Lin-Chu test , t^{*} [a]		Im-Pesaran-Shin test, $\psi_{\bar{t}}$ [a]		Maddala-Wu test, $P(\lambda)$ [b]	
	Intercept	Intercept & trend	Intercept	Intercept & trend	Intercept	Intercept & trend
A. Level						
rgdppc	-2.74 (0-5) [0.003]**	-1.23 (0-5) [0.107]	-0.49 (0-5) [0.309]	-0.83 (0-5) [0.200]	48.56 (0-5) [0.168]	47.21 (0-5) [0.201]
milex	-0.31 (0-2) [0.377]	-0.881 (0-8) [0.188]	-0.105 (0-2) [0.457]	0.809 (0-8) [0.791]	35.75 (0-2) [0.661]	31.92 (0-8) [0.815]
B. First difference						
Δ*rgdppc*	-21.66 (0-2) [0.000]**	-20.23 (0-2) [0.000]**	-21.99 (0-2) [0.000]**	-20.46 (0-2) [0.000]**	422.0 (0-2) [0.000]**	409.8 (0-2) [0.000]**
Δ*milex*	-24.09 (0-2) [0.000]**	-20.43 (0-7) [0.000]**	-22.41 (0-2) [0.000]**	-19.53 (0-7) [0.000]**	439.0 (0-2) [0.000]**	355.5 (0-7) [0.000]**

Notes: [a]Under the null hypothesis, the standardised $t-$bar statistic $\psi_{\bar{t}}$ (the IPS test statistic) is asymptotically distributed as a standard normal distribution. Lag length chosen is based on SIC which is automatically selected by EViews5.1. The numbers in parentheses denote the range of lag length and those in square brackets are *p*-values. The *p*-values are estimated from the one-tail test of the standardised normal distribution. [b]Under the null hypothesis, the Fisher test statistic $P(\lambda)$ is distributed as a chi-squared distribution with $2N$ degree of freedom. Lag length chosen is based on the basis of SIC automatically selected by EViews5.1. The *p*-values are estimated from a chi-squared distribution with $2N$ degree of freedom. Asterisk (**) denotes statistically significance at 5% level.

Test for Granger Long-run Causality

Our main purpose is to determine the causal direction between defense spending and economic growth in the OIC countries. In a panel setting we have employed the Pesaran et al. (1999) panel error-correction model approach which uses two estimators, that is the PMG and MG estimators. One important advantage of PMG over MG or the traditional dynamic fixed effect model is that the short-run dynamics (and the error variances) are allowed to differ freely while the long-run slope

coefficients are assumed to be equal across groups. Due to similar levels of economic and technological development, but differences in institutional infrastructure and cultural, we expected that the long-run equilibrium relationships between fundamental variables are similar across the OIC countries, with the speed of adjustment to the long-run equilibrium values differing freely country by country. Using the panel error-correction model, the cultural and institutional specifics of a country which usually drive short-term dynamics can be properly accounted for.

Table 2 presents the estimates of the long-run coefficient of Equation (3) based on the estimators PMG and MG. The results are based on lag orders for each country chosen by the Schwarz-Bayesian information criterion (SBC) subject to a maximum lag of 3. Then, using these SBC – determined lags order, and after imposing homogeneity restriction, the dynamic heterogenous panel Equation (3) was estimated using maximum likelihood. The estimates are computed with the Newton-Raphson algorithm, which uses both the first and the second derivatives of the likelihood function.

Table 2: Panel ECM Results of Military Expenditure (*milex*) - Economic Growth (*rgdppc*) in Selected OIC Countries from 1970 – 2005

	PMG Estimates			MG Estimates			Hausman Test	
	Coef.	s.e	*p*-value	Coef.	s.e	*p*-value	$\chi^2(1)$	*p*-value
Long run coefficient:								
	0.6774	0.2493	0.007**	1.4714	1.3349	0.270	0.37	0.5449
Error Correction Coefficient:								
	-0.1208	0.0288	0.000**	-0.2220	0.0256	0.000**		

Note: Asterisk (**) denotes statistically significant at 5% level.

In Table 2, we present the results where military expenditures act as the dependent variable, while in Table 4, economic growth act as the dependent variables. In each of Table 2 and Table 4 we also show the result of the Hausman test for determining any statistical differences between PMG and MG.In this study, we are interested in determining the significance of the error-correction term in order to infer cointegration as well as *Granger*long-run causality between economic growth and defense spending. First, the joint Hausman test statistics clearly indicate that the restriction of long-run homogeneity of all long-run coefficients cannot be rejected at the 5 percent level of significance for the estimated equation with military expenditure

as dependent variable. This implies that the long-run relationship between defense spending and economic growth is equal across the 20 OIC countries.

Next we observe for the significance of the error-correction term to infer cointegration (long-run relationship) as well as *Granger* long-run causality between the two variables – *milex* and *rgdppc*. As shown in Table 2, our results strongly suggest that the null hypothesis that there is no *Granger*long-run causality in running from economic growth to military expenditures can be rejected at the 5 percent level. This implies that economic growth "drives" military expenditures in the OIC countries. Our long-run estimated equation suggests that a 1 percent increase in economic growth will lead to a 0.7 percent increase in military expenditures, on average, among the 20 OIC countries.

The error correction term suggest the speed of adjustment when *milex* and *rgdppc* is not in equilibrium. The estimated error correction term of 0.12 would suggest that the speed of adjustment is slow in such that when in disequilibrium, it took about more that 10 month to achieve equilibrium. Table 3 indicates various speed of adjustment for each of the OIC countries, ranging from 0.01 for Indonesia to 0.45 for Sudan. In other words, the rate of adjustment is faster for Sudan than for Indonesia.

Table 3: Individual Results of PMG and MG estimate of Military Expenditure (*milex*)– Economic Growth (*rgdppc*) in Selected OIC Countries from 1970 -2005

Countries	MG		PMG	
	ECT	*rgdppc*	*ECT*	*rgdppc*
Turkey	-0.2403	-0.7213	-0.0265	0.6774
	(0.065)*	(0.131)	(0.745)	(0.007)**
Malaysia	-0.2969	-1.0944	-0.0218	0.6774
	(0.012)**	(0.000)**	(0.661)	(0.007)**
Indonesia	-0.2048	-1.3045	-0.0100	0.6774
	(0.023)**	(0.000)**	(0.745)	(0.007)**
Saudi Arabia	-0.3794	0.9162	-0.4054	0.6774
	(0.002)**	(0.057)*	(0.000)**	(0.007)**
Iran	-0.3357	2.8267	-0.1458	0.6774
	(0.004)**	(0.000)**	(0.080)*	(0.007)**
Nigeria	-0.1808	4.2265	-0.1309	0.6774
	(0.037)**	(0.125)	(0.065)*	(0.007)**
Egypt	-0.4350	-2.1262	-0.0450	0.6774
	(0.003)**	(0.000)**	(0.399)	(0.007)**
Algeria	-0.0849	-3.1576	-0.0673	0.6774
	(0.297)	(0.468)	(0.384)	(0.007)**
Pakistan	-0.1183	-1.6032	0.0443	0.6774
	(0.138)	(0.129)	(0.421)	(0.007)**
Morocco	-0.2460	-0.7511	-0.1687	0.6774
	(0.015)**	(0.294)	(0.075)*	(0.007)**
Tunisia	-0.1893	-0.8023	-0.1301	0.6774
	(0.021)**	(0.340)	(0.076)*	(0.007)**
Kuwait	-0.2329	-2.2760	-0.0135	0.6774
	(0.087)*	(0.035)**	(0.874)	(0.007)**
Syria	-0.0951	-2.6288	-0.0239	0.6774
	(0.238)	(0.250)	(0.698)	(0.007)**
Sudan	-0.4460	1.2967	-0.4544	0.6774
	(0.001)**	(0.082)*	(0.000)**	(0.007)**
Cameroon	-0.2517	0.5849	-0.2423	0.6774
	(0.030)**	(0.221)	(0.017)**	(0.007)**
Senegal	-0.0264	16.0533	-0.0498	0.6774
	(0.679)	(0.706)	(0.397)	(0.007)**
Mauritania	-0.1379	19.3676	-0.1457	0.6774
	(0.039)**	(0.119)	(0.032)**	(0.007)**
Togo	-0.2026	0.8736	-0.2105	0.6774
	(0.024)**	(0.490)	(0.003)**	(0.007)**
Benin	-0.7346	3.3692	-0.1183	0.6774
	(0.290)	(0.694)	(0.103)	(0.007)**
Burkina Faso	-0.2378	-3.6212	-0.0505	0.6774
	(0.006)**	(0.004)**	(0.493)	(0.007)**

Note: Figures in parentheses are *p-values*. Asterisk (*) and (**) denote statistically significant at 10% and 5% level respectively.

On the other hand, Table 4 clearly suggests that homogeneity should be imposed among the 20 OIC countries when we run a regression with economic growth as the dependent variable. The Hausman test is not significantly different from zero at the 5

percent level, thus implies that the Pooled Mean Group model is to be chosen. Nevertheless, our results suggest that the null of non-cointegration cannot be rejected at the 5 percent level of significance as shown by the insignificant of the error correction term. This would suggest that there is no long-run relationship between economic growth and military expenditures (when economic growth as dependent variable) and therefore implies that there is no *Granger* long-run causality running from military expenditures to economic growth. As shown in Table 4, the error correction term is close to zero (i.e. 0.002) and as presented in Table 5, many of the OIC countries registered a very low value for the error correction term with for example, Mauritania registered an error correction term of 0.0002 while Burkina Faso with 0.0008. In other words, we can infer that economic growth do not react to military expenditures in those OIC countries.

Table 4: Panel ECM Results of Economic Growth (*rgdppc*) - Military Expenditure (*milex*) in Selected OIC Countries from 1970 – 2005

	PMG Estimates			MG Estimates			Hausman Test	
	Coef.	s.e	*p*-value	Coef.	s.e	*p*-value	$\chi^2(1)$	*p*-value
Long run coefficient:								
	2.2616	1.1372	0.047**	2.4784	2.2448	0.270	0.01	0.9108
Error Correction Coefficient:								
	0.0024	0.0037	0.516	-0.1298	0.0412	0.002**		

Note: Asterisk (**) denotes statistically significant at 5% level.

Table 5: Individual Results of PMG and MG estimate of Economic Growth (rgdppc) - Military Expenditure (milex) in Selected OIC Countries from 1970 -2005

Countries	MG		PMG	
	ECT	*milex*	*ECT*	*milex*
Turkey	-0.0380	-1.9198	0.0102	2.2610
	(0.416)	(0.365)	(0.323)	(0.047)**
Malaysia	-0.0435	-0.468	-0.0026	2.2610
	(0.180)	(0.178)	(0.455)	(0.047)**
Indonesia	-0.0681	-0.3939	-0.0065	2.2610
	(0.104)	(0.080)*	(0.095)*	(0.047)**
Saudi Arabia	0.0218	5.777	0.0608	2.2610
	(0.666)	(0.655)	(0.070)*	(0.047)**
Iran	-0.2154	0.2384	-0.0014	2.2610
	(0.139)	(0.039)**	(0.889)	(0.047)**
Nigeria	-0.0857	-0.0411	0.0040	2.2610
	(0.459)	(0.872)	(0.418)	(0.047)**
Egypt	-0.0248	0.1578	-0.0041	2.2610
	(0.457)	(0.836)	(0.126)	(0.047)**
Algeria	-0.0316	1.0845	-0.0140	2.2610
	(0.621)	(0.647)	(0.108)	(0.047)**
Pakistan	-0.0121	0.5324	-0.008	2.2610
	(0.473)	(0.779)	(0.078)*	(0.047)**
Morocco	-0.0700	-0.2318	-0.0054	2.2610
	(0.212)	(0.660)	(0.427)	(0.047)**
Tunisia	0.0005	44.6862	0.0098	2.2610
	(0.978)	(0.978)	(0.049)**	(0.047)**
Kuwait	-0.1193	0.1250	-0.0182	2.2610
	(0.089)*	(0.698)	(0.094)*	(0.047)**
Syria	-0.2288	-0.1548	-0.0093	2.2610
	(0.012)**	(0.154)	(0.255)	(0.047)**
Sudan	-0.0079	1.1808	-0.0028	2.2610
	(0.919)	(0.909)	(0.804)	(0.047)**
Cameroon	-0.1142	0.0447	-0.0080	2.2610
	(0.099)*	(0.938)	(0.744)	(0.047)**
Senegal	-0.2867	-0.1128	0.0160	2.2610
	(0.044)**	(0.319)	(0.155)	(0.047)**
Mauritania	-0.8294	0.0360	0.0002	2.2610
	(0.000)**	(0.003)**	(0.934)	(0.047)**
Togo	-0.1217	-0.5565	0.0204	2.2610
	(0.157)	(0.298)**	(0.235)	(0.047)**
Benin	-0.1644	-0.1739	0.0074	2.2610
	(0.117)	(0.145)	(0.206)	(0.047)**
Burkina Faso	-0.1572	-0.2405	0.0008	2.2610
	(0.040)**	(0.022)**	(0.814)	(0.047)**

Note: Figures in parentheses are *p-value*. Asterisk (*) and (**) denote statistically significant at 10% and 5% level respectively.

5. Conclusion

This study made an attempt to examine the long-run relationship and the causal direction between military expenditures and economic growth in twenty OIC countries, namely; Algeria, Benin, Burkina Faso, Cameroon, Egypt, Indonesia, Iran, Kuwait, Malaysia, Mauritania, Morocco, Nigeria, Pakistan, Saudi Arabia, Senegal Sudan, Syria, Togo, Tunisia, and Turkey. We use annual data for the period 1970 to 2005. We applied the three panel unit root test due to Levin, Lin and Chu (2002), Im, Pesaran and Shin (1997) and Maddala and Wu (1999) for the testing of the order of integration; and we employed the Pesaran, Shin and Smith (1999) panel error-correction model to infer cointegration as well as *Granger*long-run causality between the two variables.

Our results clearly indicate that time-series defense spending and real GDP per capita are integrated of order one as a group. Our panel error-correction model indicates strongly that there is long-run relationship between military expenditures and economic growth in the OIC countries for the period under study. However, long-run causality only runs from economic growth to military expenditures, thus implies that as economic growth increases, defense spending will increase but less than the increase in economic growth.

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ISLAMIC MICROFINANCE: GLOBAL ISSUES AND CHALLENGES

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Abstract

Muslim countries position in the top of extreme ends of rich and poor spectrum. The possible bridge among these countries for the rich attempting to reach and help the poor is through Islamic microfinance. With these motivations, many countries are currently embarking into Islamic microfinance. This paper will discuss trend and development of Islamic microfinance in selected countries and respective issues and challenges. The lessons learned from other countries were then compared to Malaysian experiences. Finally, possible areas to research on towards solving Islamic microfinance problems in Malaysian perspective were put forth.

KEYWORDS: Islamic microfinance, Bangladesh, Pakistan, Malaysia

1. Introduction

The Muslim countries (mainly oil rich countries) belong to the higher middle-income countries group or the high-income group, several studies however indicated a high level of poverty within the Muslim countries (Smolo & Ismail, 2011). According to country ranking by Gross Domestic Product (GDP) based on Purchasing Power Parity (PPP) per capita, only Qatar and Brunei from Organization of Islamic Conference (OIC) countries fall at the top ten of the ranking, seven OIC countries in the top 50 ranking, while another seven OIC countries placed in the ranking whose GDP is between USD10,000 to USD15,000 per capita. The rest of 43 OIC countries have GDP based on PPP per capita of less than USD10,000. This statistic supports the fact

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that the majority of the OIC countries belong to the undeveloped or least developed countries group.

Microfinance succeeded well to alleviate poverty in some parts of the world. However it does not come without problems or failure cases. The average microfinance institutions charge interest rates as high as 30percent. Although this high interest rate is attracting funds for sustainable microfinance institutions (MFIs), it is also further suppressing the poor. Therefore, high interest rates are no longer acceptable to mitigate risk for the poor. Alternatively, Islamic finance which in it embedded just and equitability to achieve fair distribution of wealth of nation is ideal to extend solutions to problems in microfinance.

Islamic microfinance was only initiated a decade later than the conventional microfinance. It is also in demand from the Muslim clients especially when the paying and taking interests on loans are strictly prohibited by the Syariah law as mentioned in the Al-Quran (2:278-279)

> *"O you who believe! Be afraid of Allâh and give up what remains (due to you) from Ribâ (usury) (from now onward), if you are (really) believers. And if you do not do it, then take a notice of war from Allâh and His Messenger but if you repent, you shall have your capital sums. Deal not unjustly (by asking more than your capital sums), and you shall not be dealt with unjustly (by receiving less than your capital sums)."*

For the believers, the prohibition is mentioned very obviously that to declare war with Allah and His messenger is an extremely unwise action to take. Therefore, the demand for Islamic microfinance is particularly high by the poor Muslim believers. In addition, providing the microfinance products that serve the needs of the clients is important to ensure the success of any microfinance programs.

Given two decades of development of Islamic microfinance, Islamic microfinance institutions (IMFIs) were only recently established in several countries such as UAE, Kuwait, Saudi Arabia, Pakistan, Bangladesh, Malaysia, Indonesia and Australia. Excluding Australia, all of the countries which have Islamic microfinance are from OIC countries. Referring to the

survey on countries' wealth ranked by GDP based on PPP per capita, only UAE and Kuwait position in the top 20, Saudi Arabia holds 38th position, while Malaysia, Pakistan and Bangladesh placed at 59th, 133rd and 154th ranking respectively. In this paper, countries to be discussed are only Bangladesh, Pakistan and Malaysia. Bangladesh is chosen because the country is the pioneer of microfinance that introduced the viable Grameen Model to the world. The most successful Islamic microfinance country is nevertheless practiced by Pakistan, hence the decision to include the country in the discussions of this paper. Finally, the success stories from these two countries will be compared to Malaysia. Malaysia is the country where the areas of further research to be taken place. This is mainly the objective of this paper.

Malaysia is renowned for its established Islamic Banking and Finance (IBF) that the world is referring to in many areas including regulation, Syariah compliance framework, product innovation (particularly Sukuk), risk management and education. In Islamic microfinance however, the development is rather quieter compared to IBF sector. Therefore, given the readily conducive environment created for the rapid growth of IBF, it is certainly worthwhile to find possible potential areas for Malaysia to progress further with the fastest speed and in the right direction in the Islamic microfinance sector. Meanwhile, the direction is well suited to aggressive government policy to alleviate poverty in the country.

This paper will next discuss microfinance history and development. It will be followed by Islamic microfinance demand and development. Subsequently, issues and challenges of Islamic microfinance in selected countries will be scrutinized. Then, discussions on lessons learned by Malaysia as well as further research areas needed to be focused on. Final section is the conclusion.

2. Microfinance

2.1 Financial Exclusion

In the rapid development and intense competition of banking and finance era, there are some parts of the population in each country that remains excluded from getting access to the financial services. This financially excluded society is also known as the unbanked. The main characteristic of this sector of the population is being poor, which restrict them from being assessed on creditworthiness and collateral by the financial institutions. While no financial services are available to this group, they remain trapped in the poverty spiral which can be

inherited by their future generations. It is the responsibility of the government of the country to distribute the wealth of the nation as equally as possible, and alleviate poverty. Poverty not only suffered by those in the situation but the effects can also spill off to the rest of population through problems associated with poverty such as health, moral and social problems. Hence, it is imperative to provide financial inclusive environment for all the people in the country to enjoy at least the minimum acceptable standard of living. The minimum standard of living will include all the basic needs of human life such as food, shelter, personal hygiene, health and education.

According to Dusuki (2008), there are a number of barriers contributed to the financial market failure for the poor. The barriers can be categorized into three main factors namely 1) physical factors, 2) supply side and 3) demand side.

The barriers due to physical factors include the poor physical infrastructure for the poor to be reached by financial institutions. For example, few roads, few markets, no communication connections (telephone, fax, and internet) and few bank branches available to the poor. This barrier is very synonym to social exclusion.

As for the supply side, the financial institutions are unwilling to take high risk and high costs to provide financial services to this part of country population. Among others this is because of screening, monitoring and enforcement problems, no collateral, the clients are too poor to save, uneconomic to provide tiny loans and diversification problems.

The conditions of the poor also affect the demand side factor of the barriers when they have the risk aversion attitudes due to illiteracy, low self esteem, lack of assets and lands, reluctant to borrow and use better technologies. Also, risks associated with the poor concerned by the financial institutions include natural hazards, illness, political instability and economic mismanagement risks. It is fundamental to understand these factors that affecting the financial market failure for the poor in minimizing financial exclusions among these people.

Financial exclusion has become a big issue and discussed in depth in many conferences. Strategies and policies were developed to reduce financial exclusion and alleviate poverty. Can microfinance, which will be discussed next, be a possible solution to fight poverty through reduction of financial exclusion?

2.2 The Grameen Model

The idea of microfinance came up in the 1970s by the Bangladeshi economist, Mohammad Younus. He is also the founder of Grameen Bank. He believed that lending tiny sums of money to poor, rural women would help to alleviate poverty when they used the money to productively start small businesses and help their families. The model which since was adopted by other countries globally is known as Grameen Model.

In the Grameen Model, poor female is targeted mainly because women are believed to use the available money not only for themselves but most importantly for the family, particularly for the children. This is a very positive effect on the economy of the poor families.

The tiny loans provided, which do not require collateral, are mainly agricultural based with tailor-made contracts. These contracts have flexible payment schemes based on the harvest cycle. Sometimes, the payment schedule can be extended if the borrowers cannot afford to pay according to contracts. This flexibility represents one of the social orientated features of the Grameen Model.

Other than microloans or microcredit, this model also offers many other services such as microsavings, microinsurance, pension fund and scholarships. These services had helped the poor to mitigate risks of loan defaults and to protect from poor harvest season due to adverse climate. Furthermore, the saving cultures could be created with microsavings and pension fund. Scholarships are offered to the children to benefit from education, improve the employment rate and gradually bring the family out of the poverty.

In addition, with the money collected from microsavings, microinsurance and pension funds, the microfinance institution (IMF) becomes self-sustain and not depending on subsidies. This was proven when microcredits are lower than microsavings and pension fund.

The Grameen Model does not only count the financial impacts of the poor. Many programmes were created to help the poor. The model will not be complete without these social oriented programmes.

2.3 The Development of Microfinance

With the success of the Grameen Model, microcredit programmes had germinated across the developing world. The model has been exported both formally and informally around the world. The Grameen Bank Replication Program of Grameen Foundation USA was established in 1999 to support institutions and social entrepreneurs throughout the world who seek to replicate the Grameen Bank approach, or scale up existing programs to provide financial services to the poor. In 2004, via 52 partners in 22 countries (including the USA) the Grameen Foundation USA affected close to 1.2 million of the world's poorest families.

Both financial and social interests had driven the western donors, the World Bank and, most recently, commercial investors to invest and enhance the sustainability of the IMFs. The year 2005 was declared as the International Year of Microcredit by the United Nations. The development of microfinance grows rapidly and today, the investors could access data about lenders across the globe which is provided by the Microfinance Information Exchange.

The microfinance was then delineated as the provision of financial services such as credit, savings, cash transfers, and insurance to low-income clients, including self-employed, low-income entrepreneurs in both urban and rural areas.The providers of this kind of financial services niche are the specialized microfinance institutions **(**MFIs). Initially, the MFIs are either government or non-government organizations (NGOs). MFIs are usually non-profit maximizing institutions, instead care more for double bottom lines; i.e. financial and social benefits. Hence, most MFIshave a social development program along with its financing facilities.

This program aims to generate personal and social consciousness among the members. These programs focus on aspects that affect behavioral changes (such as personal hygiene, sanitation, drinking clean water, etc.), moral teachings (like

teaching to be honest, disciplined, and cooperate among themselves), and social customs (like accepting family planning, not practicing the dowry system, etc).

Although collateral is not required, loan repayment by an individual member of a group is collectively guaranteed by all the members in the group. All members will be disqualified from getting new loans if a member defaulted. This condition motivates members in the group to monitor the activities of each other. Peer pressure also induces the repayment of the loan. This is the principle of group-based lending practiced by many MFIs.

The provision of microfinance services expanded depending on the needs of each country and includes also cash transfers and remittance. The microfinance services are generally characterized by firstly focus on the entrepreneurial poor. The target group of this characteristic is the low-income, women and men, lacking access to other financial institutions. Second characteristic is client-appropriate lending. This group is served with simple and convenient access to small, short-term, and repeat loans, with the use of collateral substitutes to motivate repayment. For short-term loan, informal appraisal of borrowers and investments with simple cash flow are used in selection process. For larger and longer-term loans, project appraisal is required. Third characteristic is the provision of secure, voluntary savings services. These services facilitate small deposits, convenient collections, and ready access to funds, either independently or with another institution.

Microfinance is therefore accepted as a solution to the financial exclusion problems. To provide the microfinance services while concurrently attempting to minimize the barriers which contributed to financial market failure for the poor could be possible promising policy to minimize financial exclusion, promote better wealth distribution and most importantly alleviate poverty.

However, microfinance demonstrated both successes and failures stories. The evolution of microfinance can be summarized from 1) social intermediation[4], 2)

[4]helping the poor to be ready to enter contracts with formal financial institutions

group-based lending services[5] , 3) savings mobilization[6] and finally 4) over dependencies on subsidies[7] (Dusuki, 2008).

Grameen Foundation has played significant roles to support microfinance in the Middle East and North Africa (MENA) region since 2003. In 2007, the Grameen Foundation collaborated with a subsidiary of the Abdul LatifJameel Group, to found Grameen-Jameel Microfinance Limited (Grameen-Jameel). Using the same Grameen Model, this joint venture company as the first social business in the ArabWorld, oversees all regional activities for Grameen Foundation. The company's profits are reinvested into the business rather than distributing dividends, to smooth capital mobilization to much in need borrowers.

Grameen-Jameel, Blue Orchard8, Aramex9and the International Finance Corporation (IFC) collaborated to run a program to develop micro and small business banking investments in the Middle East, North Africa and South Asia.

In 2009, the regulatory environment in Egypt, Jordan, Yemen, Morocco and the Sudan opened and there was a clear move towards commercialization in the region. Syria has been the first in the region to license a non-banking financial institution and Egypt is in the process of adopting a microfinance law that will shift oversight to the Ministry of Investment from the Ministry of Social Solidarity. These changes provide fertile ground for the growth of microfinance.

2.4 Advantages and Disadvantages

The main advantage of microfinance is to empower the poor to survive independently using the small kick-start money provided in the microfinance programme. Higher household income and standard of living resulted from the programme will then help

[5]collateral substitutes by group members guarantee

[6]compulsory savings to reduce dependencies on subsidies and functions as collateral substitutes

[7]which could lead to lack market discipline and unsustainable institutions

[8]a Geneva-based microfinance investment manager

[9]a logistics and transportation company in the Middle East and South Asia

to alleviate poverty and bring out the poor from the poverty spiral. The graduated poor would be able to enter into true contracts with formal financial institutions. The process of preparing the poor to be part of formal financial market is also known as social intermediation.

Seven out of ten microfinance clients worldwide are women. (Al-Azzam, Mimouni, & Ali, 2012). Women, especially single mothers will spread the benefits and gains from microfinance to the family especially the children. The tiny loans effect will benefit more than their direct borrowers/clients.

The social programmes attached with financial facilities provided social gains to the poor society to improve their living standard socially. Better food, shelter, hygiene, literacy rate, employment rate and others could be benefited from microfinance.

Besides financially, other indirect advantages of microfinance are the reduction of social and health problems brought by socially and financially excluded society. Better financial inclusions through microfinance programmes will result in higher household income, employment, health standard and education level. This will automatically help to reduce the money laundering activities, crime rates and related health diseases.

However, the main disadvantage of microfinance is the high interest rates charged to the poor, which range from 27 percent to more than 30 percent. The mega interest could be as high as 100 percent (Sandberg, 2012). This high charge is required due to high cost of reaching the poor and extreme poor in the geographically difficult to access locations. Attached social programmes costs and also risk mitigation on non-repayment cases supported these high interests also. In addition, for independently sustainable MFIs, acceptable return to satisfy the investors to invest in high risk borrowers are required to attract continuous capital.

The high interest rate reduces the demand from the poor, from both worldly and religious perspectives. This affects the performance of some MFIs. To minimize lost of potentially religious borrowers, the term “interest” was changed to” borrowing cost” or “administrative fees” (Al-Azzam et al., 2012).

2.5 Problems and constraints in Microfinance

One of the problems in microfinance is the asymmetric information problem. This problem occurs when the MFIs cannot detect the uses of funds. Although the borrowers are female, usually men in the family use the funds. This situation often induces default rates when funds are used on consumption, not the real purposes of borrowing i.e. for micro enterprise or agriculture.

The economic viability and sustainability of the MFIs can be problems to microfinance. The problems arise due to lack of fund mobilization and the high administrative cost. The non-repayment of microloans and limited microfinance products offered are among factors that contributed to lack of fund mobilization of MFIs, which in turn affect the performance of the institutions.

Other problem is high drop -out rate and non graduation from poverty. Microfinance does increase the income level of the poor, the current operations of MFIs, however, are not very effective in improving the lives of the extreme poor. A root cause of this problem is a shift in focus from transformation of the clients to focus on growth of the institution. The shift of focus is also known as violation of Brameen model.

Lack of conducive environment and regulation for the MFIs to operate can also be the constraints to the microfinance. Without support from the government, the high interest rates are justified to cover the high administrative cost, which eventually may reduce or eliminate benefits of the clients.

The unprecedented failure case in microfinance happened in India by an MFI called SKS from New York. SKS charged exorbitant interests to customers and the loans are funded by investors who are invested in MF for profit, not for the spirit of releasing the unprivileged from their difficulties. With this agenda, microfinance had evolved from the niche activity to trendy asset class. There are also issues of non-repayment when the focus shifted from the poor clients to greedy investors. The other MFIs in India have also grown fast to compete with SKS and fascinated by the innovated (or violated) Brameen model. The financial excluded society which formerly difficult to

get access of finance, suddenly were spoilt by the choices and offers by competing MFIs. The clients, who are mainly female, went overboard when they took loans from more than one MFI and expended on things other than original purposes. When the problems of non-repayment on excessive interests on multiple loans became critical, some of the female borrowers committed suicides as a short cut solution to their extremely pressured problems.

Many critics received on the failure cases in India and urged MFIs to adopt consumer protection principles, including complaints mechanisms. Others say lenders must do more to measure not just their financial performance but their social impact. The case offered a lesson to global microfinance industry to have growing concern over client welfare.

The disadvantages and failure cases of microfinance had motivated this research to explore the Islamic microfinance topic further. Particularly because the main feature of Islamic financial transactions is prohibition of taking and paying interests. Brameen model had attempted to challenge this Syariah law with its success to help to alleviate poverty using higher interest rate than commercial banks. Given the fundamental of Islamic finance which emphasizes on just and equitable distribution of wealth, profit and risk sharing, as well as maqasid al Syariah (the objective of Syariah law to prioritize the benefits of the whole society), the marry of the original Brameen model with Islamic finance, or in short Islamic Microfinance, can be solutions to microfinance problems.

3. Islamic Microfinance

3.1 The Demand of Islamic Microfinance Products

Microfinance which aims to achieve improved financial inclusion and alleviate poverty, do not provide grants to the poor. Instead, only significantly high interest rate loans are provided. This method will not only suppress the poor more, but the differences in religion beliefs of borrowers will have negative impacts on the effort. If no Syariah compliant microfinance products available, 100 percent financial inclusion will never be achieved due to loss of potential demand from the poor Muslims. Not

only Muslims, old Hinduism, Buddhism and also Jews expressed disapproval for interest rate (Al-Azzam et al., 2012).

The demand for Islamic finance products is proven very strong. In Muslim-majority countries, an estimated 72 percent of the people do not engage themselves in formal financial system. The main reason is the financial services although are available, are not compliant to principles set in the Syariah law. (Nasr, 2011)

Likewise, strong demand of Islamic microfinance was proven from surveys done in Egypt, Jordan, Algeria and Syria. Statistics revealed that 20–40 percent of respondents cite religious reasons for not seeking conventional microloans. A 2007 global survey on Islamic microfinance discovered that Islamic microfinance has a total estimated global outreach of only 380,000 customers, and accounts for only an estimated one-half of one percent of total microfinance outreach. Also, the supply of Islamic microfinance is concentrated in a few countries, with the top three countries (Indonesia, Bangladesh, and Afghanistan) accounting for 80 percent of global outreach (Nasr, 2011).

Hence, it is imperative to observe what and how the Islamic microfinance had developed over time to serve the needs of religious clients and concurrently solving issues and problems of microfinance itself.

3.2 The Development of Islamic Microfinance

The interest-free banking, which is compliant to Syariah law, was first practiced by the MitGhamr Local Savings Bank in Egypt. It was set up in 1963. This is among the first Islamic banks in the modern era which was considered to be the most innovative and successful experiment with interest-free banking. The basic banking services provided include deposit accounts, loan accounts, equity participation, direct investment and social services. The main customers were mainly farmers and villagers. This proved that microfinance was already in operation during that time. The bank has successfully instilled sense of belonging, customer loyalty and prevented the community from going to money-lenders. The bank's success however was put to halt when the bank was undertaken by the National Bank of Egypt In 1967

due to political turbulent. Under the new management, interest-free products and services had been abandoned and interests were reintroduced in its operations. As a result, the number of depositors reduced substantially.

Islamic microfinance was then founded in 1980s, a decade after microfinance as well as Islamic finance came into existence. However, the growing interests on how Islamic microfinance had solves financial inclusion issues are noticeable only in recent years.

At present, the Islamic microfinance exists in a few countries; UAE, Kuwait, Saudi Arabia, Pakistan, Bangladesh, Malaysia, Indonesia and Australia. Each country has specific financial inclusion issues based on the characteristics and related predicaments of the poor.

3.3 Islamic Microfinance Institutions: Prospects and Problems

The Prospects of IMFIs

The Islamic microfinance offers potential prospects for the IMFIs. The IMFIs could be enhanced by maintaining innovative operations and programs by conventional MFIs. This could save cost of reinventing the wheels. In Islamic microfinance, more varied liabilities and assets are available. On the asset side various modes of financing can be used such as qardhasan, salam, mudarabah, musyarakah, ijarah, istisna and murabaha. On the liability side sources of income can also include *Zakat*, *Awqaf*, *Hibah* (gift) and *Sadaqah* (donations).

The target clients could be shifted from only women members to family unit, instead. This could minimize adverse selection and moral hazard problems of the recipients not using the funds appropriately. Furthermore, the Islamic social development program can help to decrease the default rate through stronger team spirit among members of the group. The religious clients also will have honest intent to repay their financing as the fund taken is perceived as religious obligation. Resulting from these contributing factors, the profitability and viability of IMFIs will improve.

In addition, Islamic microfinance financing products involve real transactions and not only cash being given out. The opportunity to use funds for other than original purpose hence is eliminated. Funds used for productive activities and proper investment may result in higher investment return and lower default rate probability.

The outreach of IMFIs is expected to be improved compared to what the MFIs have achieved. The real poor and poorest could be included in the microfinance program to effectively alleviate absolute poverty by collaborating with the institutions of *Zakat*, *Awqaf* and *Baitulmal*(house of Muslims assets). In Islam, *Zakat*and are important tools for the redistribution of income and growth. Income from *Zakat* and *Awqaf* are legitimate to be expended on consumption, asset building, and production purposes for the poorest beneficiaries. This complements well with funds from IMFIs.

Problems of IMFIs

Collaborating with institutions of *Zakat*, *Awqaf* and *Baitulmal* is an option to supply of funds for IMFIs. However, funds from some external sources cannot be accepted by IMFIs if proven the source is involved with non-Syariah compliant businesses such as gambling and selling alcohol. This lack of funds problem will then arise for the IMFIs. Other cause of lack of fund problem arises from fund provided by the government agencies. The government often set forth certain terms and conditions. Some of these terms and conditions are prohibited by the Syariah law. Therefore, the flexibility of IMFIs is in some way limited.

Besides lacking funds, the IMFIs are also lacking the competent employees. Inability to offer competitive employee benefits package, result in draining of good employees to more established conventional MFIs. Moreover, training on Islamic modes of financing and appropriate Islamic orientation of Social Development Program can be very lacking. It is too expensive when available.

3.4 Zakat, Awqaf, Baitulmal and Islamic Microfinance

As mentioned earlier, *Zakat*, *Awqaf*, *Hibah*dan*Sadaqah* are tools of wealth redistribution in Islamic economics. As described in detail by Ab Aziz (2012), paying *Zakat* is one of the pillars of Islam. *Zakat* is only obligatory to be collected from those who are Islam, free citizen (not slave), own completely the possession, reach Nisab (the minimum threshold limit of each possession), complete the Haul (period of one year) and has intention to conduct business (for *Zakat* on business). The rational of paying *Zakat* is to purify one's wealth and also the heart from selfishness and greed. It is an act of giving a small percentage of one's possessions (surplus wealth) to the *Asnaf* (eligible recipients).

Two types of *Zakat* are *ZakatBadaniyah* (*Zakat* for body or fitrah) and *ZakatMaliah*. *ZakatMaliah* is *Zakat* for the surplus possessions including cereals and fruits, farm animals, gold and silver, stock of goods and money. *Zakat* on money comprises savings, income, shares and pension funds. Institutions of *Zakat* will therefore be responsible to collect and distribute the *Zakat* to eight types of *Asnaf*. The poor and the needy are included in the list of *Asnaf*.

In Syariah, *Awqaf* is a voluntary, permanent, irrevocable dedication of a personal possession or asset, in kind or cash to Allah SWT. In other words, it is the act of returning the wealth of God entrusted to us to the community in order to get continuous charity in this world and afterlife. Possession to be given as *Awqaf* must be able to generate permanent benefits. It cannot be inherited, transferred, granted or sold. *Awqaf* property is for the usage of community according to Syariah, forever. For example, the usage which allowed by Syariah is the building of masjid, schools, hospitals, libraries, welfare house for guests and infrastructures. *Awqaf* institutions, which can be a corporation linked to a business manage the *Awqaf* collections.

Baitulmal institution has wider scope of responsibility of which fund comes from many more sources including war (from wars or peace agreements), *Jizyah* (poll-tax), *Zakat*(tithe), *Kharaj*(land tax) and *Ushu*r (custom duty) and *Rikaz* (property had been left out since the era of jahiliyyah). Among others, the roles consist of developing national revenue policy, developing national budget planning, providing financing to those in need and clearing house. However, with colonialism and introduction of secularism in the government, *Baitulmal*'s roles have been limited considerably. Most of the collection of sources of fund is taken over by federal government, as well as the management of national wealth.

Other than *Awqaf, Hibah* (gift) and *Sadaqah* (donations for the needy) are types of voluntary charity in Islam. There are slight differences between *Awqaf, Hibah* and *Sadaqah*. The Muslims can choose any of these channels to spend their wealth in accordance to Islamic teachings as written in the Quran (3:92): *"You shall not attain righteousness until you spend out of what you love (in the way of Allah). Allah knows whatever you spend"*.

Paying *Zakat* and giving *Awqaf, Hibah* or *Sadaqah* are also ways to help relieving others from difficulties. A hadith (Prophet Muhammad's saying) urged the Muslims to practice this social responsibility act as narrated by Imam Muslim: *"Whosoever relieves from a believer some grief pertaining to this world, Allah will relieve from him some grief pertaining to the Hereafter."*

Given the characteristics of capital and the contributors of capital, *Zakat, Awqaf, Hibah* and *Sadaqah* complement well with Islamic microfinance. Many literatures (Ahmed, 2010; Smolo& Ismail, 2011; Md. Hassan, Mohd Nor, & Mohd Rom, 2012) suggest the collaboration between the *Zakat*, *Awqaf* and charity institutions with the IMFIs to synergise the expertise and enhance performance of collaborated institutions. The *Zakat*, *Awqaf* and charity institutions can benefit from the IMFIs experience of conducting social development programs and outreaching the poor. The IMFIs, in return will have continuous supply of funds to give, lend or invest in the

poor society that is financially excluded from the formal system. Other recommendation is for the institutions of *Zakat*, *Awqaf* and *Baitulmal* to have their own Islamic microfinance program (Kahf, 2010).

4. Issues and Challenges in Islamic Microfinance

There are possible challenges in expanding the potential of Islamic microfinance industry in reaching millions of Muslim populations throughout the Muslim world. Islamic microfinance yet to show its true capabilities in providing much needed financial services by the poor Muslims. What critically needed to realize the potential of Islamic microfinance is a deeper market research and proven business models. In absence of those requirements, several challenges identified are building sustainable business models, authenticity issue, building capacity, Product diversity and leveraging *Zakat* and Islamic funds (Karim, Tarazi, & Reille, 2008).

Other challenges were discussed which limit the development of Islamic microfinance in poor OIC countries. The challenges include lack of infrastructures, lack of awareness about Islamic finance product and main challenge is believed the willingness of relevant parties to develop this financial system niche (Smolo & Ismail, 2011).

In addition to the above, other issues to be addressed into five broad areas: (i) Islamic contracts and products for microfinance; (ii) models of microfinance; (iii) integrating *Zakat* and *Awqaf* with microfinance; (iv) education and training for microfinance; and (v) role of government in enhancing financial inclusion through microfinance. (Obaidullah, 2008)

Next is further discussion on challenges from three countries i.e. Bangladesh, Pakistan and Malaysia.

4.1 Bangladesh

Background

Income and other social and economic indicators revealed that Bangladesh is one of the poorest countries in the world. In 2011, Bangladesh's population was estimated at 161 million and 31.5 percent live below poverty line. This accounted for 51 million poor. High inflation rate (over 10 percent) and 5 percent unemployment rate contributed push factors for Bangladesh to export extensive labour (75 million in 2011) to countries such as Saudi Arabia, Kuwait, UAE, Oman, Qatar, and Malaysia. Resultantly, the remittance reached USD11 billion in 2011. Despite this high source of income, the rest poor and extreme poor live with food insecurity, illiteracy, lack of proper health and sanitation facilities. In addition, the country is also exposed to natural disaster i.e. flood and cyclone, which increase the number of the poor when hit.

Prior to Grameen Bank and other MFIs, the main providers of small loans for farmers, traders and cottage industries were commercial banks, agricultural banks and cooperatives societies. Commercial banks services limited to collateral requirement, hence not serving the unbanked poor and targeting mainly urban areas. This implied that the private banks are not interested in small loans for the poor. Islamic Bank of Bangladesh Limited (IBBL) is nevertheless the only private bank which provides large microcredit services. With the advent of MFIs, some commercial banks recently entered into wholesale lending business with the MFIs.

BKB and RAKUB were the two agricultural banks targeting small, medium and large farmers. Land mortgage is the prerequisite of these agro banks loans. However, the poor performance limited the banks capability to serve the poor.

Cooperatives societies which attempted to target particularly small farmers, introduce farming technologies and provide loan against land mortgage, i.e. the adoption of Comilla model, faced sustainable problems to help the poor.

The Grameen Bank which began as a project in 1976 and later was incorporated in 1983 as a bank, has made the breakthrough to develop a management system to reach large number of poor with financial service. The viable model was adopted by other MFIs with minor variations to match each MFI's goals. The Grameen Bank proved sustainability of the institution can be achieved through combinations of right savings and loans policies, management system and human resources.

Besides other MFIs, non-governmental organizations (NGOs) quickly replicated the Grameen Model as it fits well with their normal operations in involving in social programs. By providing microfinance services as well, the NGOs were attracted to huge demand of microcredit by the members, opportunity to become self-reliant, potential to create sustainable permanent institution and stable career for staff members. Modifications were made in interest rate, savings and loan policies and group size. The fundamental structure of the model, nevertheless remained unchanged.(Dewan A H Alamgir, Hassan, & Dewan, 2010)

In Bangladesh, different types of lending technologies are 1) Grameenstyled group-based system, 2) Self-help group system, 3) Individual lending system and 4) Informal moneylenders.

There are four different market segments targeted for microcredits; moderately poor (mainstream microcredit), hardcore poor, microenterprise and marginal and small farmers. For each market segment, different credit limit and terms applied. For example, greater flexibility in savings and loans products are offered to the hardcore poor. The microenterprise segments loan size and duration is bigger and longer than that offered to moderately poor segment. The segment is also provided with technological, product development and training assistance. Marginal and small farmers have the flexibility to have longer or shorter term seasonal loans depending on the type of plants. The farmers also repay loans in one installment, according to harvest season compared to microenterprise fixed regular repayment schedule.

The MFIs are required to register to multiple authorities under different laws: Social Welfare Act 1960, The Trust Law, The Societies Act 1860 and The Cooperative Societies Act. Microcredit Act 2006 in addition, fills gap of the mentioned law, by

providing legal consent to allow savings mobilization. The gaps were filled with additional features in Microcredite Act 2006: 1) Criteria set by Microcredit Regulatory Authority (MRA) has to be fulfilled before MFIs can obtain licenses to offer microcredit. 2) The MRA, a separate regulator chaired by the Gavernor of Bangladesh Bank will monitor and supervise all MFIs, 3) The MRA consume wide range of authorities in introducing regulations, setting interest rates, revoking licenses and many more. 4) The MRA however are not supervising microcredit programs under various government departments.

Being the pioneer country to provide microfinance services, the initiative to alleviate poverty presented evidence on economy, social and national impacts. Economic impact of microfinance on both participants and non-participants is stronger for the extreme poor than the moderately poor. Female borrowing effect is much stronger than for male. Despite this achievement, the poverty rate remained high because the economic improvements were insufficient to lift household above the poverty line. Thus, it can be concluded that microfinance helps, but itisnotapovertyreduction. Other economicand noneconomic in terventions are also required.

Microfinance programs promote investment in human capital (e.g. schooling) and raise awareness of reproductive health issues (e.g. the use of contraceptives) among poor families, helps women to increase self-confidence and self-worth by exercising power in household decision making. Positive social impacts achieved through microfinance hence demonstrated through improved women's empowerment, children's school attendance and awareness of and demand for health services.

Other than being famous for the invention of microfinance, impact at national level can be seen by narrowing formerly huge gender gaps in economic participation, education and health(arguably largely through microfinance and the other activities of NGO MFIs). Vast employment creation among MFIs staff to provide microfinance services to the poor also contributed positively to national level impact.

Common problems of microfinance which are also faced in Bangladesh include charging an exorbitant rate of interest on their loans which leads to pressure of repayment and overlapping problems in microcredit, outreach of the hardcore poor due to higher risk for loan default, not all participants are skilled enough to initiate self-employment schemes, but are in need of opportunities in wage employment and loans taken are often used for purposes other than those the loan is endorsed for.

Other country specific problems are the absence of appropriate regulatory frameworks for the NGOs to help the organizations reaching the right people for the right purposes, declining donors funds and limited access to formal financial institutions, no proper coordination mechanism of MFIs to enable them to ensure effective coverage in all areas of the country, and no linkages between the financial institutions at the grass-roots level. In addition, loan repayment at the microfinance institutions is affected by the spillover effect of those big borrowers. A steady increase in the dropout rate from the Grameen Bank (15 percent in 1994) and non graduation from poor status (88 percent of the total dropouts) were other country specific problems. (Bahar, 2005).

RDS: Bangladesh Islamic Microfinance

Islamic microfinance was first initiated in a program named Rural Development Scheme (RDS) in 1995 by Islami Bangladesh Bank Limited (IBBL). The program aimed to alleviate rural poverty by providing Syariah based small and micro investment to the agricultural and rural sector. The investment is hoped to generate employment and raise income of rural poor. Welfare, moral and ethical services for the rural poor are also embedded in the scheme. In 2010, the scheme outreached 14,338 villages implemented through 144 branches. Some 0.65 million group members, mainly is female (82 percent) are involved in this scheme (IBBL website). Despite the Bank's continuous effort to maintain upward trends of outreach from its inception, 2010 only marked 1.3 percent penetration.

The RDS was developed based on the Grameen model also. The fundamental difference is that RDS provides only Syariah compliant program. In some study area,

RDS practices murabahah and bay mu'ajjal modes of investment for financing clients (Rahmana, Jafrullah, & Tawhidul, 2008). Investment on either off-farm or on-farm activities have to strictly adhere to Syariah laws. Profit rate of flat 10 percent is set by RDS, which is much lower than any conventional microcredit rates (15 to 22 percent). The investment recovery rate of RDS stood as high as 99.62 percent.

RDS has successfully attracted strong Syariah board members who are renowned Islamic scholars of Bangladesh, headed by the Khotib of the Central Mosque of Bangladesh. There is a system to monitor the Syariah compliance of the scheme's operations, including national Syariah board for all Islamic banking institutions, as well as Bank's own Syariah department.

A special feature of RDS model is an emphasis to develop clients' moral and ethical value. The field supervisors include elaborated discussions based on Quran and Hadith on moral and ethical related religious issues in the organized weekly meetings. Religious rituals by clients are also urged to practice and monitored through weekly meetings. Religious rituals practiced include fasting and wear hijab (head cover) for most of the female clients.

Issues and Challenges

Dewan A. H. Alamgir (2009) discussed in length the challenges of MFIs in Bangladesh. Challenges are elaborated under these headings in detail:

1) Reducing vulnerability (recession, natural disaster and etc),

2) Economic growth influence (lower growth affects microfinance adversely),

3) Policy and the Producing Class (Price control policy on raw materials produced by the poor reduced income),

4) Microcredit and Consumption Loans (Issues on how to control loans usage taken by clients),

5) Institutional Preparedness to offer Demand-driven Products (flexible products to meet needs of clients can be costly.),

6) Research and Innovation (lack of up-to-date research for policy makers),

7) Resource mobilization (public savings as an alternative to obtaining fund from PKSF[10] and costly commercial banks),

8) Regulatory environment (MRA to assume enhanced authority to regulate MFIs, coupled with state-of-the-art research and right tools to effectively guide and monitor the MFIs),

9) Institutional and HR development (HR has to keep pace with different client groups and fast developing increased size MFIs),

10) Portfolio Quality (A drop in portfolio quality over time due to some issues),

11) Application of ICT (ICT capabilities to keep pace with fast growing of client base) and

12) Support for Business Expansion (Insufficient non-financial support for Income Generating Activities to grow further)

In addition to the above challenges, IMFIs in Bangladesh have more challenges based on the observations mentioned inRahmana et al., (2008). RDS-IBBL has successfully replicated the group-based Grameen model in terms of savings and investment policies through creation of the Bank's separate division together with appropriate human resources and management system similar to MFIs. Furthermore, the model has been innovated by providing only Syariah compliant microfinance services. The innovated model is effective as shown in investment recovery rate and rate of return for the poor of 20 percent per annum (2010), which is two-third of large MFIs (30 percent per annum). Despite lower profit rate required by RDS, its financial

[10]Palli Karma-Sahayak Foundation (PKSF) (Rural Employment Support Foundation) is an apex organization involved in loaning Government of Bangladesh and donor funds (World Bank, USAID, ADB and IFAD) to its partner organisations (POs) for on−lending as microcredit. It was established by the Government of Bangladesh in 1990, a signal that microfinance was coming of age as public policy. PKSF is now a main means through which Bangladeshi MFIs access funds, and may be both the largest and most successful of such organisations globally.

performance is comparable or superior to similar or larger MFIs due to better operating efficiency.

One challenge for RDS-IBBL is how to reach the huge demand of Islamic microfinance in Bangladesh. The barrier to enter is quite high when IBBL; a commercial bank, need also to get MRA permission to open new branches. For RDS branch to be created, IBBL branch in the area is a prerequisite. This has limited the pace of branch expansion of RDS-IBBL. The barrier is not faced by other MFIs. As long as the regulation related to new IMF branch of a bank is not created or amended, RDS-IBBL will remain struggling to overcome the difficulties of expanding and serving the massive demand of Islamic microfinance services.

4.2 Pakistan - a leading country

Background

Pakistan with population of 132 million, is an agricultural country. Out of 22 percent economically active, almost 50 percent of the employment is in agricultural sector. Due to high unemployment rate of 19 percent, Pakistan exported majority of the labour to the Middle Eastern countries. The below poverty lives of the over 26 million are squeezed further with high inflation rate of 13.7 percent. Living standard, health and education level achieved by the people in Pakistan are low. The majority of the people are only educated up to primary education.

67 percent of the population in Pakistan lives in rural areas. Pakistanis who speak more than 55 languages spread out in the country, of which some lives in remote and disadvantaged terrains. The language, geographical and illiteracy had become barriers for banks to penetrate into the rural areas. These barriers partly contributed to intense financial exclusive problems in Pakistan. Consequently, 42 percent of Pakistan’s population is under 15 years of age and about 24 percent of the population lives below poverty line. The unreachable population is scarcely getting access of not only financial services but also health and education infrastructures and benefits.

Since 2000, microfinance landscape in Pakistan had changed after a reform in ownership and management. The impacts on almost all economic indicators were positive. The growth rate of microfinance loans is the fastest and significant i.e. 333 percent rate in three years (from 2003 to 2006). The number of aggregate borrowers also doubled in the same period i.e. from 2.7 million to 5.5 million. The annual growth rate of 40 percent after year 2000 positions Pakistan in the top quartile for microfinance globally.

The Pakistan microfinance is also unique because it synchronizes with partnership and social cohesion and mobilization. Pakistan Poverty Alleviation Fund (PPAF), National Rural Support Program (NSRP) and the President's Rozgar Scheme are example of public private partnerships. The PPAF is owned by the Government and funded by the World Bank and leading donors.

The PPAF provides funding for projects that help generate income, improve physical, socialinfrastructure, and skills of the vulnerable. NSRP, a non-profit organization, is the largest Rural Support Programme in the country in terms of its outreach, staff and development activities. The The largest nationwide bank, National Bank of Pakistan, offers small loans to unemployed and poor to finance purchase of auto rickshaws, setting up utility stores under franchise of the Utility Corporation, and setting up public call office etc. The Government helps the borrowers to pay half of the interest charged.

Subsequently, SBP and Pakistan Microfinance Network (PMN) worked together under Microfinance Strategy to transform MF operators from being charitable and social service providers to sustainable financial service providers. MFIs are urged to aim for scalability and sustainability by augmenting their reach and developing alliances with other players, provision of wide ranging financial services and nurturing both financial and social sustainability

Strategies and initiatives have been carried out to build inclusive financial system in Pakistan as described in the speech of Governor of State Bank of Pakistan (SBP); Shamshad Akhtar (2007). This is part of government's holistic approach to halve the poverty rate and eventually reduce to a single digit. Strategies to increase the

education and health level are implemented, while concurrently preparing conducive atmosphere for private and public private partnerships to participate in financial inclusion strategies.

In implementing financial inclusion strategies, both Government and Central Bank are committed to participate in specific initiatives.

The Government initiatives are:

1) To bring all MFIs underone legislative and regulatory framework in order to introduce level playing field for microfinance banks (MFBs).
2) To offer 5 years tax break to MFB as an incentive to encourage MFIs to upgrade themselves to a full-fledged bank
3) To develop special funding/financing arrangements for MFIs which have potential for exploiting scale but have resource constraints. Central bank is exploring mechanisms to encourage relationships and alliance between the commercial banks and MF providers with liquidity issues.
4) To facilitate entry of new international players such as BRAC[11], Shore bank, etc. andencouraging setting up a Build-Own-Trust Model supported by the Grameen Trust.
5) To encourage restructuring of First Women Bank Ltd. to enhance its role in serving microcredit requirements of women.
6) To enhancement of capacities of PPAF to offer credit enhancement to leverage resources for microfinance industry and supporting other industry-wide initiatives.
7) PMN further positions itself to serve as a think tank, advocacy group and collate trends and analysis of industry and has played an instrumental role in steering the industry and strategy.

[11]BRAC is a development organisation dedicated to alleviating poverty by empowering the poor to bring about change in their own lives. It was founded in Bangladesh in 1972 and a pioneer in recognising and tackling the many different realities of poverty. It is globally known as microfinance success. Its non-formal primary education programme is particularly well-regarded simple and flexible enough to apply to different contexts or countries. It exported itself to a few countries.

The Central Bank is dedicated to improve the outreach through these special initiatives:

1) SBP's Annual Branch Licensing and Basic Accounts Policy
2) Promotion of Post Office network
3) SBP's Sector Prudential Regulatory Framework catalyzed to service under-served.
4) working with the Government to develop adequate and commercially viable credit enhancement mechanism
5) encouraging promotion of insurance products to support micro and small lending
6) promoted electronic banking which should lay the foundation for country wide connectivity of financial institutions.
7) restructured itself in September 2006 and established a full-fledged Development Finance Group

Pakistan is also committed to achieve 12 targets of The Millennium Development Goals (MDGs) and realize the eight MDGs outlined by the United Nation. The MFIs directly involved in achieving all the targets in the areas of eradicating poverty, promoting children's education, improving health outcomes for women and children, empowering women, and environmental sustainability. An impact study concluded that MFIs have been effective in contributing, directly and indirectly, to all the eight MDGs (Setboonsarng, 2008).

An Outstanding Islamic Microfinance Performance

Having 95 percent of the population are Muslims, there is a massive potential of Islamic microfinance in Pakistan. The inception of Pakistan's experience in Islamic microfinance started off with the intention of the central bank and government to improve outreach of financial exclusions through Financial Inclusion strategies. The growth of Islamic microfinance experiencing in Pakistan is explosive with penetration rates of between 2-4 percent. As reported by some surveys, half of 1.4 billion Muslims worldwide would choose for Islamic finance if given a competitive

alternative to conventional services. The potential to sustain the growth remains high (Nasr, 2011).

A study has also shown that Akhuwat; an NGO with Islamic microfinance approach, has demonstrated a low cost methodology that use of philanthropy source of income (zero borrowing cost) and religious establishments to conduct business (Siddiqi, 2008). Its prime objective is welfare for the poor, regardless religion, in the spirit of brotherhood as promoted in Islamic teachings. It pioneered Islamic micro credit in Pakistan by offering *Qard Hassan* (benevolent zero interest loans) to the poor Pakistanis. Akhuwat outstanding capability is to reach the extreme poor (90 percent of client base). Donations grew 29 folds from 2002 to 2006 to Rs. 28 million. Akhuwat offers both individual and group-based loans, of which the repayment rate is 99 percent and 97 percent respectively. Further donations and outreach supported Akhuwat effort in achieving sustainability with economies of scale.

Issues and Challenges

However, a study shows that Pakistan is facing country specific barriers to Islamic banking (Butt et al., 2011) . The barriers may also contribute directly or indirectly to the growth of Islamic microfinance. The major barrier of not using Islamic banking is that the perception of Islamic banks do not follow Islamic principles. Users and non-users both agreed that they felt Islamic banks only moderately follow Islamic principles. Branch network and locations of Islamic banks branches had also considered as barriers to use the services.

Meanwhile, other factors such as religious rulings, services and return offered by Islamic banks and risk of losing deposits were found not to be the barriers when selecting Islamic banks.

Therefore, a challenge for the key partners in Islamic microfinance (IMFI, the Government, Central Bank, Islamic Banks) is to convince the massive potential of Muslim poor by demolishing these barriers.

On the backdrop, similar challenges faced by the MFIs are also affecting IMFIs in Pakistan. Pakistan's challenges in microfinance conclusively are the unreachable for banking facilities due to geographical constraints, lack of enabling environment at provincial level, banking behavior and practices that aimed at profit maximization, poverty or illiteracy or cultural and language barriers, lack suitability of products and also regulatory barriers (Akhtar, 2007).

Another prove of undivided and tireless commitment of the Government is the partnership projects with Islamic Development Bank (Islamic Development Bank Group, 2011). A detailed roadmap from 2011 to 2015 was drawn and can be accessed from the IDB website (http://www.isdb.org/irj/go/km/docs/documents/IDBDevelopments/Internet/English/IDB/CM/Publications/Parnership_Strategies/Pakistan.pdf). This serious effort undoubtedly contributes to the further success of Pakistan in both Islamic microfinance and microfinance.

4.3 Malaysia

Background

Malaysia with population of 29 million, has successfully maintained low inflation and low unemployment rate for more than a decade, marked 3.2 and 3.1 percent respectively in 2011. The country is also doing very well in achieving eight MDGs. According to Malaysian Statistics Department, all of the MDG targets including health and education are on track, if not achieved. Most importantly the poverty rate of 3.8 percent is very low. The target to halve the poverty rate was long achieved in 1997.

However, the unemployment rate for the youth aged between 15 to 24 years old, is high at 10.9 percent. Despite high education level achieved by Malaysia, this problem remains existed. Unemployed graduates are encouraged to take part in self-employed small medium entrepreneurship (SME) sector.

The unbanked society is also very low in Malaysia. Among 183 countries, the World Bank has ranked Malaysia as number one in terms of ``Getting Credit´´ (Bank Negara Malaysia, 2010). 27 percent increase in the number of ATMs in Malaysia translate into an increase in coverage by more than 10 ATMs per 100,000 adults (The World Bank, 2011).

Instead, population living below poverty line in urban areas is increasing. Malaysian microfinance is a public initiative. National budgetary allocations continue to be directed towards providing resources in eradicate hardcore and urban poverty, assist the poor and vulnerable groups by increasing home ownership, enhancing the social safety net and expanding public health facilities.

In the interim, micro, small and medium enterprises have proven to increase employment, income and contribute to economic growth. Recognising this potential, a lot of efforts by several institutions are put to help these entrepreneurs to get access to financial aids in sustaining and growing their enterprises.Malaysia has three different microfinance schemes which aim at three different targets. AmanahIkhtiar Malaysia (AIM) aims to provide microcredits to poor female all around Malaysia. Yayasan Usaha Maju (YUM) provided microcredits to poor women in Sabah who are involved in agricultural business. TEKUN, National fund dedicated for entrepreneurs in Malaysia provide microcredits to both female and male who are doing agricultural based business also. All three are subsidized and only offer microcredits and no other microfinance services. TEKUN charged the lowest interest rate of 4 percent followed by AIM at 10 percent and YUM at 10-18 percent.

No microsavings can be offered as complying to BNM regulation of not taking deposits, unless registered as a bank. AIM practices group lending system while YUM and TEKUN use individual lending sytem. Both AIM and YUM experienced better repayment rates at more than 95 percent, while TEKUN suffers from lower repayment rate of 80 percentish and higher NPLs. The targets for all this microfinance are not only the poor but also to near poor people. Contracts are standardized for all three schemes. AIM collect installments weekly, regardless of the income cycle of the borrowers. Conversely, YUM and TEKUN provide more flexible installments based on business and income cycle of the borrowers' business.

Meanwhile, Agrobanks and SME Banks are two dedicated banks to help the agricultural projects and SMEs respectively. Both are government subsidized banks. They nonetheless are fairly aggressive in outreaching the needy poor.

Microfinance Framework 2009 established by BNM recognized the importance of micro enterprises as contributors to economic growth. The framework specified that micro entrepreneurs are more efficiently served by the formal financial system. The provision of advisory services such as financial management are commonly provided by micro financing institutions (MFIs) as part of the complement of financing solutions. Significant resources are allocated by MFIs to help micro enterprises develop business capabilities, enhance viability and growth potential through broad range of developmental services (training workshops, networking events and business advisory services) (Bank Negara Malaysia, 2010).

In *PembiayaanMikro 2006* (Microfinancing 2006), non-subsidised microcredit providers are nine private commercial banks. The microcredit scheme requires no collateral, and applies simple application procedures, minimal documentation and a quick approval and disbursement turnaround to meet the unique financing needs of micro enterprises. As long as the interested client can get access to those banks, micro loans are available to them. To compensate the risk of loan defaults, Bank Negara Malaysia (BNM) i.e. the central bank, regulate for all the microloans to be guaranteed by Credit Guarantee Corporation (CGC). No social programs are attached to the quick credit services or rigorous effort to improve outreach. Hence, the interest rate can be kept low, between 5-10 percent.

The microfinance in Malaysia is relatively new compared to Bangladesh, Pakistan or other developing countries (Adejoke, 2010). The product is limited to microcredit, sometimes with some training programmes.

The presence of Islamic microfinance is rather automatic in Malaysia, benefiting from incredible growth experience in Islamic Banking and Finance for decades and natural demand from the clients. Though microfinance started with conventional microloans, MFIs and microcredit providers increasingly offer Islamic microfinance products. AIM has already started the interest-free Syariah compliant loans, while other

commercial banks provide both conventional and Islamic microfinance product. Agrobank which provide smicrofinance to micro entrepreneurs in agricultural sector is committed to be a full-fledged Islamic bank by 2015.

The newly established Shariah-compliant SME Financing Scheme (SSFS), participated by 13 Islamic banks which also provide micro financing, is seen to be a promising progress towards enhanced Islamic microfinance in Malaysia.

Issues and challenges in Malaysia are partly common with other microfinance issues in other countries, and some are specific to Islamic microfinance. The following are some observable challenges to microfinance in Malaysia:

1) Outreach performance

   Other than AIM, YUM and TEKUN, all other commercial micro loans do not specifically aim to serve the hardcore poor. Due to mandate for providing quick microloans to not only to the poor, but also the non-poor, the outreach of microfinance programmes in Malaysia is rather low. AIM managed to reach 77 percent of poor borrowers of the total reached poor. According in a study, 45 percent segment of poor remains unreachable and unserved(Adejoke, 2010).

2) Resource mobilization.

   No other services are provided such as microsavings, microinsurance, pension funds or scholarships. This is unlike the original of microfinance model, Grameen bank in Bangladesh. The limited services provided is due to 1) complying to BNM regulations of not taking deposits if not registered a bank and 2) because it is subsidized, therefore no incentive to compete or improve sustainability or growth. The MFIs therefore are only dependent on allocated funds or grants, subsidies and loan repayment to sustain.

3) Regulatory environment

   The regulation of not taking deposits by other than banking institutions is aimed to protect the people especially from scam and etc. However, MFIs can only be self-sustained if it can mobilize resources from microsavings, microinsurance and other sources. In absence of specific regulations for MFIs and IMFIs, it will slowdown the growth of sustainable microfinance in the country.

4) Over dependencies on subsidies

This problems lead to several other issues. For example sustainability issue is at stake because no other funding options are sought after. Unlike self-sustained MFIs in much poorer countries, limited social programs to uplift the living standard of the poor are attached to microcredits supplied. The relationships between borrowers and MFIs are consequently loose. Active roles by the Malaysian government to provide infrastructures such as roads, education and medical services leave minimal motivation for the MFIs to provide non-financial supports to the clients.

5) Support for business expansion

The success rate of unskilled micro entrepreneur clients is uncertain. For example, unemployed graduates who join SME projects are not sufficiently experienced and need a lot of guidance. If the success rate is low, non-repayment rate is expected to be higher.

The guidance, although sometimes provided, may not be sufficient. As an example, non- repayment rate is higher, particularly by the micro entrepreneurs of TEKUN. This may due to inability to expend the loans accordingly and to grow micro or small enterprise in competitive environment.

6) Loans on IGAs and onsumption

It is difficult to control on usage of microloans. This is a universal information asymmetry problems occur in global microfinance. Microloans expended on consumption rather than IGAs will result in difficulties to repay the loans.

7) Quality of Portfolio

There is a study on profitable IGAs in selected states in Malaysia (Saad, 2011). High IGAs in trading, production and service sectors were studied and can be a guide in selection process.

8) Multiple loans and debt trap

Some commercial banks provide microloans with no collateral to micro entrepreneurs. Multiple loans taking from multiple providers is allowed by the scheme. If the clients are not disciplined enough to utilize the facilities on IGAs, it is easy for them to fall into debt traps if the multiple loans are defaulted.

9) Microfinance products to meet the clients' needs

Not all clients are interested and capable in entrepreneurship but forced to join due to pressure of long unemployment period. The wrong decision made may also due to peer pressure and considered as the only way to get access of much needed funds. Some of the poor are in need to pay their old debts and need to spend on consumptions. In absence of social programmes to satisfy consumption needs of the clients, this segment of poor society will remain excluded.

10) Human resource development

The size of human resource for MFIs has to be developed fast enough to perform effective roles of MFIs. Inability to employ the right staff will obstruct the desired financial inclusive system through microfinance.

11) Missing network among microfinance providers

The partnership or coordinated alliances among different MFIs with banks or other institutions are yet to be seen. Additionally, the issues and challenges on Islamic microfinance in Malaysia include the following:

a) Unless called by the BNM, the Islamic banks or Islamic subsidiary banks are only providing small financing using Syariah compliant products. The initiatives of social Islamic programmes or outreach issues are not the banks' main concerns. Despite the spirit of embedded social responsibility in Islamic finance, serving the poor and helping the needy ones are observed not to be Islamic banks' main agenda. To remain competitive with conventional banks and profitable within manageable risk are observed to be favored more.

b) Islamic microfinance products need knowledgeable and skilled personnel. The Syariah board to advice and oversee the whole Islamic microfinance operations is also critical. The shortage of those Syariah experts in IBF may hinder the growth of Islamic microfinance sector.

c) Islamic microfinance programme which provides religious programmes is proven fruitful. The programme which includes Islamic education require human resources with teaching skills particularly in the subjects of *fardhuain* (individual Muslims' obligatory knowledge on God oneness, rituals and moral values). With the practice of this knowledge, the moral hazard can be automatically reduced or solved. Shortage of human resources in this area,

nonetheless is a challenge that if not resolved will deter the clients to fully benefit from the programmes.

d) A well known recommendation to ensure sustainability is to through collaboration between MFIs and Islamic institutions such as *Zakat*, *Awqaf*, Charity and *Baitulmal*. The marriage between two different organizations is not always straightforward. A recommended modus operandi for microfinance in *Zakat* starts with selection/screening process, appraise and package of facility, forming a group, training, disbursement process, monitoring and feed-back, rehabilitation and restructuring, and finally ends with evaluation on the performance of the business (Md. Hassan et al., 2012).

5. Discussions

Lessons to be learned by Malaysia

There are different approaches taken by all three countries: Bangladesh treats microfinance as a public policy, Pakistan put emphasis on commercialization and public private partnership, while Malaysian approach is a hybrid of public policy and commercialization.

The sustainability of MFIs and IMFIs is the biggest issue. Bangladesh proved that sustainability can be achieved with the combinations of right loans and savings policies, management system and human resources. Akhuwat's in Pakistan success in attracting zero borrowing cost of philanthropy funds are also proven productive in contributing to sustainability.

Regulatory environment is vital to support the growth of MFIs and IMFIs. An authority or specific acts are required to supervise and monitor the operations of MFIs and IMFIs. In addition, national Syariah body is also prominent in overseeing the Syariah compliant products and operations. Muslims in Pakistan evidently demonstrated that moderately Islamic products are not favored and the poor are more willing to remain unserved, instead.

Financial services alone are not sufficed to uplift the living standards of the poor. Social programs are viable in keeping close contact, improving repayment rate and enhancing both financial and social sustainability. Furthermore, Islamic social programmes conducted by RDS in Bangladesh which elaborately discuss moral and ethical values based on Quran and Hadith proven beneficial to all parties involved.

There are different models that can be adopted to aim for self-sustained IMFIs. RDS-IBBL evidently reveals that dedicated Islamic microfinance division within a bank is a possible model for an IMFI to be successful and sustainable.

Microfinance product offered must be flexible and variety to suit different needs of the clients. Many different Islamic products available are potentially beneficial to clients needs. Furthermore, with zero cost philanthropy's funds, more of Islamic financial products' potential can be realized due to less fear of risk.

Possible areas to research

Based on above discussions and success models by other countries, recommended future research areas are sustainability of IMFIs, sources of funds to IMFIs, financial programs, social programs, Islamic based programs, the clients, the operations, human resource development, Islamic financial products, outreach, income generating activities and collateral substitutes. In addition, regulation, IMFIs model for sustainability (Islamic banks, Islamic institutions and etc) and IMFIs network are areas offer a lot of rooms for future research in Malaysian perspective.

Some possible research questions are:

1) Which parent should the IMFI choose? Islamic banks, Islamic Institutions or standalone?
2) Which Islamic financial products are suitable to match the clients' needs?
3) What are the factors that influence the outreach performance?
4) How to measure double bottom line success of an IMFI?
5) What factors contribute to non-repayment incidence?

6. Conclusion

Microfinance has been a recognized solution to financial exclusive problems. Islamic microfinance in particular further enhanced microfinance through variety of Islamic financing modes and Islamic sources of funds. More importantly, it serves the needs of majority Muslims in poor society. Other than impacts on poverty level, sustainability of IMFIs is central in ensuring continuous double bottom lines success of an IMFI. There are challenges in achieving sustainable IMFI state. To continuously improve the performance of Islamic microfinance, main research areas recommended are sustainability, source of funds, financial and social programmes, Syariah compliant products, outreach, the clients' behavior and needs, regulation and human resource development. Once sustainable, the Malaysian Islamic microfinance model can be replicated and bridge the wealthy and the poor.

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THE STUDY AND COMPARING THE POSITION OF DEFERRED CLAIMS IN GUILANIAN BANKING SYSTEM

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Abstract

During recent years, the issue of banks deferred claims has becomes one of most outstanding difficulties in Iranian banking system. Upswing trend of facilities payment since 2004(1383), raising inflation, normative reduction of interest rates in bank advances and lack of carful and comprehensive control and monitoring on the state of bank advances consumption, has provided a situation, in which present balance of deferred claims in banking system is higher than international standards in deferred claims. Lack of deliberation and solution in deferred claims in this field and continuity of current situations will followed by decreasing of efficiency and weakness of banks that it will be the foundation of future financial crisis. This study is performed in order to investigating and comparing the situation of banking deferred claims in Guilan banking network. This research is an applied one that is descriptive and a survey research. This research has been used the data of Coordination Commission in Guilanian banks, since 2008-2001(1387-1390). Aforementioned data are analyzed through One-Tailed Analysis of Variance Test (Anova) and through post hoc comparison Tukey HSD test. The results of survey show that the average of total deferred claims and imperative deferred claims in Guilanian "Saderat" banks, in comparison to other banks, have significant differences and improper situation. Moreover, the ratio of deferred claims to consumption in specialized banks ("Agricultural" and "Maskan") is higher than commercial banks, which show less efficiency, in comparison to two specialized banks in Guilan.

Keywords: Past due claims, Deferred claims, Bad debts, Banking system

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1. Introduction

Banking deferred claims is a part of banking literature in economics. Since, as all economic activities are encounter to specific ratio of risk, banking activities, also have various risks. One of these risks is referring to insolvency by customers of banking system and/or their disinteresting to paying up. Therefore, in economic literature deferred claims are as a part of common problems of banking activities. Nevertheless, according to its destructive effect on banking system efficiency, its reduction is an outstanding and significant issue (Amini at al, 2010).

The opinions of Iranian Banking Systems' executive board, along with the different reports and researches, indicate that currently high rate of banking deferred claims, is one of the most important problems of banks, credit and financial agencies. High rate of deferred claims indicates high credit risk in Iranian Banking System and it makes banks involving in market risk and liquidity (Ekrami&Rahnama, 2009).

In this field, the published economic reports are contradictory. Although, the opinions of Iranian Banking Network executive board are without exact statistics of banking deferred claims, according to the latest report of Central Bank at the end of 2010, total rate of Iranian banking credit balance (23 banks) is 420 thousand Rials and more than 50 percent of the total banks claims are doubtful accounts (Heidari et al,1390;Nosratabadi, 2011).

Since the origin of most economic crisis during last 30 years, in different part of world, have been nations' banking system and its reason is banking deferred claims (Heidari et al, 2011), the issue of studying the reason of developing such claims in banking network and its inhibiting techniques, have become the most important and critical issues of Iranian Banking System.

2. Literature Review

According to prevailing rules on Banking Systems, the rate of deferred claims, should not being more than five percent of total balance of each bank facilities (Ghasemi, 2010; Kavefirooz & Irannejad, 2009). In the most countries of the world, banks deferred claims are not more than one percent, but Iranian private banks deferred claims are about 15 percent and public banks' are more than 20 percent that it is a serious risk in national economy (Amini et al, 2010) because, according to the report of "International Monetary Fund", if the credit statues of bank or financial companies become serious, it will be the first risk of banking sector (Vogiazas & Nikolaidou, 2011).

The importance of banking deferred claims and their role in reducing the banks' capital, and pessimistically, their bankruptcy, has made cabinet decide to pass some regulations and their apprising along with collecting banking claims, and in order to controlling those claims and trusting accurate banks performance, numerous rules and regulations, were notified them, by other circulars of Central Bank through political- supervisory packages.

2.1 Deferred Claims in Universal Arena (basis of financial crisis)

Banking crisis will make difficulties in payments systems, decrease the trusts to financial companies and reduce the rate of deposit, and finally through the continuity of such crisis, banks will involve in bankruptcy (Detragiache, 1998). Moreover lowering the liquidity statues will increase the possibility of developing financial crisis (Lederman & Reinhardt, 1994). Investigating the history of world financial crisis indicates that the latest universal financial crisis (2008), in magnitude regards is the greatest universal financial crisis in the last 70 years (Shokravi & Moradiyan, 2010).

The surveys, about the roles that banks play in universal financial crisis, show that, banks as a significant part of nations' financial system, always, have potentiality of receiving instability and risks and in higher degrees, "crisis". In general, high leverage ratio and low banks' capital in proportion to the volume of their balance sheets, in comparison to

other commercial companies, time disproportion of maturity between assets and liabilities, the necessity of maintenance the regular trust of depositors, involving in various risks such as exchange rate risk and lack of definite transparency in published financial statements, are items that have introduced banks as sources of developing crisis in economy (Noori et al,1388)

During 20th century, many developed and developing countries have experienced severe financial crisis (Chile, Argentina, Mexico, 1980, Sweden 1990, Thailand, Malaysia, Korea, Philippines, Indonesia, 1997, Russia, 1998 and Turkey in 1994, 2000, 2001). The main reasons of these crisis is poor banking operating, inadequate capital, poor evaluating credit risk and upswing increase of deferred claims (Sufian, 2009).

The origin of financial crisis of 2008 is banking deferred claims. In fact from September of 2001 by artificial degradation of interest rate in America, (because of lacking trust in market and fear of recession), the interest rate that was more than 9 percent in 2000, has decreased to 4 percent in 2003 (its least value in history of America). This situation increased the American economic growth, from 0.76 percent to 3.92 percent in 2004 (Ezati, 1388).

2.2 The Statues of Banking Deferred Claims in Iran

According to Central Bank of the Islamic Republic of Iran, the public banks paid-up facilities, from 2004 to 2007 have been an upswing trend (Kavefirooz & Irannejad, 2009). Moreover the report of General Inspectorate of Iran indicates that during the years of 2004, 2005, 2006 and 2007, more than 446,549,791 and 1001 thousand billion Rials facilities, respectively, have been paid by public banks and during the years of 2005, 2006, 2007, the rate of those facilities, respectively, have growth of 22.9, 44, 26.5 percent (General Inspectorate of Iran, 1386).

Meanwhile, from public banks total paid-up facilities, the ratio of imperative facilities has had upswing trend, since 2004 (from 7.9 percent in 1383 to 9 percent in 1386) that

indicate government' expansionary policy, in order to guarantee and paying up these kind of facilities. Furthermore overdue and deferred claims of public banks (except Iranian Post Bank) have had an ascending trend, so that, during the years of 2005, 2006, 2007, have had a growth of 65.5, 54.5, and 26.4, respectively. In addition, the rate of public banks deferred claims, from all paid-up facilities during the years of 2004, 2005, 2006 and 2007 are 10.5, 14.3, 15.3 and 15.3 respectively, that there is an outstanding difference in comparison to acceptable average of all banks in the world (3 to 5 percent) that is as a result of illogicality of bank interest rate, improper bank policy, lack of optimal management of resources and banks consumption, lack of adequate respect to the conditions and the regulations of paid-up facilities, banks´ obligation to paying up facilities to schemes that are without economic justification and with administrative corruption(Kavefirooz & Irannejad, 2009).

In annual performance report of domestic banks, in 2010, that has investigated the performance of 24 domestic active banks, the total claimed balance of banking system is the amount of 426 thousand billion Rails. Nevertheless the total balance of facilities in Iranian Banking System is 269 thousand billion Tuman (2690000 billion Rials). In other word, about 15 percent of paid-up facilities have converted to claims, by Iranian banks (Nosratabadi, 2011).

Meanwhile, according to the report of General Inspectorate of Iran, about half of the paid- up facilities that are over 10 billion Rails, have paid to governmental companies and institutes, and in this way some companies, because of financial and managerial difficulties had failed to repayment the installments of facilities (Ekrami & Rahnama, 2009).

2.3 The Factors of Creating Deferred Claims

The reasons and factors of formulation banking deferred claims are too various, and different studies have done in this field. Several researches have divided the main factors of formulation banking deferred claims to "in house" and "outsource" factors. "In house

factors" are as a result of internal performance and activities of bank, and the result of executive managers' practices and decision makings, and performance of personnel (Ghasemi, 1389, Amini et al, 1389), and are contained of lacking precise and reliable credit database in Iranian banking system, lack of precise evaluating of banks customers, existent legal rules and slow trend of collecting claims, poor quality of process and stages of studying paid- up facilities. "Outsource factors" include enormous economic factors and variables, political situations, differences between deposit rate and bank facilities and market interest rate, the changes in exchange rate and prevailing global economic crisis, instability of financial and monetary policies(Kavefirooz & Irannejad, 2009; Hasanzade, & Habibi, 2010;Ghasemi, 2010)

Another study that has investigated the effect of enormous economic indicators in banks deferred claims, has studied the effective factors on formulation deferred claims by three "monetary, financial and structural" variables, then the effect of these factors have been confirmed on developing of banking deferred claims. According to the finding of this research, the effect of some variables such as Non-Oil Gross Domestic Product, Inflation, and Liquidity, the interest rate facilities increases banks deferred claims (Heidari et al, 1390).

In general, one can attribute the reasons of developing banking deferred claims to three factors of "bank, internal situation, external situation" that are discussed in detail, in this section:

2.3.1 Bank

Bank is the most important "in house factors" to formulation and enhancing the banking deferred claims. Poor management and supervision in banks and banking network, over optimism in order to evaluating customers' credit degree and decreasing the banks professional behavior have become the most important reasons of developing deferred claims in banking system(Hassan Zade & Habibi, 2010). It is obvious that banks should enforce careful monitoring on three stages of "resources allocation", its "consumption"

and “resources recapturing”, in order to preventing deferments of paid-up facilities (Najaf, 2008).

2.3.2 Domestic Economic, Political, and Social Conditions

Second factor, in order to developing deferred claims that is classified in group of “outsource factors” is domestic economic, political, and social conditions. The rate variance of interest in money and financial market by banks’ defined interest rate, recession and improper economic condition and banks’ obligations about date of grace and/or demurrage remission and occurrence of unexpected accidents such as flood, drought and earthquake and ordering to banks, are the significant effect of domestic sector in order to increase the banks deferred claims. Furthermore dependency of Central Bank is the most important reasons of developing financial instability and consequently its deferred facilities. Through a practical research in this field, the relationship between Iranian Central Bank and financial institutes are studied, since 1973-2005, and the financial instability is measured by using structural indicators, then, other variables such as economic growth, exchange rate and inflation are applied too. The result of this research shows that the indicators of dependency of Central Bank (lack of independency) have positive impact on financial instability (Piraee, 2009).

2.3.3 International Economic, Political, and Social Conditions

The third factor, in order to developing deferred claims that is classified in group of “outsource factors” is International Economic, Political, and Social Conditions. The global financial crisis experiences have indicated that despite of planning, scientific effort and proper management in an economic or industrial aggregate, it is possible that economic, political, and social problems affect the financial markets and disturb all predictions. Developing such crisis enforce much pressure on investors and specifically, producers and inhibit them to timely repayment of their debts (Zonnoriyan, 1390).

2.4 Research Background

There are numerous studies about the reasons and the basis of developing banking deferred claims in Iran and other counties. For instance, “Najaf, Morteza” (2008) in his study, has investigated the effective factors on developing deferred claims from managers and experts of Mell at Banks point of view. On the basis his finding, the main reasons of deferring banking facilities are Poor expertise to lending, Personal intervention to credit granting, Impressionability of banking system as a result of domestic political and economic changes, Rate variance of paid-up facilities to costumers, Weakness of mechanized process of paying facilities to costumers, Poor monitoring and controlling process in the field of collecting claims, Weak judicial affairs in collecting banking claims process, Weakness in the process of getting collateral and its proper applying.

In another research, the relationship between nine variables that include “the six-month average inventory of current account”, “having bounced check”, “record of opening current account”, “the basis of applicant producing activity”, “the credit record of customer”, “the type of presenting collateral”, “the amount of creditor turnover current account”, “the facilities value” and “the ratio of facilities value to average of inventory” as independent variables, are investigated by the condition of facilities repayment as a dependent variable. The results of this research indicate, increasing a unit in variables of bounced check, credit record and the ratio of value to inventory average, the possibility of deferring facilities will increase, and in contrast, through increasing a unit in the applicant’s amount of creditor turnover current account, the possibility of deferring facilities will decrease(Ekrami & Rahnama, 2009).

The results of a research that have performed in order to investigating and analyzing deferred claims of banking network in the province of “Kazvin”, show that 72 percent of its banking deferred claims are related to Commercial Banks and 28 percent are related to Specialized Banks and less deferring is developed in housing sector(Amini et al, 2010).

Another study that has performed in order to identify the factors of formulating deferred claims in Romania (by comparative studying of Greece financial crisis) shows that the variables of macroeconomics such as inflation, the rate of unemployment and the ratio of country's foreign debts play a role on credit risk and enhancing deferred claims(Vogiazas & Nikolaidou, 2011).

The finding of another research that has performed in order to investigating the creator factors of banking crisis in developed and developing countries since 1980-1994, show that high Gross Domestic Product(GDP) have significant role in developing and formulating of banking crisis in aforementioned countries (Demirguc & Detragiache, 1998).

3. Research Method

Present paper, on the basis of purpose is an applied research and based on its data collection technique is a descriptive research and its type is survey. Statistical universe of this research contain, several Guilanian Banks such as Melli, Saderat, Sepah, Mellat, Tejarat, Agricultural, Refahkargaran, and Housing.

The method of data collection was based on resultant data of Coordination Commission in Guilanian Banks, since 2008-2011 and these resultant data are analyzing through One-Tailed Analysis of Variance Test (AVONA) and then, in order to precise analyzing, the situation of investigated banks with regarding to deferred claim are comparing through Post-hoc Comparison Tukey HSD.

3.1 Research Hypotheses

a) The statues of Guilanian Banks in ''Total Deferred Claims'' are not equal to each other.
b) The statues of Guilanian Banks in heading of ''Imperative Overdue Claims'' are not equal to each other.

c) The statues of Guilanian Banks in heading of ‘’Non-Imperative Overdue Claims’’ are not equal to each other.

d) The statues of Guilanian Banks in heading of ‘’Imperative Deferred Claims’’ are not equal to each other.

e) The statues of Guilanian Banks in heading of ‘’Non-Imperative Deferred Claims’’ are not equal to each other.

4. Result & Finding Analyzing

In this section, the information and the performance report of eight Guilanian Banks are analyzing in two parts of “descriptive statistic” and “inferential statistic”. In descriptive statistics, the performance of Guilanian Banks are analyzing through the facilities to deposit ratio, deposit to branches, facilities to branches, and deposit to personnel ratio that are indicators of evaluating banks situation.

In inferential statics, claims rate of different banks since 2008-2011 are comparing by heading of “imperative and non-imperative overdue claims”, “imperative and non-imperative deferred claims”, and “total deferred claims”, through the comparison test of average and have become research hypothesis.

4.1 Descriptive Statistics

1- Facilities to Deposit Ratio

This indicator indicates the amounts that banking system has used its deposit and its internal resources to pay- up facilities. In 2011, about 100 percent of obtained deposits and banks resources have paid-up through facilities. Data show that this ratio in Guilanian Agricultural Bank is about 165 percent that indicate, according to expansion of agricultural activities in Guilan, this bank (Agricultural Bank) during 2011, have paid 65 percent facilities more than its deposits. The main point is that, the data of Guilanian Banks Deferred Claims at the end of 2011 indicates that Agricultural Bank, by possessing more than 913 billion Rials deferred claims in 2011 (16 percent of total Guilanian

claims), after Tejarat Bank, have the highest rate of deferred claims that this can be a noticeable, and dangerous point to executive boards of Guilanian Agricultural Bank.

2- Deposit to Branches Ratio

This ratio indicates, increasing the ability of Guilanian banking network in order to obtaining deposits and organizing them. In 2011, each branch of Guilanian Banks has obtained 85 billion Rials deposits that the growth of this amount, in comparison to last year is about 16 percent.

In 2011, Housing Bank among Guilanian Banks, by value of 139 billion Rials have had the most ratio of obtained deposits, in comparison to branches, and Mellat Bank, by the value of 133 billion Rials is in second grade and Melli, Saderat, and Tejarat Banks are in next grades, respectively.

3- The Facilities to Branches Ratio

This indicator indicates the amount of paid-up facilities to each branch. In 2011, this ratio was about 85 billion Rials for Guilanian banking network that in comparison to last year have reduced about 23 percent, and this indicates the contractionary policies of banks in order to paying facilities during several recent years.

Investigating the data show that Mellat, Housing, and Melli Banks, by having 144, 139 and 108 billion Rials, respectively, possess the most ratio of facilities to branches in Guilanian branches, and amongst these three banks, Housing and Melli Banks, respectively are in third and fourth grade, based on ratio of total claims in 2011 that this indicates increasing ratio of offering facilities by these two Banks, will increase their deferred claims.

4- The Deposit to Personnel Ratio

This ratio indicates the rate of obtaining deposit instead of each personnel that is one of indicators of banks efficiency and show the performance of banking system in obtaining deposits and controlling liquidity in society. In 1390, this ratio in Guilanian banking network is about 9 billion Rials that in comparison to last year, has increased about 21 percent. The Housing, Mellat, Saderat banks, by 14, 13 and 11 billion Rials, respectively has the most ratio of obtaining deposits, in comparison to their personnel.

5-Deferred Claims to Consumption Ratio

In fact this indicator shows how many banks paid-up facilities are deferred and in deed are as bank's null resources. Certainly this issue has direct impact on the ability of banks paid-up facilities in next years and will reduce the bank's resources in order to paying facilities and offering other banking services.

Table1: The Statistic of Sources, Consumptions and Deferred Claims of Guilanian (Million Rials)

Bank		Resources	Consumption	Deferred Claims	The Ratio of Deferred Claim to Consumption
Commercial Banks	**Melli**	11,117,996	13,630,835	634,871	4.66
	Saderat	9,975,226	6,460,416	772,427	11.96
	Sepah	3,371,113	1,431,790	450,431	31.46
	Mellat	7,581,563	8,244,534	37,020	0.45
	Tejarat	4,661,069	4,456,385	950,836	21.34
	Refah kargaran	3,087,261	3,387,413	263,978	8.03
The sum of commercial banks		**39,794,228**	**37,511,373**	**3,109,563**	**8.29**
Specialized Banks	**Agriculture**	3,581,288	5,925,490	913,200	15.41
	Housing(Maskan)	6,711,400	6,711,400	873,574	13.02
The sum of specialized banks		10,292,688	12,636,890	1,786,774	14.14
Total Sum		**50,086,916**	**50,148,263**	**4,896,337**	**9.76**

Source: The Report of Coordination Commission in Guilanian Banks and Research Computation

A survey of this indicator on the investigated Guilanian banks shows that this ratio in all Guilanian banks is 9.76 percent. Furthermore the percentage of this ratio in Specialized Banks is more than Commercial Banks i.e., in Specialized Banks, in contrast with Commercial Banks, more percentage of paid-up facilities are deferring and this can be a noticeable point for Guilanian Specialized Banks, such as Agricultural Or Housing Banks.

Sepah Bank, by 31.46 percent, has the most ratios of deferred claims. After that Tejarat Bank by 21.34 percent, Agricultural Bank by 15.41 percent and Housing Bank by 13.02 percent are in subsequent stages and Mellat Bank by 0.45 percent has the least ratio of deferred claims to consumptions. It is noticeable that statistic and data of banks' consumption only, contain the consumptions of 2011, but the ratio of deferred claim, on the whole is until the end of 2011. Detailed data of resources and paid- up facilities of investigated Bank, until the ends of 2011 are illustrated in table 2 and 3:

Table 2: The Rate of Guilanian Banking System Sources, Until the End of 1390 (Million Rials)

Bank	Gharz ol Hasan		Deposits		Other Deposits	Total Sum of Resources	Number of Branches	Number of Personnel
	Current	Savings	Short Term	Long Term				
Melli	2,053,455	1,075,597	2,895,141	4,138,604	955,199	11,117,996	126	1,494
Saderat	1,595,914	1,063,804	3,217,763	3,626,599	471,146	9,975,226	126	888
Sepah	593,468	357,672	1,237,180	1,091,314	91,479	3,371,113	58	475
Mellat	1,826,491	587,991	2,052,128	2,542,888	572,065	7,581,563	57	578
Tejarat	831,334	427,385	1,636,412	1,637,495	128,443	4,661,069	60	618
Agriculture	781,780	535,845	1,017,815	1,108,348	137,500	3,581,288	67	556
Refah	904,750	362,965	748,546	832,052	238,948	3,087,261	42	388
Housing	763,828	487,504	2,372,961	1,497,912	1,589,195	6,711,400	48	455
Total Sum	**9,351,020**	**4,898,763**	**15,177,946**	**16,475,212**	**4,183,975**	**50,086,916**	**584**	**5,452**

Source: The Report of Coordination Commission in Guilanian Banks

Table 3: The Rate of the Rate of Guilanian Banking System Facilities by Division of Banks and Economic Sectors until the End of 1390 (Million Rials)

Bank / Sector	Agricultural	Housing and Building	Mining and Industry	Commercial and Services	Export	Sum
Melli	1,493,783	3,430,091	2,134,905	6,518,623	53,433	13,630,835
Saderat	1,507,013	1,436,640	1,468,700	2,004,750	43,313	6,460,416
Sepah	106,544	848,207	342,462	134,577	-	1,431,790
Mellat	455,575	1,537,173	1,351,235	4,833,538	67,013	8,244,534
Tejarat	194,297	892,692	1,341,869	2,027,527	-	4,456,385
Agriculture	5,694,430	138,500	-	92,560	-	5,925,490
Refah Kargaran	98,457	726,130	192,419	2,270,407	-	3,287,413
Housing	763,828	487,504	2,372,961	1,497,912	1,589,195	6,711,400
Total Sum	**10,313,927**	**9,496,937**	**9,204,551**	**19,379,894**	**1,752,954**	**50,148,263**

Source: The Report of Coordination Commission in Guilanian Banks

4.2 Test of Hypothesizes

1- The comparison test of the averages of societies, in order to comparison of Guilanian banks deferred claims rate

Table 4: Comparison Test of The Averages of Communities

Types of Banks Deferred Claims		Sum of Squares	Freedom Degree	Mean Squares	Test Statistics (F)	Test Validity
Imperative overdue claim	*Between group-*	1.36	7	1.95	2.89	0.031*
	intra	1.28	19	6.73		
	total	2.84	26			
Non-Imperative overdue claim	*Between group-*	8.86	7	1.26	3.47	0.015*
	intra	6.63	19	3.65		
	total	15.80	26			
Imperative deferred claim	*Between group-*	2	7	2.86	17.89	0.000*
	intra	3.03	19	1.59		
	total	5.03	26			
Non-Imperative deferred claim	*Between group-*	5.87	7	8.38	2.40	0.061
	intra	6.62	19	8.49		
	total	12.5	26			
The total deferred claims	*Between group-*	3.29	7	4.67	6.40	0.001*
	intra	1.39	19	7.31		
	total	4.68	26			

Source: research computation

On the basis of above table, one can observe that the value of test validity in heading of "imperative overdue claims", "non-imperative overdue claims", "imperative deferred claims" and "total deferred claims" is less than 0.05, therefore, in confidence level 95 percent for these variables, null hypothesis that is based on lack of differences between banks, on basis of aforementioned headings are rejected.

Test of First Hypothesis

First hypothesis: “the statues of Guilanian banks in heading of “total deferred claims” are not equal to each other”. Since the value of test validity is less than 0.05, null hypothesis about equality of the investigated banks statues in heading of rejected deferred claims, and since null hypothesis is inconsistent of claims; first hypothesis is confirmed by confidence of 95 percent.

Test of Second Hypothesis

Second hypothesis: “The statues of Guilanian banks in heading of ‘imperative overdue claims’ are not equal to each other”. Since the value of test validity is less than 0.05, null hypothesis about equality of the investigated banks statues in heading of imperative overdue claims is rejected, and since null hypothesis is inconsistent to claims, the second hypothesis is confirmed by confidence of 95 percent.

Test of Third Hypothesis

Third hypothesis: “The statues of Guilanian banks in heading of ‘non-imperative overdue claims’ are not equal to each other”. Since the value of test validity is less than 0.05, null hypothesis about equality of the investigated banks statues in heading of non-imperative overdue claims is rejected, and since null hypothesis is inconsistent to claims, the second hypothesis is confirmed by confidence of 95 percent.

Test of Fourth Hypothesis

Fourth hypothesis: “The statues of Guilanian banks in heading of ‘imperative deferred claims’ are not equal to each other”. Since the value of test validity is less than 0.05, null hypothesis about equality of the investigated banks statues in heading of imperative deferred claims is rejected, and since null hypothesis is inconsistent to claims, the second hypothesis is confirmed by confidence of 95 percent.

Test of Fifth Hypothesis

Fifth hypothesis: “The statues of Guilanian banks in heading of ‘non-imperative deferred claims’ are not equal to each other”. Since the value of test validity is less than 0.05, null

hypothesis about equality of the investigated banks statues in heading of non-imperative deferred claims is rejected, and since null hypothesis is inconsistent to claims, the second hypothesis is confirmed by confidence of 95 percent.

Test of Fifth Hypothesis

Fifth hypothesis: “The statues of Guilanian banks in heading of ‘non-imperative deferred claims’ are not equal to each other”. Since the value of test validity is less than 0.05, null hypothesis about equality of the investigated banks statues in heading of non-imperative deferred claims is rejected, and since null hypothesis is inconsistent to claims, the second hypothesis is confirmed by confidence of 95 percent.

Post Hoc Comparisons

As test of first, second, third and fourth hypothesis indicate, the average balance of claims in different banks have significant differences to each other, so in this section, in order to specifying significant difference between investigated banks and analyzing the various reasons, post hoc comparison is used through Tukey HSD method.

First Hypothesis:

The results of Tukey HSD, in the field of first hypothesis indicated that average of Saderat Bank in heading of total deferred claims, have significant differences in contrast with Sepah, Mellat, Refah and Housing Banks.

Table5: The Statues of Banks with Regard to Total Deferred Claims

Bank	Number	Subset of Alpha 5%	
		1	2
Mellat	2	2.29	
Refah Kargaran	4	2.43	
Sepah	2	3.31	
Housing	4	5.25	
Tejarat	4	7.70	7.70
Agricultural	3	8.62	8.62
Melli	4	8.94	8.94
Saderat	4		1.28
Test validity		**0.096**	**0.311**

Source: research computation

The results, also, indicate that Tejarat, Agricultural and Melli Banks, in heading of total deferred claims have had an average about the mean of two aforementioned groups and Melli Bank, also, has significant differences in contrast to Refah Bank.

Third Hypothesis

The results of Tukey HSD about third hypothesis show that the average of Melli Bank, in heading of non-imperative overdue claims has significant differences in contrast to Refah Bank and other investigated banks in this field have an average about the mean of two aforementioned banks.

Table6: The Statues of Banks With Regard to Non-Imperative Overdue Claims

Bank	Number	Subset of Alpha 5%	
		1	2
Refah Kargaran	4	2.14	
Sepah	2	3.68	3.68
Mellat	2	3.93	3.93
Saderat	4	7.24	7.24
Agricultural	3	7.59	7.59
Tejarat	4	1.33	1.33
Housing	4	1.40	1.40
Melli	4		1.90
Test validity		**0.27**	**0.07**

source: research computation

Fourth Hypothesis

The results of Tukey HSD about fourth hypothesis indicate that the statues of Saderat Bank, in heading of imperative overdue claims has significant differences with all investigated Guilanian Bank and the statues of Saderat Bank in this heading is more serious than others. As table 5 illustrate, Saderat Bank in second group is alone.

Table7: The Statues of Banks With Regard to Imperative Overdue Claims

Bank	Number	Subset of Alpha 5%	
		1	2
Mellat	2	8.01	
Sepah	2	1.55	
Housing	4	2.23	
Melli	4	5.70	
Refah Kargaran	4	7.03	
Tejarat	4	2.39	
Agricultural	3	2.77	
Saderat	4		8.25
Test validity		**0.19**	**1.00**

source: research computation

5. Conclusions

In Iran, yearly, because of lacking timely repaying the installments by banks customers a great part of paid-up facilities of correspondent banks, transmit to heading of “deferred claims”, and in addition to increasing the financial pressure on banks, will cause recession of their financial resources and lack of proper directing toward economic productive sectors that have had harmful effect on economy and banking system. In this direction, the result of present research that is performed in order to comparing Guilanian banks in the field of banking deferred claims, include:

a) The result of present research show that, during recent years, enhancement and upswing trend of paying banking facilities are containing the growth of deferred claim in Guilanian banking system, and in addition, it has caused the ratio of claims to banking consumption in Guilanian Commercial Banks being 8.29

percent and in Specialized Banks reach to 14.14 percent. Sepah Banks, amongst Commercial Banks and all banks, has the highest deferred claims to consumption ratio, and Agricultural Banks, amongst Specialized Banks are in the highest grade too, by 15.41 percent. Moreover this indicator in all investigated banks of this research is 9.76 percent.

b) Another result of this research is Agricultural Banks overgrowth of paying facilities in 2011. So that this Bank during 2011, have paid 65 percent more than its deposits and credit ability, and in other hand, the banks deferred claims data indicate that, in 2011 ,Agricultural Bank, by more than 913 billion Rials deferred claims, is in second level amongst other Guilanian banks, in the field of deferred claims that this issue can have negative effect on efficiency and performance of Guilanian Agricultural Banks and according to expanse of agricultural activities in Guilan, the shortcoming of Agricultural Bank, certainly will have negative effect on Guilanian agricultural sector.

c) The result of research hypothesis indicate that Guilanian Saderat Bank in heading of ‘’total deferred claims’’ and ‘’imperative deferred claims’’ have significant differences and its statues is worse than other banks. Noticeable point is that based on political- supervisory package of 2011 that is notified by Central Bank of Islamic republic of Iran, Saderat Bank can allocate more than 37 percent of its resource to facilities in Mining and Industry sector, and certainly, increasing the rate of deferred claims in Guilanian Saderat Banks and decreasing the their efficiency are effective on performance of Guilanian industry and in long time will encounter Guilanian industry sector to serious difficulties in preparing liquidity.

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BANKING, COMPETITION AND MARKET STRUCTURES: PANEL EVIDENCE FROM JORDAN AND GULF COUNCIL COOPERATION (GCC)

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Abstract

This paper provides new empirical evidence on the market structures and the competitiveness of banking industry in Jordan and GCC countries for the period of 2003-2010 using method proposed by Panzar and Rosse (1987). Using a static and dynamic panel framework, and a sample of 90 banks, the results of the *H* statistics and Wald test indicates that banks in Jordan and GCC countries earned their revenue in monopolistic competition condition. The empirical finding indicates that the Jordanian banks are enabled to compete with the banking sectors in GCC countries.

Keywords: Competition; market structure; banking; static panel data

1. Introduction

Past decade has witnessed revolutionary changes in the financial industry all over the world particularly within the banking sector due to rapid financial deregulation, technological advances and financial innovation. This may give the impact on the role of banks and financial intermediaries in pooling financial resources from surplus units and channeling the funds to deficit units for investment purposes, in which will generate the economic growth. Keenness of competition by the financial deregulation together with rapid advances in information and telecommunications technology and development in financial theory have led to financial innovation with financial intermediaries, including

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banks, providing households and firms with new investment opportunities to earn higher revenue and greater risk management. Here, financial production takes the place of financial intermediaries to do a systematic approach in an attempt to put the best financial solutions to specific problems of their clients taking into account the current state of technology, finance and organization theory (Merton, 1995).

Structural changes in the institutions of financial intermediation are perceptible in the banking sector today. The rapid technological developments in the banking sectors cause reduction of costs and enhance competition between banks and financial market has led to banks operating in all the cross geopolitical differ significantly from each other because of the difference in size and complexity, and available technology, and political backgrounds, cultural and historical, which led to a number of different "banking systems" still perform the same function of financial intermediation.

In this dynamic new banking environment, the competitiveness within the banking system not only depends on the banks' overall operating efficiency but also on banks' ability to bear out financial innovation as they respond to new technological changes. Hence, banks' competition measures are good indicators as to how competitive banks are as the industry continues to develop. Since it is expected that the banks are relatively non-productive will lose market share and be replaced by more productive.

There are several reasons why the study of banking structure and competition are interesting for the case study of Jordan relative to GCC countries. First, the banking system in Jordan has experienced high evolution in terms of adoption the Internet and the regulatory environment since the late 1990s. Second, Gulf Cooperation Council is in the transition from Cooperation stage to the Federation countries and in this regards Jordan plan to be a member of the Union and due to that banking sector in preparing for huge competition in Jordan within the GCC countries. It is therefore important to evaluate the banks in Jordan to know their ability to compete and survive in the Gulf Union. Third, the importance of the principal role played by banks in providing brokerage services and the process of capital formation in economies in Jordan, since the money and capital markets

are still in the developing stage, where, Jordan has banking systems and financial performance of the banking system plays a key role in economic development and proper functioning of industrial sectors. Finally, there is also more general reason why the market conditions in the banking industry in Jordan needs more attention. This due to the soundness and stability of the financial sector may in various ways be influenced by the degree of competition. Maintaining the health of the financial system is nowadays one of the key objectives of bank supervisors.

The aim of this research is to provide empirical evidence on the level and evolution of competition in Jordan and GCC banking sector. For this purpose, we employ Panzar-Rosse model, which enables calculation of a measure of market structure, the *H*-statistic, as the sum of the elasticities of total revenues of the bank with respect to its input prices.

This study contributes to the existing literature on market structure and banking competition by examining the Jordan relative to GCC banking systems. Specifically, this study is extending and improving the existing literature on market structure and banking competition in two dimensions. First, this will be the first study for Jordan relative to Gulf countries on competition and market structure by using a larger sample of banks in the most recent time. Second, theory suggests that the revolutionary changes in the banking sector, in particular the internet impact is definitely changed the nature of market structure and the extent of competition level among banks, (Yildirim and Philippatos (2003), Claessens *et al* (2001), Galindo *et al*. (2007), Bikker and Sperdijk (2008), Vivas 2001 and Strahan 2003).

This study will therefore consider the sample period of 2003-2010 due to structural changes and the adoption of latest technology in the banking industry of Jordan and GCC countries. Al-Muharrami, *et al* (2006) investigate the competition level among GCC countries using Panzar and Rosse (1987) for the period 1996-2002 that is before revolution of technologies and the adoption of Web services in the banking industry. Based on Al-Muharrami, *et al* (2006), study on the market structure prevailing in related countries has used static panel in their estimation while the present study uses the

foremost recent panel data technique, that is, the generalized method of moment (GMM) proposed by Arellano and Bond 1991), Arellano and Bover (1995), and extended by Blundell and Bond (1998). This method has an advantage for addressing the Nickell (1981) bias related to the fixed effects in short panels (e.g., bias as a result of the presence of the lagged dependent variable and bias as a result of the endogeneity of alternative explanatory variables).

Studies of competitive conditions in the developed economies banking markets are extensive, there have been no study relatively conducted for Jordan relative to GCC economies in the recent years. Therefore, this paper tends to examine the effects of recent changes within the market structure of the Jordan relative to six GCC banking countries and to examine the level of market contestability for the period 2003-2010 with the aim of evaluating the monopoly power of the banks over this period and to know the position of Jordanian banks whether they can compete with the GCC banking industry.

The results of this study revealed that the estimated *H* statistics for the sample period are positive and the Wald test for either monopoly or perfect competition market structure is rejected. Thus, the finding indicates that banks in Jordan and GCC countries earned their revenue in a monopolistic competition condition. Therefore, it is expected that the banking sectors in Jordan will have the ability to compete with any banks in GCC countries.

The remainder of this article is organized as follow: The next section discusses the previous study relating to the measuring competition level in various countries. The third section deals with the theoretical aspect of the bank-competition. The fourth section explains the estimation procedures by using the dynamic panel data in GMM framework. The fifth section reports the empirical findings, and the last section summarizes and concludes.

2. Literature Review

This section will review the most relevant studies on banking competition using Panzar and Rosse (1987) based on cross country and individual studies in developed and developing countries.

The theory of contestable market has been developed by Baumol *et al.* (1982) who stated that oligopolies and monopolies sometimes behave similar like perfectly competitive firms. Since then, the theory of contestable markets in the banking industries has been examined by many researchers. For example, the most significant studies among many others are Shaffer (1982, 1985, 1994), Nathan and Neave (1989) and Molyneux *et al.* (1994, 1996) using Rosse and Panzar (1977) and Panzar and Rosse (1987) in which examined the competitive conditions in the banking industry in the U.S., Canada, Japan and Europe. Most of the previous studies found that the banking is operating under monopolistic competition.

While Shaffer (1982) revealed the first application of the Panzar-Rosse test to banking data, obtaining monopolistic competition for a sample of banks operating in New York. Consistently, similar results by Molyneux *et al.* (1994) for European banks namely, France, Germany, Spain and the UK for the period 1986-1989 while monopoly market for Italy banking sectors. De Bandt and Davis (2000) found a monopolistic competition markets for France, Germany, Italy and the US during the period 1992-1996. Study by Nathan and Neave (1989) for Canada, Molyneux *et al.* (1996) for Japan, Staikouras and Koutsomanoli-Fillipaki (2006) for large number of European Union reported similar results that the banks are operating under the monopolistic competition. On the other hand study by Bikker and Haaf (2002) examined the competitive condition for banking industries for 23 industrial countries using both the Panzar-Rosse model and model and they conclude that the banking industries are characterized by monopolistic competition.

This study uses the most popular model of Panzar and Rosse, with adaptations recommended of Bikker *et al*. (2006) and Goddard and Wilson (2009). Rosse and Panzar (1977) and Panzar and Rosse (1982, 1987), simultaneously with applications to

banking by Nathan and Neave (1989) and Perrakis (1991), assumed that firms can enter or leave the market quickly, without losing their capital, and that possible competitors operate on the same cost functions as established firms. One of the restrictions of the Panzar-Rosse tests is that it gives ambiguous results when the banks in question are not completely adjusted to the market conditions. However, the test usually shows that the market is competitive, it shows that the monopoly power is not been exercised. Secondly, it cannot differentiate between competitive pricing and simple costing plus pricing. Interpreting the Panzar-Rosse is not very clear, once this limitation taken into account.

Several studies analyze competition in banking industry overtime using Panzar and Rosse (1987), either assuming that competition changes gradually overtime or by providing yearly estimates of competition. Some of this study focuses on cross country comparison in developed countries. On cross country studies, Goddard, and Wilson (2009) for G7 countries, Gunji, *et al* (2009) for New Zealand, South Africa, and the Netherlands, Turkey, Denmark and Japan and Berger *et al* (2009) estimate 8,235 banks in 23 developed countries, Bandt, and Davis, (2000) for France, Germany, Italy and Yildiri and Philippatos (2007) for 11 Latin American countries.

The results of Goddard, and Wilson (2009) and Gunji, *et al* (2009) indicate that banks in these countries are operating under monopolistic competition while Berger *et al* (2009) suggest that consistent with the traditional competition-fragility" view banks with a higher degree of market power also have less overall risk exposure. The result also provides some support for one element of the "competition-stability" view that market power increases loan portfolio risk. They show that this risk may be offset in part by higher equity capital ratios. Bandt, and Davis, (2000) for France, Germany, Italy and the US for the period 1992-1996, result shows within the European Union, whereas Germany and France tend to show monopolistic competition for large banks and monopoly for small ones, in Italy there is evidence of monopolistic competition for small and large banks. Yildiri and Philippatos (2007) examine the competitive conditions in the banking industries of eleven Latin American countries for the period 1993–2000. They conclude

that banks in these countries seem to earn their revenues, as if operating under conditions of monopolistic competition.

While some other researchers focus on individual country in developed countries that is Daley and Matthews (2012) for Jamaican banking market for the period 1998 to 2009 and Mkrtchyan (2005) using the sample of American banking sectors, they find monopolistic competition in the market as a whole. Matthews *et al* (2007) examine the major British banks, during a period of major structural change. Specifically, estimates of the Rosse–Panzar H-statistic for a panel of 12 banks for the period 1980-2004. The results confirm the consensus finding that competition in British banking is most accurately characterized by the theoretical model of monopolistic competition.

On the other side few studies examine the competition level for banking industry in developing countries using Panzar and Rosse for cross country, Ariss, (2009), Ariss, (2010), and Al-Muharrami *et al* (2006). The study of Ariss, (2009), for Middle East countries show that, except for countries in North Africa where monopolistic conditions are found, the prevailing market structure in MENA banking is mostly monopolistically competitive, while Ariss, (2010) analyze the competitive conditions prevailing in Islamic and conventional global banking markets, using a sample of banks across 13 countries during 2000–2006. The results indicate that Islamic banking is less competitive compared to conventional banking. While the only study on GCC countries by Al-Muharrami *et al* (2006) investigate the market structure of GCC banking industry during the period of 1993–2002 and evaluates the monopoly power of banks. Their investigation suggests that there is some advantage to examining the banks of the GCC countries as an aggregate. In total the GCC banking system can be thought of as operating under conditions of monopolistic competition. The results show that all countries are an equilibrium and Kuwait, Saudi Arabia and UAE have un-concentrated markets and are moving to less concentrated positions. The Panzar and Rosse results suggest a mixed bag of competitive, monopolistic competition and monopoly within the GCC economies.

Finally, a study by Hamza (2011) aimed to estimate the market structure of Tunisian banks. The Panzar and Rosse *H*-statistic shows positive and less than one. This result implies that banks in Tunisia earned their revenue in the condition of monopolistic competition. Zulkhibri, *et al* (2007) investigates the market structure of Islamic banking industry in Malaysia during 2001-2005 and evaluates the degree of competition using the *H*-statistic by Panzar and Rosse (1987). The estimated *H* statistics for the whole sample periods are positive and the Wald test for the market structure of monopoly or perfect competition is rejected implying that the Islamic banks in Malaysia earned their revenue in the condition of monopolistic competition.

Based on this backdrop, this study provides a noble contribution by providing new empirical evidence on the degree of market structure and level of competition of the banking industry in the case of Jordan and GCC countries. Therefore, our paper will make comprehensive empirical analysis by examining the market structure and competition condition for Jordan relative to the entire six GCC banking industry using large numbers of commercial and Islamic banks using the most popular method proposed by Panzar and Rosse (1987) and applying the foremost recent panel data technique, that is, the generalized method of moment (GMM) proposed by Arellano and Bond 1991), Arellano and Bover (1995), and extended by Blundell and Bond (1998).

3. Theoretical Model

Panzar and Rosse (P-R) has been widely used in the literature to assess the degree of market power on the basis of a reduced form equation that explains revenue in terms of factor input prices and other explanatory variables. P-R has been challenged by a new strand appearing in the literature on two main reasons. First, the argument of Bikker *et al*. (2006) is the revenue equation is miss specified since it is effectively reduced to a ‘price equation if the logarithm of relative income is taken as the dependent variable’ as is the case in much of the extant literature. They further argue that similar misspecification occurs with the use of covariates that reflect scale (such as the natural logarithm of total

assets) and that the use of such a scaling variable renders the equation 'indistinguishable from a price equation. The second point of challenge is that the model equation of Panzar and Rosse is static and presumes equilibrium or instantaneous adjustment to equilibrium at each point in time when the data are observed. For example, Goddard and Wilson (2009) note that the reality is not in line with this presumption as adjustment towards equilibrium is often not instantaneous and markets are therefore not necessarily in equilibrium and recommend a dynamic estimation model. However, Shaffer (2004) notes that the Rosse-Panzar model is preferable as it is robust even in small empirical samples and works well with firm-specific data on revenues and factor prices without requiring information about equilibrium output prices and quantities for the industry.

Rosse and Panzar (1977) and Panzar and Rosse (1987) developed a simple model of market competition in examining the market structure. The model assumes that firms can enter or leave rapidly, without losing the potential competitors or lose of their capital, "the functions of the cost of the same companies that are already on the market. The central argument is that, although if the market is contestable, the threat of market entry with price-cutting by potential competitors enforces marginal cost pricing by incumbents, so that in equilibrium they will not earn excess profits and no entry is observed to occur. The test of the model is based on properties of a reduced form revenue equation at the level of the firm or the bank and uses the *H* statistic, which under certain assumptions, and as a measure of the competitive behaviour of banks. The test is derived from a general banking market model, which determines equilibrium output and the equilibrium number of banks, by maximizing profits at both the bank level and the industry level. This implies, first, that bank *m*aximizes its profits, where marginal revenue equals marginal cost:

$$R'_{it}(y_{it}, n_t, k_{it}) - C'_{it}(y_{it}, p_{it}, q_{it}) = 0 \qquad (1)$$

R_{it}indicates to revenues and $C_{it}$to costs of bank *i* (the prime denoting *marginal*), $y_{it}$is the output of bank *i* , *n* is the number of banks, $p_{it}$is a vector of *m* factor input prices of bank *i* , $k_{it}$is a vector of exogenous variables that shift the bank's revenue function, $q_i$is a

vector of exogenous variables that shift the bank's cost function. Secondly, at the market level, it means that, in equilibrium, the zero profit restriction holds:

$$R_i^*(y^*, n^*, k^*) - C_i^*(y^*, p, q) = 0 \qquad (2)$$

Variables marked with an asterisk (*) refers to equilibrium values. Market power is considered by the extent to which a change in factor input prices (dp_{mi}) is reflected in the equilibrium revenues (dR_i^*)earned by bank *i*. Panzar and Rosse define a measure of competition *H* as the sum of the elasticities of the reduced-form revenues with respect to factor prices:

$$H = \sum_{k=1}^{m} \frac{\partial R_i^*}{\partial w_{ki}} \frac{w_{ki}}{R_i^*} \qquad (3)$$

Where $R_i$indicates to revenues of bank *i* (* refers to equilibrium values) and $w_i$is a vector of *m* factor input prices of bank *i*. Market power is considered by the extent to which a change in factor input prices $\partial w_{ki}$is reflects the equilibrium revenues ∂R_I^* earned by bank *i*.

The H-statistics measures the sum of the elasticities of banks' total revenue with respect to input prices. Hence, it is calculated as the sum of the input prices coefficientsβ_1, β_2 and $\beta_3$as shown in equation (4):

$$H = \sum_{j=1}^{J} \beta_j \qquad (4)$$

Where *j*=1,…*J*, and *J* is the number of inputs included in the calculations. The Panzar-Rosse *H* statistics will interpret as follows: *H* is equal to zero or negative when the competitive structure is a monopoly or a perfectly colluding oligopoly. When *H* is equal to 1, it refers to perfect competition and 0<H<1 refers to monopolistic competition. *H* can be interpreted as a continuous measure of the level of competition, in particular between

0 and 1, in the sense that higher values of *H* indicate stronger competition than lower values (Bikker and Haaf, 2000; Goddard *et al*. 2001; Casu and Girardone, 2006). Table (2) summarizes the interpretation of the Panzar-Rosse model.

Table 1:The theory and interpretation of the Panzar-Rosse *H* statistic

Equilibrium Test	
E = 0	Equilibrium
E < 0	Disequilibrium
Competitive Conditions Test	
H ≤ 0	Monopoly or conjectural variations short run oligopoly
H = 1	Perfect competition or natural monopoly in a perfectly contestable market or sales maximizing firm subject to a break even constraint
0< H <1	Monopolistic competition

Source: Rosse and Panzar (1977), Panzar and Rosse (1982, 1987), Shaffer (1982, 1983), Nathan and Neave (1989), Molyneux *et al*. (1994), Hondroyiannis *et al*. (1999), etc.

The empirical application of the P–R approach assumes a log-linear marginal cost function (dropping subscripts referring to bank *i*).

$$lnMc = \beta_0 + \beta_1 lny + \sum_{i=1}^{m} \delta_i p_i + \sum_{j=1}^{g} \gamma_j lnq_j \qquad (5)$$

Where *y* is output of the bank, $p_i$are the factor input prices and *q* are other variables, exogenous to the cost function as in equation (4). Equally, the underlying marginal revenue function has been assumed to be log-linear of the form.

$$lnMR = \alpha_0 + \alpha_1 lny + \sum_{i=1}^{h} \varphi_i lnk_i \qquad (6)$$

Where $k_i$are variables associated to the bank-specific demand function? For a profit-maximizing bank, marginal costs equal marginal revenues in equilibrium, yielding the equilibrium value for output (denoted by an asterisk):

$$lny^{*} = \left[(\beta_0 - \alpha_0 + \sum_{i=1}^{m} \delta_i \ln p_i + \sum_{j=1}^{g} \gamma_j \ln q_j - \sum_{i=1}^{h} \varphi_i \ln k_i) \,/\, (\alpha_1 - \beta_1) \right] \qquad (7)$$

The reduced-form equation for revenues of bank *i* is the product of the equilibrium values of output of bank *i* and the common price level, determined by the inverse-demand equation, in logarithms, of the form $lnP = \tilde{\omega} + \eta ln \sum_i y_i^*$.

4. Research Method

Data

This study employs an unbalanced annual bank level data of the banks operating in Jordan and GCC countries (namely, Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates (UAE)) for the period 2003-2010 covering 90 banks operating in Jordan and GCC countries, 15 banks in Jordan and 75 banks in GCC countries including commercial and Islamic banks. The data has been collected from the Bankscope database of Bureau van Dijk's company.

Estimation Procedure

This study uses two types of panel data techniques namely static and dynamic model. For static model we use fixed effects and random effects models work to remove omitted variable bias by measuring change within a group. Fixed effect is controlling for unobserved heterogeneity when heterogeneity is constant over time and correlated with independent variables while the random effect if differences across entities have some influence on the dependent variable then we should use random effects. On the other side the generalized moments of method (GMM) proposed by the Arellano-Bond (1991) and Arellano-Bover (1995), Blundell-Bond (1998). This technique has an advantage for addressing the Nickell (1981) bias associated with the fixed effects in short panel, bias

due to the presence of the lagged dependent variable and bias due to the endogeneity of other explanatory variables.

The Panzar and Rosse H statistic is equal to the sum of the related elasticities:$H = PF + PL + PK$. Panzar and Rosse show that this statistic (the *H*-statistic is calculated from the reduced form revenue equation and measures the sum of elasticities of total revenue of the banks with respect to the banks' input prices) can be used to recognize the structure of the market in which the firm operates. The value of *H*=1 indicates perfect competition, in which an increase in cost causes some firms to exit, price to increase, and the revenue of survivors to increase at the same time as increase in costs (Goddard *et al*., 2001). H will be negative for a collusive oligopoly or a monopoly in which an increase in costs causes output to fall and price to increase. An upward shift in the marginal cost curve will be associated with a reduction of revenue as a result of the optimality condition for the monopolist. $0 < H < 1$ Indicates monopolistic competition, in which an increase in costs causes revenues to increase at a lower rate than that of costs.

Following previous studies Shaffer (1982, 1985),), Molyneux *et al*. (1994), Nathan and Neave (1989) and Hondroyiannis *et al*. (1999), this study estimate the bank revenue function in static model in equation (8) in which revenue is explained by factor prices and other bank-specific variables. A fixed effects and random effect panel data model will be used to estimate reduced form revenue equation in order to derive the Panzar-Rosse *H*-statistic method we estimate the following equation:

$$\ln(REV_{it}) = h1\ln(PF_{it}) + h2\ln(PL_{it}) + h3\ln(PK_{it}) + \ln ASSETS + lnEQUITY + lnLOAN + lnFIXED + u_i + \lambda_t + \varepsilon_{i,t} \quad (8)$$

For $t = 1 \ldots T$ where T is the number of periods observed, and $i = 1 \ldots n$, and where n is the total number of banks and *ln* is the natural logarithm. The dependent variable (REV) is the ratio of total revenue to total assets and thus account for both the banks interest and non-interest income. The variable is divided by total assets in order to account for size

differences. Usually with intermediation approach, it is assume that banks use three inputs factors-namely, deposits, labor, and physical capital. Variables PF, PL and PK are the unit prices of these three inputs or reasonable proxies: (PF) the ratio of interest expenses to deposits and other liabilities, (PL) the ratio of personnel expenses to total assets, and (PK) the ratio of other non-interest expenses to fixed assets.

This study will include some of bank-specific factors to account for size, risk, and capacity differences. The factors are total assets (TA) to account for possible scale economies, equity (EQTY) which is the ratio of total equity to total assets, net loans (LOAN), and capacity indicator such as total fixed assets. To control for the yearly macro effects, under the PR framework, the *H*-statistic is equal to the sum of the elasticities of the revenue with respect to the three input prices: $H = h1 + h2 + h3$. The testable hypothesis for monopolistic competition is $0 < H < 1$, while $H \leq 0$ is monopoly. All variables are in logarithmic form.

Finally ε_{it} is a two-components error term that for the *i*-th firm that can be written as follows: $\varepsilon_{it} = \mu_{it} + v_{it}$where $v_{it}$is a two-sided error term capturing the effects of statistical noise, assumed to be independently and identically normal distributed with zero mean and variance σ_v^2 and independent of the $\mu_{it} = \{\mu_i exp[-n(t-T)]\}$where$\mu_i$is a one-sided error term to capture the effects of inefficiency and can be assumed half normally distributed with mean zero and varianceσ_u^2;*n*is an unknown parameter to be estimated capturing the effect of inefficiency change over time.

Since the PR-model is only valid if the market is in equilibrium, we also estimate the following equation for each country:

$$\ln(1 + ROA_{it}) = h1 \ln(PF_{it}) + h2 \ln(PL_{it}) + h3 \ln(PK_{it}) + \ln ASSETS + lnEQUITY + lnLOAN + lnFIXED + u_i + \lambda_t + \varepsilon_{i,t} \quad (9)$$

Following Claessans and Laeven (2004) and Casu and Giradone (2006) the measure of ROA (is actually calculated as ln(1+ROA) to adjust for (small) or negative values of

ROA, where *ROA* is the pre-tax return on assets (pre-tax profits to total assets), because return on assets can take on (small) negative values. This can define the equilibrium *E*-statistic as. $h_1 + h_2 + h_3$ to know the test whether *E* = 0, again using an *F*-test. If rejected, the market is assumed not to be in equilibrium. The scheme behind this test is that, in equilibrium, returns on bank assets should not be linked to input prices. This approach for testing whether the observations are in long-run equilibrium has previously been used in the literature (Shaffer 1982 and Molyneux *et al*. 1996).

Dynamic Panel GMM

We use further the Generalized Method of Moments (GMM) to compete the following equation:

$$\ln(REV_{it}) = \alpha_0 + \alpha_1 ln(REV_{it-1}) + h1 \ln(PF_{it}) + h2 \ln(PL_{it}) + h3 \ln(PK_{it}) + \alpha_2 \ln ASSETS + \alpha_3 lnEQUITY + \alpha_4 lnLOAN + \alpha_5 lnFIXED + \eta i + \lambda_t + \varepsilon_{i,t} \quad (10)$$

To remove the firm specific effect (ηi) in Equation (10), Arellano and Bover (1995) proposed a forward orthogonal deviation transformation or forward Helmert's system. This transformation fundamentally subtracts the mean of future observations available in the sample from the first *T* -1 observation. The advantage is to maintain sample size in panels with gaps. On the other side, a first-difference transformation has some weakness, which is, if some explanatory variable (REV_{it}) is missing, then $REV_{it}$and REV_{it}+1 are missing in the transformed data (Roodman, 2009a). However, under orthogonal deviations, the transformed REV_{it}+1 need not go missing.

Since the use of a 'static' estimator such as fixed effect or random effect may lead to bias in the estimates (Goddard and Wilson, 2009). The form of a linear dynamic panel regression in equation (10), where one or more lags of the dependant variables are included as covariant and unobserved individual contain fixed or random effect. By assembly, the individual effects are correlated with the lagged dependent variable,

interpretation the standard fixed or random effects estimators inconsistent. Arellano and Bond (1991) adopted a Generalized Method of Moments (GMM) estimator for such model, where this model known as the difference GMM. The lagged exogenous variables values constitute genuine instruments for the first-differenced, lagged dependent variable. Though, these lagged variables may provide little information about the first differences (Arellano and Bond, 1995; Blundell and Bond, 1998).

The reliability of the system GMM estimator depends on both the assumptions that the error term is not auto-correlated and also on the strength of the used instruments. There are two specification tests are explained. The first is to examine the validity of the instruments by analyzing the sample analogue of the moment conditions used in the estimation procedure based on Hansen test of over-identifying restrictions. The second test examines the hypothesis of no autocorrelation in the error term. The occurrence of first-order autocorrelation in the differenced residuals does not mean that the estimates are not consistent. However, the occurrence of second-order autocorrelation implies that the estimates are not consistent.

The addition of the lagged dependent variables in the baseline banks revenue function in Equation 10 implies that there is correlation between the regressors and the error term because the lag of banks loan supply $\ln(REV_{it}) - (REV_{it-1})$ depends on $\varepsilon_{i,t-1}$, which is a function of the bank-specific effect (ηi). Therefore, because of the correlation, the dynamic panel data estimation in Equation (10) suffers from Nickell (1981) bias, which disappears only if *T* is large or approaches infinity. Arellano and Bond (1991), Arellano and Bover (1995), and Blundell and Bond (1998) proposed GMM estimators to deal the endogeneity problem (the correlation between the lagged dependent variable and the error term).

Arellano and Bond (1991) and Arellano and Bover (1995) recommend that the lagged levels or untransformed regressors are used as an instrument for the transformed variable. This indicates to the difference GMM. However, Alonso-Borrego and Arellano (1999) and Blundell and Bond (1998) prove that if the lagged dependent and the explanatory

variables are determined over time or nearly a random walk, then lagged levels of these variables are weak instruments for the regression equation in differences. This take place either as the autoregressive parameter (α) approaches unity, or as the variance of the individual effects (ηi) increases relative to the variance of the transient shocks (ε_{it}). Hence, to decrease the prospective bias and imprecision related with the difference estimator, Blundell and Bond (1998) proposed a system GMM approach by combining regression in differences and regression in levels. In addition to the regression in differences, the instruments for the regression in levels are the lagged differences of the corresponding instruments.

The system GMM can generate moment conditions prolifically as noted by Roodman (2009). When adding too many instruments in the system GMM overfits endogenous variable even this may weaken the Hansen test of the instruments' joint validity. This study uses two main techniques to avoid instruments proliferation and to limit the number of instruments such as using only certain lags instead of all available lags for instruments and combining instruments through addition into smaller sets by collapsing the block of the instrument matrix.

This study used one and two step difference GMM estimation. However, for robustness checking, this study also will estimate one step and two-step system GMM. The benefit of using GMM estimator in producing unbiased, consistent, and efficient results is highly dependent on the adoption of the suitable instruments. Therefore, there are three specifications tests as suggested by Arellano and Bond (1991), Arellano and Bover (1995), and Blundell and Bond (1998). First, the Hansen test of over identifying restrictions, which tests the overall validity of the instruments by analyzing the sample analogue of the moment conditions used in the estimation process. If the moment condition holds, then the instrument is valid, and the model has been correctly specified. Second, it is important to test that there is no serial correlation among the transformed error term. Third, to test the validity of extra moment's conditions on the system GMM, the difference in Hansen test is used. This test measures the difference between the

Hansen statistic generated from the system GMM and the difference GMM. Failure to reject the three null hypotheses gives support to the estimated model.

5. Empirical Analysis

In order for the test results to be valid, the banking industry should be in the long run equilibrium during the period of test. Following Claessens and Laeven (2004) and Utrero-Gonzalez (2004), we compute the dependent variable as $\ln(1 + ROA)$[2]. The equilibrium in the banking industry is examined by estimating the equations (9) this study apply the Wald F-test to the models and consistently reject the null hypothesis of long run equilibrium 1% significant level. The sum of the input price elasticities of the factors, are significantly different from zero for all specification, The Wald test does not reject the null hypothesis H=0, leading us to conclude that Jordan and GCC banking industry are in the long-run equilibrium over the period 2003 to 2010.

Focusing on the degree of competition in Jordan and GCC banking sectors, this study will show the results for degree of competition based on several methods, e.g. static (fixed and random effect) and dynamic GMM (difference and system).

Table 2 shows estimated revenue for Jordan and GCC countries using statistic test for both fixed and random effect in Panzar and Rosse model. Referring to fixed effects test in the second column, the H value of 0.40 indicates that the market structure operates under monopolistic competition. Similarly, random effects test in column 5, the H value of 0.27. We can therefore describe that the market structure of Jordan and GCC banking system during the sample period as monopolistically competitive.

The results in Table 2 are consistent with previous studies, which have used the Panzar and Rosse model which found monopolistic competition in the banking industries. For example, Molyneux *et al*. (1994) and Bikker and Haaf (2002) find improved competition

[2]We do not report the results of the long-run equilibrium tests to save space but they are available fromauthors upon request.

in the 1998s and between the beginning and the end of the 1990s. Claessens and Laeven (2004) find relatively strong competition during the 1990s, while Casu and Girardone (2006) estimate a relatively low level of competition with *H*-statistic of around 0.3. While the different estimates of *H* can be attributed to the variation of sample periods and sample size, the established view is that the Jordan and GCC banking system can be described as one of monopolistic competition.

Table 2: Panzar and Rosse model for Jordan and GCC banking market

Variables	Fixed effect	*t* value	Std. Err.	Random effect	*Z* value	Std. Err.
Intercept	-2.824	(-4.29)***	0 .657	-2.625	(-4.94)***	0 .531
lnPF	0. 282	(5.96)***	0.038	0.265	(5.66)***	0.046
lnPL	0 .285	(3.13)***	0.065	0.262	(4.53)***	0. 057
lnPK	-0.165	(-2.13)***	0.081	-0.257	(-3.56)***	0. 072
lnASSET	0 .427	(4.21)***	0.106	0.370	(3.66)***	0. 101
lnEQUITY	0 .532	(6.27)***	0.090	0.640	(7.85)***	0. 081
lnLOAN	0 .119	(2.04)**	0.069	0. 132	(2.26)***	0. 058
lnFIXED	-0.140	(-1.70)*	0.076	-0. 180	(-2.21)**	0. 081
H Value	0.40			0.27		
F test H = 0	13.37	(0.00) ***		31.15	(0.00) ***	
F test H = 1	29.39	(0.00)***		226.96	(0.00)***	
F Statistic	87.82					
Adj. R^2	0.856			0.866		
No. of Obs.	638			638		
No. of Group	90			90		
Competitive Condition	Monopolistic Competition			Monopolistic Competition		

Note: "*t*" and 'z' values in parenthesis
*Significant at 10% , **Significant at 5% , ***Significant at 1%

Concerning the other explanatory variables in Table (2), ASSET and LOAN take a positive and significant coefficient. As expected, a bigger bank size and a higher share of loans play an important role in generating revenues. In contrast, the ratio of equity to total assets does not influence banks' income, as its coefficient is not statistically different from zero.

To assess the degree of competition in Jordan and GCC banking sector, we then examine the value of the Rosse-Panzar *H*-statistic and apply usual statistical framework to test hypotheses as set out in table (3) reports the estimated values of *H* based on equation (10)

with results for the one-step estimator as well as the robust one-step estimator. We focus initially on columns 2 to 5 in table (3) which describe the estimates for total revenue as the dependent variable. From these columns we observe that of the three input prices, the unit price of funds (*PF*) is significant at conventional levels of significance, suggesting that the cost of funds is an important contributor to total income. The *H* value is 0.748 and similarly the two-step difference in column 5 shows H value is 0.933. This indicates that, the market structure in Jordan and GCC countries are operating under monopolistic competition.

Table 3: Panzar and Rosse Dynamic panel-data estimation, GMM

Variables	Coefficient	*P* Value	Std. Err.	Coefficient	*P* value	Std. Err.
	One step Difference			Two step Difference		
$ln(Rev)_{t-1}$	0.310	(0.00)***	0.108	-0.050	(0.00)***	0.322
$lnPF$	0 .115	(0.27)	0.095	0.242	(0.02)***	0.094
$lnPL$	0.658	(0.01)***	0.252	0.515	(0.03)***	0.246
$lnPK$	-0.025	(0.94)	0.273	0. 176	(0.57)	0. .301
$lnASSET$	1.173	(0.00)***	0.313	0.893	(0.00)***	0.189
$lnEQUITY$	-0.203	(0.51)	0.275	-0.335	(0.00)***	0.204
$lnLOAN$	-0.422	(0.03)***	0.194	-0.057	(0.00)***	0.134
$lnFIXED$	-0.242	(0.37)	0.271	0.323	(0.00)***	0.200
H Value	0.748			0.933		
F test H = 0	5.26	(0.02)		45.16	(0.00)***	
F test H = 1	45.05	(0.00)		804.28	(0.00)***	
Sargan test of overid. restrictions	132.84	(0.24)		77.89	(0.54)	
Difference (null H = exogenous):	2.45	(0.48)		0.86	(0.93)	
AR(1)	-4.01	(0.00)***		1.79	(0.07)*	
AR(2)	-0.23	(0.81)		1.39	(0.16)	
Wald chi2	558.89	(0.00)***		217	(0.00)***	
Number of Group	90			90		
No. of Obs.	638			638		
No. of Instruments	80			88		
Competitive Condition	Monopolistic Competition			Monopolistic Competition		

***, **, * Significant at 1%, 5%, and 10%, respectively;

P-values in parenthesis

H-value is the estimated Rosse-Panzar *H*-statistic

Sargan is the *p*-value for the Sargan test for the validity of the over-identifying restrictions for the GMM estimates

AR(2) is the *p*-value for the test for 2nd order autocorrelation for the GMM first-difference estimate residuals

The results in Table (4) show that the AR (2) for testing the serial correlation and the Hansen test for testing the validity of instrument adopted are also valid. As shown the *p* values for the AR(2) and Hansen tests are higher than 0.10, that is, statistically insignificant at the 1% significance level. This implies that the instrument adoption is valid because there is no serial correlation (autocorrelation) in the transformed residuals, and the instruments (moment conditions) used in the models are valid. Turning to one step and two step system in Table (4) show that the AR(2) for testing the serial correlation and the Hansen test for testing the validity of instrument adopted, are also valid. In one-step system the *p* values for the AR(2) is -1.38 and Hansen tests are 77.89 which is higher than 0.10, that is, statistically insignificant at the 10% significance level. Similarly in two-step system the results of AR (2) and Hansen test implies that the instrument adoption is valid because there is no serial correlation (autocorrelation) in the transformed residuals, and the instruments (moment conditions) used in the models are valid. Whereas the H value is 0.33 in column 2 and 0.014 in column 5 which indicates the market structure in Jordan and GCC banking industries are operating in monopolistic competition.

Table 4: Panzar and Rosse Dynamic panel-data estimation, GMM

Variables	Coefficient	*P* Value	Std. Err.	Coefficient	*P* value	Std. Err.
	One Step System			Two Step System		
$ln(Rev)_{t-1}$	-0.045	(0.14)	0.025	0.195	(0.00)***	0.068
$lnPF$	0.333	(0.00)***	0.066	-0.007	(0.91)	0.061
$lnPL$	-0.289	(0.17)	0.284	-0.153	(0.00)***	0.046
$lnPK$	0.286	(0.36)	0.290	0.174	(0.02)***	0.075
$lnASSET$	0.915	(0.00)***	0.284	0.633	(0.00)***	0.158
$lnEQUITY$	-0.372	(0.19)	0.225	-0.384	(0.01)***	0.163
$lnLOAN$	0.326	(0.20)	0.254	0.424	(0.00)***	0.087
$lnFIXED$	-0.043	(0.62)	0.088	0.109	(0.09)*	0.065
H Value	0.33			0.014		
F test H = 0	0.48	(0.49)		1.63	(0.20)	
F test H = 1	9.82	(0.00)***		3649.86	(0.00)***	
Hansen test of overid	77.89	(0.54)***		84.93	(0.92)***	
AR(1)	1.88	(0.06)**		-2.33	(0.02)***	
AR(2)	-1.38	(0.16)		0.10	(0.92)	
Difference (null H = exogenous): chi2(4)	0.86	(0.93)		0.44	(1.00)	
Wald chi2	1303.23	(0.00)***		217.84	(0.00)***	
Number of Group	90			90		
No. of Obs.	638			638		
No. of Instruments	88			83		
Competitive Condition	Monopolistic Competition			Monopolistic Competition		

***, **, * Significant at 1%, 5%, and 10%, respectively;

P-values in parenthesis

H-value is the estimated Rosse-Panzar *H*-statistic

Sargan is the *p*-value for the Sargan test for the validity of the over-identifying restrictions for the GMM estimates

AR(2) is the *p*-value for the test for 2nd order autocorrelation for the GMM first-difference estimate residuals

Overall the results in table 2, 3 and 4 indicate that the competitive condition confirms that, almost all of the estimated coefficients are statistically significant at the 1% level.

All tests at the same time confirm the good fit of models. The F-statistics for testing the hypotheses H=0 and H=1 indicate that we can reject the null hypotheses at 1% level of significance for all estimations. The estimation for the test statistic H is significantly positive for the overall sample. These results suggest that the value of the test statistic H is positive and statistically different from 0 and unity, rejecting both the monopoly and perfect competition hypotheses. The economic interpretation of these statistics is that banks in Jordan and GCC banking industry have actually operated under monopolistic competition.

While the coefficients on the bank specific factors for the pooled sample, the sign on the size coefficient (TA) is positive and significant in all cases, suggesting that size differentials in assets among banks lead to higher total revenues per dollar of assets for the larger banks. This can suggest that larger banks are more efficient compared to smaller banks. Another significant variable with positive coefficient is the loan, and it suggests that banks with a higher proportion of lending in their total liabilities are able to generate higher interest revenues. The risk coefficient, (EQTY), is not significant in most cases and has the expected negative sign, indicating that banks with low proportion of equity capital (riskier banks) are able to generate higher income per dollar of their assets.

Overall, the above results are consistent with the expectation that globalization and deregulation of financial markets with the adoption of new technology have increased the competitive conditions in Jordan and GCC banking markets. Based on the results it is expected that banking sectors in Jordan are able to compete with the GCC banking sector.

6. Conclusion

This paper provides new empirical evidence on the market structures and the level of competition in banking industry in Jordan relative to six GCC countries. and to examine the level of market contestability for the period 2003-2010 with the aim of evaluating the monopoly power of the banks over this period and to know the position of Jordanian

banks whether they can compete with the GCC banking industry. By using static and dynamic GMM tests the results of this study revealed that the estimated *H* statistics for the sample period are positive and the Wald test for either monopoly or perfect competition market structure is rejected. Thus, the finding indicates that banks in Jordan and GCC countries earned their revenue in a monopolistic competition condition. Therefore, Jordan can join the GCC group and based on the results it is expected that banks in Jordan can compete the banking sectors in GCC countries.

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EFFICIENCY OF ISLAMIC AND CONVENTIONAL BANKS IN EGYPT AND JORDAN

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Abstract

This paper attempts to investigate the efficiency of both Islamic and conventional banks on 35 Egyptian and 20 Jordanian banks over 1999-2010. Specifically, estimates bank efficiency using Stochastic Output distance Approach while controlling for environmental variables such as country macro economic conditions, bank type and banking services accessibility. Empirical results show that, Islamic banks in Egypt are more efficient compared to their conventional counterparts while those in Jordan display the same efficiency levels. The findings may help the authorities in their policy making particularly in countries which operate both Islamic and conventional banks as different considerations are needed for the former as compared to the latter.

Keywords: Efficiency, Islamic banks, conventional banks, stochastic output distance approach

1. Introduction

Many of the developing and developed economies today are bank based as banks dominate their financial institutions since they control most of the financial flows and possess most of the financial assets, provide credit and other financial services, thus playing a very important role in the growth and development making their soundness and efficiency very crucial. The MENA region economy just like a large number of developed and developing economies have deregulated their banking systems over the past two decades. So many reforms like bank privatization have been made with the main objective of improving productivity, profitability, and efficiency of the banking systems as well as to increase international competitiveness. Developing countries in particular,

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mostly followed International Monetary Fund (IMF) and/or World Bank inspired programs, which sought to improve the performance and efficiency of the financial sectors in these economies to enhance their overall economic performance.

Egypt and Jordan just like other MENA countries have similarities in terms of their economic structure, the order of implementation of structural adjustment programs, the liberalization of state-owned companies, the attraction of direct foreign investments and resource-scarcity in relation to population and have therefore perceived the importance of financial sector reform in allocating investment and enhancing productivity by identifying promising projects and firms, mobilizing savings, encouraging good corporate governance, and enabling the trading, hedging, and diversifying of risk, as well as facilitating the exchange of goods and services as Ben Naceur et al. (2009) mentioned about the reforms in the MENA region.

It is worth noting that in these two economies, two banking systems operate side by side and that is; the Islamic and conventional banking with the conventional being the oldest while Islamic banking was established in Egypt in the 1970s. Today two Islamic banks operate in Egypt and three in Jordan. The Islamic banks were established due to the biggest population in these countries being Muslims who wanted to bank their money in interest free institutions. However, they have not been able to grow and compete favourably with the conventional especially in Egypt despite being the first country to establish this system. The difference between these two institutions is that Islamic banks operate on an interest free basis following the shariah (Islamic law) while conventional banks operate on interest basis.

Therefore, this paper is designed in an attempt to give light on the objectives of the financial reforms in Egypt and Jordan by measuring the efficiency and performance of both conventional and Islamic banks in these two economies allowing for relative environmental, macroeconomic and the bank type differences between the countries. Despite this substantial transformation of the countries' banking and financial sectors in recent years, and the fact that the regulatory requirements being imposed by national

regulators are now closely in line with international standards, there is still a lack of empirical studies investigating bank performance and efficiency. This paper contributes to the scarce studies on Islamic and conventional banking efficiency studies in Egypt and Jordan.

Notably, the studies have used either the parametric (e.g., stochastic frontier analysis) or non-parametric (e.g., data envelopment analysis) techniques to estimate the efficiency of banks. A stochastic output distance function approach is adapted to measure efficiency of Islamic and conventional banks. This follows the assumption of an output oriented approach, and therefore measuring efficiency by comparing actual output relative to potential output, given fixed inputs. The advantage of this approach is that it allows the use of identifiable output and input quantities and also describes entirely the technology used. It just needs information about physical quantities of outputs and inputs used to get measures of technical efficiencies. It therefore does not require price information as well as any behavioural assumption such as cost minimisation or profit maximization hence it avoids the possible problem of input price endogeneity (Orea 2002).

Following several previous studies that include both conventional and Islamic banks, intermediation approach is also adopted in this study since it is most suitable for comparably defining the relationship between bank outputs and inputs. This is because Islamic banks adopt anequity participation principle that effectively intermediates between savers (depositors) and investors or borrowers (e.g.Al-Jarrah&Molyneux2005; El-Gamal&Inanoglu 2005).

2. Review of the Literature and the Modeling Approach

According to the literature, two approaches are used to measure efficiency of banks; the parametric and non parametric approaches. This study contributes to the existing literature by employing a parametric approach specifically stochastic output distance approach measure of efficiency across the countries of Egypt and Jordan and on the comparative efficiency of Islamic and conventional banks. Recent studies on cross

country efficiency tried to control for the differences in the economic environments like country macroeconomic variables, (e.g., income per capita, population, deposit, branching densities and bank structure and regulation) and market structure and regulation (e.g., concentration ratio, intermediation ratio, average equity capital ratio, risk, and firm specialization) while some studies do not assume that any environmental conditions influence frontier estimation, and hence location of the frontier (e.g.,Allen&Rai,1996 ; Altunbas et al. 2001) while those which considered these factors include; Dietsch & Lozano-Vivas (2000), Lozano-Vivas, Pastor & Hassan (2001), Lozano-Vivas & Pastor (2002), Maudos et. al, (2002) and Kwan (2003), Fries &Taci (2005); Carvallo&Kasman (2005) , Kasman & Yildirim(2006).

Furthermore, certain studies have allowed exogenous factors to directly influence inefficiency effects by including country dummies, bank organisational structure controls such as an Islamic bank dummy (assets, liquidity and concentration ratios e.g. Al-Jarrah & Molyneux, 2005), Williams & Nguyen (2005), Maudos & De Guevara (2007), Abdul-Majid et al. (2010) and apply a Battese and Coelli (1995)'s inefficiency effects model and also followed the recent practice of controlling for differences in economic and regulatory environments between countries that may explain differences in efficiency, by including country-specific variables directly in the distance function.

Other studies have employed stochastic output distance approach byShephard et al. (1970) and has been applied by some studies on efficiency of firms like Färe & Primont(1995) to obtain efficiency of banks. Pastor et al.(1997) estimated the efficiency, productivity and differences in technology of banks in different European and US banking systems by applying malmquist indexes using the notion of output distance function and estimation using non-parametric Data Envelopment Analysis(DEA). Their results show different levels of efficiency, productivity and technology across banks in the different countries. Cuesta&Orea(2002)) applied a stochastic output distance function to test the temporal variation of technical efficiency of Spanish savings banks during the period 1985–1998. They further tested whether merged and non-merged firms have different levels and temporal patterns of technical efficiency and their results show

that merged and non-merged firms have different patterns of technical efficiency change thus the mergers have some impact on technical efficiency.

Besides including country-specific variables in the estimated function, Williams and Nguyen (2005) also use the. In the current model, the authors have followed the recent practice of controlling for differences in economic and regulatory environments between countries that may explain differences in efficiency, by including country-specific variables directly in the distance function.

Chaffai et al. (2001)b, Dietsch (2002), Chaffai & Dietsch(2002), Chaffai & Dietsch (2007), Abdul-Majid et al. (2008) applied the output distance function approach while controlling for environmental differences to obtain technical efficiency across banks in different countries. All the studies conclude that environmental effects as well as risk and regulatory effects should not be ignored in the analysis since they play a major role in the productivity of banks. With international comparisons of efficiency, it should be noted that international differences in accounting information might lead to distorted price estimates, thereby undermining the common use of both cost and profit functions for measuring bank efficiency. Therefore this study follow the studies made by Abdul-Majid et al.(2010) and will measure the efficiency of banks in Egypt and Jordan using an output distance function from 1999-2010, which not only does not require price information, but also does not require any behavioural assumption such as cost minimisation or profit maximisation. It will thus join the limited number of studies using an output distance function approach to judge cross-country banking efficiency.

3. Methodology

3.1 Output Distance Function

The stochastic output distance model takes into account the possible noise, although it is known that the econometric approach is sensitive to the choice of the functional form which represents the frontier. Therefore following Fare & Primont (1995) and Cuesta &

Orea (2002), and also allowing for exogenous factors, the general form of a stochastic output distance function can be shown as:

$$1= D_0(Y_{i,t}, X_{i,t}, Z_{i,t}, \beta)h(\varepsilon_{i,t}) \quad (1)$$

Where $h(\varepsilon_{i,t})$ =exp $(u_{i,t} + v_{i,t})$,$Y_{i,t}$ is a vector of outputs,$X_{i,t}$ is an input vector,$Z_{i,t}$ is an exogenous factor vector and β is a vector of parameters. Inefficiency is accommodated in the specification of$h(.)$,$\varepsilon_{i,t}$ is a composed error term comprised of$v_{i,t}$ which represents random uncontrollable error that affects the n-th firm at time t, and $u_{i,t}$is assumed to be attributable to technical inefficiency.The standard practice of imposing homogeneity of degree one in outputs on the distance function is followed in order to facilitate estimation, which implies that

D_0 (Z, X, πY) = $\pi \mathbf{D_0(Z,X,Y)}, \pi > 0.$

Arbitrarily choosing the n-the output,π can then be defined by

$\pi \frac{1}{Y_N}$and

$$D_0(X_{i,t}, Z_{i,t}, \frac{Y_{i,t}}{Y_{N,i,t}}) = D_0\left(\frac{(Y_{i,t}, X_{i,t}, Z_{i,t})}{Y_{N,i,t}}\right) \quad (2)$$

Which after assuming $Y^*_{i,t}$= $(Y_{1,i,t}/Y_{N,i,t}, Y_{2,i,t}/Y_{N,i,t}, \ldots\ldots\ldots\ldots Y_{N-1,i,t}/Y_{N,i,t})$.
Rearranging terms yields the following general form:

$$\frac{1}{Y_{N,i,t}} = D_0(Y_{i,t}, X_{i,t}, Z_{i,t}, \beta).h(\varepsilon_{i,t}) \quad (3)$$

This study also uses the translog functional form as described by Mester (1999) and Isik & Hassan (2002) among other functional forms is the cob-Douglas and Fourier flexibility. In the literature, the translog function is preferred in estimating a parametric distance function as Fuentes et al. (2001) mentions because it is flexible and is expanded

by second order Taylor series. A Battese & Coelli(1995) specification that allows to control for specific cross-country environmental conditions is also used in this analysis.

3.2 The Data and the Empirical Specifications

Data on 23 Islamic and 50 conventional banks from Egypt and Jordan were drawn from the BankScope database for the period 1996–2002 resulting in an unbalanced panel of 223 observations, with 23 of these observations being for Islamic banks and 200 for conventional banks. All those Islamic banks with complete data were selected for inclusion in our sample, as was a sample of conventional banks with incomplete information has been dropped from the sample. Table 1describes the sample distribution of both conventional and Islamic banks across the two countries.

3.3 Choices of Variables

Table 2 gives a summary of inputs and outputs as well as the environmental variables. While making a choice of inputs and outputs an intermediation approach by Sealey Jr. & Lindley(1977) has been used similar to a number of studies on efficiency. Table 3reports the average values of the environmental variables for each country over the period 1999–2010. Particularly, Egypt has a higher average of all the variables as compared to Jordan except for the concentration and intermediation ratios where Jordanian display higher ratios.

Table 4 shows the average total bank assets, inputs and out puts in constant 2000 US dollars for each country and bank type where Egyptian banks have more assets as compared to the Jordanian banks and possess more inputs and outputs across all bank types during the period of study. Similarly, conventional banks possess more assets as well as inputs and outputs in both countries as compared to the Islamic banks.

4. Results and Findings

4.1 Empirical Results

The estimated output distance parameters are represented in table8 with (lambda) $\gamma = \sigma_u^2/\sigma_u^2+\sigma_v^2$ being high at 1.326 suggesting that the deviation from the estimated frontier is mainly due to inefficiency. Many country-specific environmental variables[3] become insignificant when they were included in the inefficiency specification, thereby suggesting that these factors serve as proxies for cross country differences in bank efficiency, rather than legitimate determinants of potential output.

The significant general growth rate of the banks in terms of increased output of 0 .2% as shown in table 8 over time t can be attributed to a number of factors like the financial reforms made by the two countries' central banks. This is in line[4] with the investigations by Lee (2002) on the impact of liberalization and foreign entry in a selected MENA countries whose findings show that financial liberalization, accelerated by foreign bank entry and privatization of domestic state-owned banks, contributes to net profitability and better capitalization for domestic banks and also confirm that a more efficient financial market underpinned by well-balanced development of financial sectors induces a higher banking efficiency.

[3] These include population density, GDP, GNI, roads paved, number of telephone lines, concentration ratio and intermediation for both countries under study.

[4]The results are contrary to the findings of Ben Naceur et al Ben Naceur, S., Ben-Khedhiri, H. & Casu, 2009. What Drives the Efficiency of Selected Mena Banks? A Meta-Frontier Analysis. on the efficiency of a selected MENA countries whose study found variation in the efficiency level of banks in the MENA countries despite the similar financial reforms undertaken and attributed this variation to differences in technology across the countries' banking systems.

Loan quality is positive with a 36.2%decrease in outputs obtained as a result of the high risk of these non performing loans in both countries.[5]The Equity to total assets ratio has a negative relationship with bank outputs indicating that as the equity-to-asset ratio increases, inputs increase with those banks that depend more on deposits[6], reducing the inefficiency in these banks[7].The Islamic bank dummy has a positive coefficient, indicating that full-fledged Islamic banks are found to have potential efficient outputs that ceteris paribus are 12.4%lower than conventional banks. Therefore the results suggest a systematic reduction in potential output that can be attributed to Islamic banking, which may result from constrained opportunities in terms of investments as a result of shariah compliance in these two countries. This should not be considered as evidence of managerial inefficiency but should be considered as evidence of differences in unobserved operating characteristics and/or applicable technology, which result in lower potential output for Islamic banks for given input usage.[8]

There is a 37% decrease in the Outputs of the merger between Mohandes and National bank of Egypt (MERGERE) as well as a decrease of 72% in outputs of merger between the United Bank of Egypt, Nile Bank and Islamic international bank for investment and Development (MERGERF) as shown in table 8. This is similar[9] to the findings of Cuesta

[5]And [4] Similar to the findings of Abdul-Majid, M., Saal, D. S. & Battisti, G. 2008. The Efficiency and Productivity of Malaysian Banks: An Output Distance Function Approach. On the impact of Islamic banking on the cost efficiency and productivity change of Malaysian commercial banks and the findings of Fries and Taci (2004).

[7] These findings are similar to those of both Grigorian&Manole and by Yildirim&Philippatos.

[8] This is in line with the findings of Abdul-Majid, M., Saal, D. S. & Battisti, G. 2010. Efficiency in Islamic and Conventional Banking: An International Comparison. *Journal of Productivity Analysis* 34(1): 25-43.

[9] However this is in contrast with the findings of AltunbaşMarquésAltunbaş, Y. & Marqués, D. 2008. Mergers and Acquisitions and Bank Performance in Europe: The Role of Strategic Similarities. *Journal of Economics and Business* 60(3): 204-222. Who investigated the effect of mergers and acquisition on banks in Europe. Their findings show that on average, merged banks in Europe have increased their performance hence increased outputs.

& Orea(2002) who found the immediate effect of mergers was to decrease technical efficiency for the sometime after which banks stabilize and improve.Badreldin & Kalhoefer(2009) who measured the success of mergers in Egypt as a result of the financial reforms using basic Return on Equity(ROE) measure to investigate the performance of banks that had undergone merger and acquisitions. Their research found that there was no clear impact on the performance of involved banks whether domestic or cross-border as a result of mergers and acquisition which had been brought about by the CBE set of reforms that saw the successful consolidation in the operating banking units from 61 banks to only 39 in 2009 through both voluntary and involuntary mergers and acquisitions according to the credit risk exposure capital adequacy constraint of Basel Accord II.

4.2 Efficiency estimates

Tables 5 reports the average efficiency estimates by country and by bank types across all years. The efficiency of all banks is on average1.168 ranging from 1.042 to 1.680. As shown in table 5, banks in Jordan displayed better efficiency results compared to banks in Egypt with 1.163 for Jordanwhile Egyptwas 1.189 and Islamic banks in Jordan were found to be more efficient compared to those in Egypt with a score of 1.2 to 1.1.the results also show conventional banks to be less efficient in Egypt as compared to Islamic while in Jordan, both banks display the same levels of efficiency. On average all banks in both countries are efficient at 1.168 with year 2004 displaying the lowest efficiency levels across all banks in the two countries of 1.125 as shown in table 6 with Islamic bank efficiency being lowest in 1999 with 1.067 while conventional banks have their lowest efficiency levels in 2004 of 1.123. Due to the unavailability of data on Islamic banks in Egypt, there were no efficiency scores for the period 1999 to 2008 and the same for the conventional banks for the period of 1999 to 2003. This has been shown in table 7 while full efficiency results are shown on both bank types in Jordan due to the availability of data on those banks.

5. Conclusions

An output distance function has been employed to examine the efficiency of conventional banks and Islamic banks in Egypt and Jordan, for the period 1999–2010. It has been shown that technical inefficiency is large in Jordanian banks as compared to the Egyptian. The results also show conventional banks to be less efficient in Egypt as compared to Islamic while in Jordan, both banks display the same levels of efficiency. This gap on efficiency while controlling for risk in the model and environmental effects has been covered and the resulting model enables better understanding of difference between Islamic and conventional banks and across different countries. Results on Islamic and conventional banks show that ceterisparibus, Islamic banks have 12.4% lower outputs for given inputs. Moreover, we have also found that the inclusion of an Islamic bank dummy in the inefficiency specific action can be rejected as statistically insignificant. This therefore suggests that the reduced output of Islamic banks cannot be attributed to managerial inefficiency, but results from a reduction in potential output attributable to shariah compliance.

The results also indicate that the banking reforms in Jordan and Egypt including increase in interest rates in Jordan decreased outputs by approximately 20% in 2006 while the global financial crisis of 2007 also affected the outputs of these banks with a reduction of about 25%. The first and second bank reforms in Egypt also had a negative change on the outputs by lowering them by approximately 20% and 16% respectively. The merger dummies also indicate that on average an increase in inputs by 1%, it results in a decrease in output by 37% and 72% for Merger E and F respectively. This shows an effect of mergers on the efficiency estimates.

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Table 2: Summary of Inputs and Outputs

Inputs	
X1	Interest expenses
X2	Noninterest expenses
Outputs	
Y1	Total loans
Y2	Other earning assets
Y3	Off-balance sheet items
Environmental variables	
Risk	Equity Ratio (EQ)(equity /total
loan quality	NPL /Total loans
Macroeconomic conditions	population density, per capita income(GNI) and per capita GDP measured in US dollars
Structure of each banking industry	banking concentration and the intermediation ratio
bank mergers	Dummy for bank mergers and acquisition
Bank type	Dummy variable 1 for Islamic, 0 otherwise.
Yearly dummy	Dummy for 1999-2010

Source: BankScope, International Financial Statistics, World Bank, central Bank of Jordan, central Bank of Egypt

Table 3: Average Value of the Environmental Variables by Country (1999-2010)

CountryEgypt		**Jordan**	**All countries**
Macro economic conditions:			
Per capita income: GNI per capita	55.687	44.827	47.067
GDP per capita	51.804	43.544	45.248
Population density: inhabitants /km^2	78.827	60.946	64.634
Banking services accessibility:			
Roads paved(%total roads)	88.814	100.000	97.693
Number of telephone lines per 100 inhabitants	12.910	11.042	11.428
Bank structure:			
Concentration ratio(int$)	0.537	0.732	0.692
Intermediation ratio: loans/deposits	0.727	1.820	1.595

In constant 2000 USD
Sources: BankScope, International Financial Statistics, World Bank, central Bank of Jordan ,central Bank of Egypt ,own calculations

Table4: Descriptive statistics on the average value of total assets, inputs and outputs by country and bank type from 1999- 2010

country	Total assets	inputs		outputs		
		Interest expense	Noninterest expense	loans	Other earning assets	Off balance sheet
Egypt	2,845.2	1,128.04	343.61	9,371.26	14,187.8	15,030.1
Jordan	8,841.12	230.31	230.31	3,718.78	3,847.44	4,425.77
All countries	12,640.7	429.82	196.63	5,025.03	6,124.03	6,794.66
Egypt						
Islamic	9,164.60	371.83	136.56	3,385.60	4,622.03	502.34
conventional	28,984.2	1,276.14	383.12	10,686.1	15,861.3	17,377.1
Jordan						
Islamic	1,569.14	28.18	24.92	770.79	330.94	162.41
conventional	9,715.60	254.61	169.23	4,073.29	4,270.31	4,938.45

All values are given in Int'l $ mil: constant at 2000 USD
Source: Bank scope

Table 5: Average efficiency estimates by country and by bank types,All years

Average efficiency for all countries, all banks	
Average	1.168
Standard deviation	0.095
Minimum	1.042
Maximum	1.680
Egypt	
Average	1.186
Standard deviation	0.113
Minimum	1.054
maximum	1.570
Jordan	
Average	1.163
Standard deviation	0.090
Minimum	1.042
Maximum	1.680
Average efficiency by country and bank type	
Egypt	
Islamic	
Average	1.145
Standard deviation	0.042
Minimum	1.112
Maximum	1.206
Conventional	
Average	1.190
Standard deviation	0.117
Minimum	1.054
Maximum	1.570
Jordan	
Islamic	
Average	1.110
Standard deviation	0.176
Minimum	1.060
Maximum	1.680
Conventional	
Average	1.158
Standard deviation	0.073
Minimum	1.042
Maximum	1.439

Table6: Average efficiency estimates for all banks, by bank types

Years	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Average efficiency all banks	1.160	1.158	1.156	1.154	1.165	1.125	1.214	1.166	1.162	1.172	1.179	1.174
Standard deviation	0.068	0.070	0.051	0.061	0.061	0.042	0.138	0.082	0.063	0.079	0.124	0.133
Minimum	1.067	1.084	1.089	1.093	1.054	1.057	1.061	1.064	1.048	1.042	1.053	1.065
Maximum	1.284	1.278	1.274	1.303	1.349	1.210	1.570	1.340	1.276	1.310	1.599	1.680
Average efficiency by bank types												
conventional	1.167	1.155	1.156	1.141	1.154	1.123	1.222	1.172	1.166	1.181	1.168	1.163
Islamic	1.067	1.181	1.159	1.303	1.349	1.158	1.099	1.116	1.133	1.096	1.259	1.250

Table 7 : Average efficiency of banks by country, type and year

Country	Egypt			Jordan			
Year	All banks	Islamic	conventional	All banks	Islamic	conventional	Yearly average all banks
1999	n.a	n.a	n.a	1.160	1.067	1.167	1.160
2000	n.a	n.a	n.a	1.158	1.181	1.155	1.158
2001	n.a	n.a	n.a	1.156	1.159	1.156	1.156
2002	n.a	n.a	n.a	1.154	1.303	1.142	1.154
2003	1.187	n.a	1.187	1.161	1.349	1.146	1.165
2004	1.105	n.a	1.105	1.130	1.158	1.127	1.125
2005	1.346	n.a	1.346	1.197	1.099	1.204	1.215
2006	1.195	n.a	1.195	1.161	1.116	1.167	1.166
2007	1.128	n.a	1.128	1.167	1.131	1.172	1.163
2008	1.204	n.a	1.204	1.166	1.096	1.176	1.172
2009	1.186	1.171	1.188	1.173	1.348	1.149	1.179
2010	1.182	1.120	1.192	1.167	1.380	1.136	1.174
All years	1.186	1.145	1.190	1.163	1.200	1.159	1.168

n.a. unavailable data

Table 8:Maximum likelihood estimates for parameters of the output distance function for Egypt and Jordan banks: 1999-2010

Parameters	Coefficient[1]	Model A[2] Estimated value	Standard error	Model B[3] Estimated value	Standard error
θ_0	constant	-0.235***	0.050	-0.203***	0.048
α_1	$\ln X_1$	-0.39413 ***	0.033	-0.392***	0.033
α_2	$\ln X_2$	-0.630***	0.039	-0.636***	0.039
$\alpha_{1,1}$	$(\ln X_1)^2$	-0.043*	0.024	-0.043*	0.024
$\alpha_{2,2}$	$(\ln X_2)^2$	-0.186***	0.045	-0.193***	0.045
$\alpha_{1,2}$	$\ln X_1 \ln X_2$	0.068**	0.029	0.070**	0.0292
β_1	$\ln Y_1$	-0.037	0.041	0.647***	0.042
β_2	$\ln Y_2$	0.109**	0.043	0.314***	0.051
$\beta_{1,1}$	$(\ln Y_1)^2$	-0.037	- 0.041	-0.041	0.041
$\beta_{2,2}$	$(\ln Y_2)^2$	0.108**	0.043	0.111***	0.043
$\beta_{1,2}$	$\ln Y_1 \ln Y_2$	-0.089**	0.040	-0.086**	0.040
$\lambda_{1,1}$	$\ln X_1 \ln Y_1$	-0.026	0.026	-0.027	0.026
$\lambda_{1,2}$	$\ln X_1 \ln Y_2$	-0.029	0.029	-0.033	0.029
$\lambda_{2,1}$	$\ln X_2 \ln Y_1$	0.039	0.035	0.037	0.035
$\lambda_{2,2}$	$\ln X_2 \ln Y_2$	0.027	0.028	0.034	0.028
ρ_1	t	-0.026**	0.011	-0.024***	0.007
$\rho_{1,1}$	t^2	0.025***	0.004	0.026***	0.004
δ_1	$\ln X_1 t$	0.023***	0.008	0.022***	0.008
δ_2	$\ln X_2 t$	-0.024***	0.008	-0.024***	0.008
ξ_1	$\ln Y_1 t$	0.007	0.007	0.007	0.007
ξ_2	$\ln Y_2 t$	0.024***	0.007	0.023***	0.007
ζ_1	Loan quality	0.355***	0.064	0.362***	0.064
ζ_2	Equity to asset ratio	-0.723***	0.199	-0.714***	0.194
ζ_3	Islamic bank dummy	0.116*	0.068	0.124*	0.069
ζ_4	Intermediation ratio	0.0001	0.003		
ζ_5	Merger A	0.107	0.080		
ζ_6	Merger B	0.053	0.087		
ζ_7	Merger E	0.386***	0.135	0.373***	0 .138
ζ_8	Merger F	0.716***	0.176	0.722***	0.177
ζ_9	e-banking and commerce laws in Jordan(dummy1 for 2000)	0.123**	0.063	0.115*	0.059
ζ_9	Interest rate reductions in Jordan and Crawling peg in Egypt.(dumy1 for 2001)	0.026	0.062		
ζ_{10}	Foreign bank entry in Jordan and EFSAP in Egypt(dummy 1 for 2002)	0.016	0.061		

ζ_{11}	Banking crisis in Egypt(dumy1 for 2003)	-0.081	0.057		
ζ_{12}	Interest increase in Jordan and new banking reforms in Egypt(dumy1 for 2006)	0 .201***	0.055	0.196***	0.054
ζ_{13}	Global Financial crisis(dumy1 for 2007)	0.254***	0.059	0.245***	0.055
ζ_{14}	BRP, in Egypt (dumy1 for 2008)	0.203***	0.062	0.197***	0.053
ζ_{15}	End of 1st BRP in Egypt (dumy1 for 2009)	0.170***	0.058	0.161***	0.043
ζ_{16}	2nd BRP in Egypt(dumy1 for 2010)	0.026	0.072		
λ	lambda	1.661***	0.279	1.326***	0.224
σ	sigma	0.253***	0.001	0.240***	0.001
Log Likelihood		62.549		61.439	

[1]X1,X2,Y1,Y2,Y3, t refer to interest expenses, noninterest expenses, loans, other earning assets, off balance sheet items and year.

[2]And [3] *, **, *** Significant at 90, 95 and 99% confidence level.

RISK MANAGEMENT IN THE OPERATIVE BANKS IN IRAQ: A STUDY OF LIQUIDITY RISKS MANAGEMENT IN PRIVATE BANKS.

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Abstract

The purpose of this study is to assist Iraqi Private Banks to apply advanced practices regarding liquidity risk management which has been proposed by the Basel committee. The study recommends that banks develop strategies, policies and practices regarding Risk Management and also should have proper instruments to measure, follow, and control liquidity risks. Supervisors should also regularly perform comprehensive assessments of a bank's overall liquidity risk management policies and liquidity position in order to determine whether the banks would be able to deliver an adequate level of resilience to liquidity stress, given the bank's role in the financial system.

Keywords: risk management, liquidity risk, operative bank

1. Introduction

Gualandri, Landi, and Venturelli, (2009), the researchers in this study identified the importance of managing liquidity in light of global economic crises and the evolution of the concept of liquidity that focused on the role of control and supervision of financial institutions. Currently, there is a need to make adjustments on the concepts of Basel (2), and a need for coordination between the various countries to implement systems for managing liquidity in private groups that operate in more than one state.

Gngliemo (2007) showed the important challenges facing Liquidity Risk Management in banks resulting from the evolution and complexity of the financial statements of those

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banks. The researcher proposes a method for (LRM), for the Director of the tasks to become a successful manager. (Ratnovski, 2007),in his study focused on the importance of retaining bank liquid assets and improving transparency in the bank to facilitate the task of re-financing and liquidity risk management in the provision of cash needs for the bank. The researcher conducted a number of practical tests to develop a model linking liquidity risk and the degree of transparency needed for funding.

Wagner (2005) illustrates that Liquidity of assets and the banking system ensures stability. The researcher in his study focused on the importance of credit derivatives in the development of risk management of the banks' liquidity. This was carried out by providing banks with alternatives which are different for sale and hedge against risks. The benefits will be derived from the liquidity of the assets of the Bank and its role in the stability of the financial situation and risk management.

Bech & Garrett (2002) studies have analyzed the behavior of banks in settling the obligations related to time and linked to the policy of credit risks in the bank. The statement of incentives that lead banks to defer payments when the costs of providing liquidity during the day is high will have a negative impact on the reputation of the bank.

Liquidity risk management of critical issues have increased in importance as a result of changes in economic conditions and the impact on the banking industry in most countries of the world, has signed banks into the credit crisis, despite all the controls and stringent standards of the Basel Convention on the management of liquidity, and in the presence of laws and regulations of the firm issued by most central banks (Banque De France, 2006).

Researchers evaluated the conditions resulting from the global economic crisis and the need to adopt new standards for liquidity management, and the application of the best practices that would be effective at the level of risk management and also develop procedures for internal work that would allow bank management to monitor any defect in the management of liquidity risks as soon as it occurs. This would enable appropriate steps to be taken as soon as possible and without delay.

The banks in Iraq are faced with, as is the case with banks around the world, big challenges as to how to manage liquidity risk and the steps and actions to be taken to ensure the safety and solvency of the bank to overcome any crisis and to achieve growth for the post-crisis as well as the basics of management of liquidity risk of negative consequences for the banks in general.

Liquidity is the bank's ability to provide the money necessary to finance the increase in the assets of the bank and to meet its obligatory due dates without incurring unacceptable losses. The nature of the traditional work of the Bank, which includes mainly transfer of customers deposits, short-term to long-term loans and the Bank's exposure to various risks make up most of the important liquidity risk. In practice, any process of banking carried out by the Bank's impact on its liquidity that guarantees the bank's ability to meet its obligations on time is identified as the availability of effective risk management of liquidity in the bank. (Guglielmo, 2007).

In February of 2008, Basel Committee issued the bank's bulletin entitled (Liquidity Risk Management and Supervisory Challenges). It was confirmed via this newsletter that many of the banks in the world had failed to abide by factors essential in the management of liquidity risk, and that most of these banks failed to adopt a comprehensive framework in liquidity risk management. Many banks also do not take into account the volume of liquidity that may be needed by the indirect result of commitment to this obligation, whether contractual obligation or otherwise. ((BIS) February 2000,

2. Problem Statement

The problem that the study aims to test is the extent to which banks operating in Iraq have the best banking practices in the management of liquidity risk by answering the key question which is:
Does the banks in Iraq, have a comprehensive framework for liquidity risk management to ensure and provide sufficient liquidity to conduct banking business?

3. Research Questions

a) Are Iraqi banks dependent on factors of governance in the liquidity risk management?
b) Are Iraqi banks dependent on appropriate tools to measure liquidity risk management?
c) Are banks in Iraq committed to the requirements of disclosure of liquidity risk?
d) Are the banking supervision bodies required to monitor the liquidity risk in banks operating in Iraq?

4. Research Objective

The main purpose of this study is to measure the extent of application for practices that are internationally adopted approaches for liquidity risk management (LRM) strategy which has been proposed by the Basel Committee.

- To analyze the extent to which banks operating in Iraq for the factors of liquidity risk management.
- To enrich practical knowledge and conceptsof Basel 2 Committee,.
- To explore the tools and policies appropriated by the Private Banks in Iraq.
- To develop a new strategy for (LRM) for private Banks.
- To understand the role of banking supervision bodies to monitor liquidity risk.

5. The Theoretical Framework

The following is a quick review of the factors of liquidity for risk management issued by the Basel Committee and previously referred to as: (BIS). September, 2008

Principle (1):

Every bank must adopt a comprehensive framework for liquidity risk management to ensure the provision of sufficient liquidity for the conduct of banking as well as an additional margin that consists of a group of assets with high quality, high liquidity, and to observer the adequacy for each of the framework for liquidity risk management as well as to develop liquidity for the bank. Necessary action must be taken against the bank in case of liquidity deficits or weakness in the management of risks in order to protect the depositors as well as the banking system in the State to prevent any adverse effects may affect it in the future.

Principle (2):

The bank should clearly define the desired level of risk that fits with the strategy of the Bank's work and its role in the country's financial system.

Principle (3):

The executive management of the Bank must develop strategies, policies and practices for managing liquidity risk in accordance with the desired level of risk to the bank and the bank must guarantee a sufficient level of liquidity.

The executive management is to review constantly the information on the evolution of liquidity of the bank and report to the Governing Council periodically. The Board of Directors is to review the strategy, policies and practices, and once approved, ensure that executive management manages liquidity risk effectively.

Principle (4):

The bank shall calculate the costs and benefits of liquidity, risks and take into account the pricing procedure and performance measurement, when introducing new products in activities within or outside the budget.

Principle (5):

On the Bank's management to provide solid procedures to identify, measure, monitor and control liquidity risk, a comprehensive framework to predict the cash flow generated

from the assets and liabilities of the bank and off balance sheet items during specific periods of time should be included.

Principle (6):
The bank must monitors and follows-up the liquidity risk and funding needs of the institutions, units, or its legal activities and the various currencies, taking into account the constraints of legal, regulatory and operational transformation, may limit the liquidity of one unit to another.

Principle (7):
The Bank must prepare a funding strategy that will provide effective diversification of sources for funds as well as the length of periods of funding.

Principle (8):
The bank should actively manage the liquidity situation as well as the risks at the same time (Intraday Liquidity Position) to meet both payments and cash settlements, both during normal times or during periods of crisis.

Principle (9):
The bank should effectively manage assets and distinguish between assets and restricted assets, and also monitor the conditions and legal guarantees and the possibility for implementation..

Principle (10):
The bank’s implementation of the conditions for testing various sources of funding short-term and resource-generating liquidity on a regular basis to ensure the survival of exposures present within the level of risk desired, and the use of the results of these tests to adjust the strategies, policies and attitudes of liquidity has spurred these banks to develop effective contingency plans to manage liquidity risk.

Principle (11):

The bank’s official adoption of a contingency plan for funding and liquidity management strategies clearly identify the provision of liquidity under conditions of crisis. These plans must include the policies of the Department of Environment and the pressing need for the adoption of lines of responsibility and clear procedures that are tested periodically to ensure they are practical and durable.

Principle (12):

The bank shall retain a margin of safety made up of highly liquid assets that represents a margin of safety against liquidity risk scenarios in cases of pressing circumstances, which include loss of secured sources of liquidity.

Principle (13):

The bank must make disclosures regularly for people with interests in the market to enable them to judge the effectiveness of risk management and the liquidity position of the bank.

Principle (14):

Bodies on banking supervision regularly select the overall framework for risk management in banks and liquidity conditions and have to decide if these conditions are available at these banks with a sufficient level of flexibility in light of liquidity pressures arising from the financial system in the state.

Principle (15):

The bodies concerned should identify liquidity risk management framework and liquidity positions in the bank periodically during control procedures that rely on internal reports as well as reports of the hedge and market information.

Principle (16):
Oversight bodies intervene and demand from banks the adoption of effective measures to identify weaknesses in liquidity risk management operations and the liquidity situation in the bank.

Principle (17):
Bodies on banking supervision should communicate with other oversight bodies and local authorities to facilitate control over the management of liquidity risk in banks.

The concept of liquidity risk: Liquidity risk is the risk that may lead to bank losses because of the difficulty in securing funds or forcing the bank to get money at higher prices under natural conditions because of the lack of harmonization between the maturities of assets and dates of maturity of liabilities or as a result of unexpected foreign cash flow

Liquidity risk also includes the possibility of the bank taking losses because of not being able to implement the sale of sure assets at acceptable prices under natural conditions or because of specific economic crisis.

6. Research Methodology

The researcher adopted a statistical analytical method in this study to analyze the practices of Iraqi banks in the management of liquidity risk by collecting data through a questionnaire designed for this purpose. The responses were then analyzed along with the data using appropriate statistical programs to gain access to the findings and recommendations.

7. Conceptual Framework

The Basel Committee, issued in September 2008 a Bulletin entitled, "The factors of liquidity risk management and effective supervision. (Principles for sound Liquidity Risk Management and Supervision).

This publication included seventeen factors that represented the key factors inmanaging liquidity risks in banks and these banks must be guided by these factors in the management of liquidity risk (BIS.September, 2008). These factors were divided into the following groups:

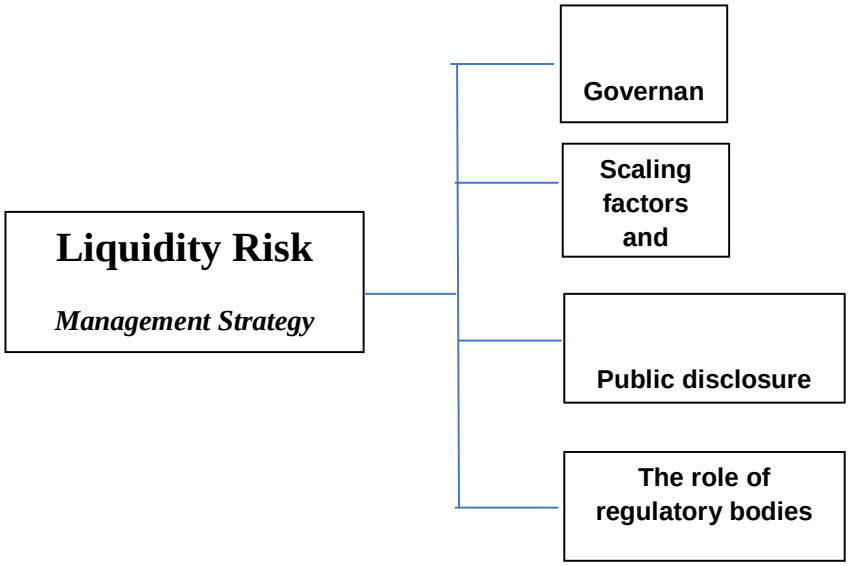
(1) a combination of factors of governance for the management of liquidity risk

(2) a combination of factors measuring and managing liquidity risk

(3) a combination of factors pertaining to public disclosure

(4) a combination of factors pertaining to the role of oversight bodies.

Based on these factors, the study is as follows:



Model of Liquidity Risk Management

Variables of the Study

The dependent variable is made up of the extent of the application of factors, liquidity risk management in banks operating in Iraq, while the independent variables are as follows:-

(1) Corporate governance factors.
(2) Scaling and management factors
(3) Public disclosure factors
(4) The factors of the role of regulatory bodies.

Research Hypotheses

Main hypothesis was formulated as follows:-

HO1: Iraqi banks do not apply the key factors in managing liquidity risk.

The sub-hypotheses as follows:

HO2: banks in Iraq do not apply corporate governance factors for managing liquidity risk.

HO3: banks in Iraq do not use appropriate tools to measure and manage liquidity risk.

HO4: The banks in Iraq do not comply to public disclosure about liquidity risk.

HO5: Regulatory bodies in Iraq do not play an active role in monitoring the liquidity risk.

8. Population and Sampling

The study population was made up of all the workers in the management of liquidity risk in the banks of Iraq (22) and the staff of these banks A random sample of seven Iraqi banks were selected and (40) questionnaires were distributed. The study sample included directors of the departments of Treasury, risk management service managers and staff working in those departments and who were involved in the management of liquidity risk in the bank. An intensive follow-up was retrieved (33) questionnaires were excluded (3) questionnaires had incomplete data and (30) questionnaires for analysis at the rate of 75% from the total number of questionnaires distributed**.**

9. Validity And Reliability Study Tool

To ascertain the veracity of the tool (Validity), a resolution on a number of arbitrators with jurisdiction was undertaken. This was to ensure honesty and clarity of the statements, as a preliminary study on the number of employees from the departments of Treasury and the other departments in the banks abide by the set resolution. As regards to stability the tool used was the reliability coefficient Chron-beach Alpha.

2. Test KS (Kolmogrov-Smirnov) was used to test the data for the normal distribution which could be adequately applied together with the statistical methods.

3. Arithmetic means and standard deviations to demonstrate the application levels of liquidity risk management factors

4. Three correlation coefficients are the Pearson's correlation coefficient, correlation coefficient Kendall's tau-b and Spearman's correlation coefficient Spearman's ho were utilized to indicate the relationship between independent variables and the dependent variables.

First Hypothesis

HO1: do not apply to the banks operating in Iraq. The key factors to manage liquidity risk.

KS test was used to make sure that the study data was distributed normally. The following table shows that the data follows a normal distribution for all the variables in the study, and that the answers of the respondents are statistically significant at the level of significance (0.05), was also used in the descriptive statistics (arithmetic mean. mean and standard deviation) to determine the level of application of the banks operating in Iraq, the key factors to manage liquidity risk, as the arithmetic mean, which is located between (3.5-5) are of a high-value, and that which has less than (2.5) have a low value.

One-Sample Kolmogorov-Smirnov Test

		Factors of risk management	Governance	Measurement	Disclosure	Control
N		38	38	38	38	38
Normal Parameters[a,,b]	Mean	4.13	3.8755	3.7268	4.2105	3.8039
	Std. Deviation	.704	.64473	.50796	.57694	.59039
Most Extreme Differences	Absolute	.347	.229	.230	.379	.170
	Positive	.311	.113	.230	.379	.170
	Negative	-.347	-.229	-.222	-.331	-.145
Kolmogorov-Smirnov Z		2.139	1.413	1.419	2.338	1.050
Asymp. Sig. (2-tailed)		.000	.037	.036	.000	.220

a. Test distribution is Normal.

b. Calculated from data.

From the result in the last line (Sig.) in the table above, the hypothesis that the distribution of all variables is normal is accepted.

In order to test the first hypothesis based on the above table, the arithmetic mean 4.13 and the standard deviation of 0.704 and 0.000 significance level, has a high level of application of the factors essential in managing liquidity risk. Based on the above results, the hypothesis is rejected and accepts the alternative hypothesis, which states that banks operating in Iraq implement key factors in managing liquidity risk.

Second Hypothesis

HO2: does not apply to the banks operating in Iraq s governance factors for managing liquidity risk.

Based on the test KS described above, the data follow a normal distribution for all variables of the study, and the answers of the respondents are statistically significant at the level of significance (0.05), and by using the descriptive statistics (mean and standard deviation) to determine the level of application of the banks operating in Iraq, the key factors to manage liquidity risk, the arithmetic mean, which is located between (3.5-5) are of high-value, and less than (2.5) means having a low value.

In order to test the second hypothesis on the basis of the above table, the arithmetic mean and standard deviation of 3.875 and 0.664 significance level of 0.037, is an indication of a high level of application of the factors of governance in the management of liquidity risk. Based on the above results, the hypothesis is rejected while nihilism is accepted. The alternative hypothesis, states that banks operating in Iraq implement key factors to manage liquidity risk.

Third Hypothesis

HO3: does not use banks operating in Iraq to measure and manage liquidity risk.

The arithmetic average of the responses comply and the extent of the use of the appropriate tools to measure and manage liquidity risk for the banks in Iraq was found to be at 3.7268 and the deviation standard at.50796. The level of significance was at 0.0360 which is of a high level of use of banks in Iraq for the appropriate tools to measure and manage liquidity risk. Based on the above results, the hypothesis has rejected nihilism and accepted the alternative hypothesis, which states that banks operating in Iraq use the appropriate tools to measure and manage liquidity risk.

Fourth Hypothesis

HO4: The banks in Iraq do not complyto public disclosure about liquidity risk

The Arithmetic average of the responses sample regarding the degree, and commitment of the banks operating in Iraq's factors of public disclosure regarding liquidity risk is at 3.8039 and the standard deviation is at.57694 .0000. The level of significance and was found to be high for the Banks in Iraq's factors, pertaining to the public disclosure about liquidity risk. Based on the above results, the hypothesis has rejected nihilism and accepted the alternative hypothesis, which states that banks operating in Iraq are committed to the factors of public disclosure concerning liquidity risk.

Fifth Hypothesis

HO5: Does the regulatory bodies in Iraq play an active role in monitoring liquidity risk?

The arithmetic average of the responses Aferda based on the sample on the effectiveness of the role of regulative bodies in Iraq in monitoring liquidity risk is at 3.8039 and deviation standard is at .59039. The level of significance is at .220, a level that is higher than the significance level adopted (0.05). Therefore, the premise of nihilism is accepted, which states that regulative bodies in Iraq do not play an active role in monitoring liquidity risk. This is the logical result found for the global oversight bodies that must review the instructions of liquidity risk management which are currently internationally adopted brought about by the inadequacy of the global economic crisis after 2008.

10. Analysis of the relationship between independent variables and the dependent variables

The relationship between the independent variables and the dependent variable were tested using the Pearson correlation coefficient and the results are as follows:

The independent variable	Pearson's correlation coefficient	Kendell's tau-b	Spearman's rho
Governance, the significance level	0,625 0,000	0.476 0.000	0.538 0.000
Measurement and management level of significance	0,4680 0,001	0.249 0.037	0.288 0.040
Public disclosure	0,386	0.311 0.024	0.317 0.026
Regulatory bodies	0,449	0.302 0.016	0.346 0.017

It is clear from the above table that the relationship between all the independent variables, and the dependent variable relationship is positive and statistically significant at a confidence level of 5%. It was the strongest between governance and the application of liquidity risk factors, indicating the importance of commitment to corporate governance factors demanded by the Central Bank of Iraq, where the directory of governance was distributed to all Ukrainians and were urged to abide by them. The second Pearson's correlation coefficient measurement tools and management and the role of oversight bodies ranked last. The public disclosure factors for this arrangement differed when using other correlation coefficients, where was ranked last in the scaling factors and management.

The researcher calculated the coefficient of R Squared where 0.448, which shows that the statistical analysis was explained at 44.8% of the relationship between independent variables and the dependent variable.

11. Strategy for Liquidity Risk Management

The Board of Directors was to develop a strategy for managing liquidity which would be consistent with the general strategy of the bank. On the Bank's side for management, in order to ensure harmony among the strategic objectives of liquidity with the objectives of the operating assets of the bank, the structure of assets and liabilities of the Bank and the usability of trading and liquidity based on the levels of different customers for all products in the case of investment, finance and capital adequacy money were taken into account. (BIS). February 2000.

12. Liquidity Risk Management Policy

The bank developed the policy of risk management for liquidity , mainly: the role and responsibilities of the Board of Directors in the management of liquidity risk and the establishment of a unit in the bank concerned with the management of liquidity risk and to identify the functions and powers of this unit and to determine the limits of liquidity risk and to identify tools and methods of measuring and identifying and controlling and reducing liquidity risk and determining the policy of liquidity risk under the economic crisis. (BIS). September 2008.

13. Reasons for the Difficulty of Managing Liquidity Risk

There are many reasons for liquidity risk management pertaining to the difficult tasks faced by the departments of the banks, including the uncertainty of outward future cash flow that would be needed to cover the obligations as this may depend on external events which are not under the control of the bank and the difficulty faced in predicting the future This is especially so in conditions of economic crisis and the speed of worsening liquidity problems at the start of a particular event in the bank which in turn infers the existence of a liquidity problem for the bank. There is a point in time when the situation of liquidity is addressed. After this point, this would be impossible and could lead the

bank to bankruptcy in addition to non-adoption of the liquidity risk on capital adequacy. (Banque de France.2008)

14. Measuring liquidity Risks

There are four methods used to measure the banks' liquidity risk, namely:

(1) Net cash method which is based on a method whereby a list is prepared showing sources of liquidity and liabilities in the bank and which falls under the sources of liquidity: monetary assets and borrowing ceilings and cash reserves available over a period of time.

This falls under the use of liquidity which encompasses borrowed money from the money market and funds borrowed from the central bank,

(2) Methods of comparison like institutions which depend on the ratios and indicators of liquidity for the bank in terms of size and geographical location.

(3) Method of Bank for International Settlements (BIS Approach), which is a method recommended by the bank for International Settlements; Bank Of International Settlements (BIS) and depends mainly on the preparation of maturity and scenario analysis that also includes: select in flow of cash and outflow of cashfor all different categories of time including: Category I: day one up to (7) days, category II: (8) days up to one month, Category III: one month up to (3) months, Category IV: more than (3) months and up to (6) months, Category V: more than (6)months to a year and, Category VI: for more than a year. With this method, the daily financing needs of the Bank can be determined to assess the liquidity situation, through sensitivity analysis (Sensitivity Analysis) as well as by the method of analysis of different scenarios.

(4) The basic method of surplus and deficit liquidity that banks rely on, is the traditional method which involves the preparation of future cash flows that may fail to

meet the requirements for daily liquidity because cash flows according to the categories of time in excess of (30)days may not help the bank when it needs cash quickly. Therefore, banks have found that relying on conventional methods in the calculation of cash flows is useful. Banks have resorted to the development of the method of surplus and deficit of liquidity that takes into account the items within the budget as well as items off the balance sheet, and this method has proven its effectiveness for over(25)years in many international banks within and outside the United States of America. These assets start as Cash and the repository is given consideration for liquidity which includes all the assets that can be converted into cash within (30) days, whether they are already assets in the form of cash or near cash, or if it is possible to sell the level of loss or mortgage assets as collateral to get cash or extend the maturity for the next thirty days (Guglielmo R.Michael.2008).

There are eight questions based on liquidity risk management that are linked to the Management Committee regarding the assets and liabilities of the Bank) Asset-Liability Management Committee ALCO) which has been answered and they are as follows: (Guglielmo R.Michael.2008)

1 - What is the size of the liquidity that is available at the bank for the purpose of operating emergency reserves?

2 - What is the extent of dependence on this liquidity and what is the cost?

3 - What is the size of operational liquidity which the Bank may require in both the short- and long terms?

4 - How can the needs of the bank be met in terms of providing liquidity in the case of changing market conditions and economic conditions?

5 - What are the crises or events that may significantly affect the operational needs of the bank's liquidity and negatively affect the possibility of providing the bank with the cash requirements in case of an emergency?

6 - Does the bank’s early- warning system enable it to adequately take the necessary action before the problem occurs?

7 - What are the actions the bank may resort to in the event of a liquidity crisis? And for how long will the bank be able to continue to work normally?

8 - Are the bank's procedures and tools adequate enough to control and ensure the implementation of the action plans successfully?

If the bank's management is unable to answer the above questions, the management will need to develop positive action plans to face any liquidity risks that may occur.

15. Strengthen Liquidity Risk Management,

The management of liquidity risk in banks is becoming complicated day by day as more complications have risen due to the banks' balance sheets getting bigger and bigger in size. The following six steps may help to manage the Bank and strengthen the management of its liquidity risk (Ismal Rifki.2008).

1 - Determine the size of liquidity available to the bank to secure the Bank's ability in providing cash quickly (within 30 days) with minimum loss, and at an acceptable cost termed as the primary definition of liquidity.

2 - Determine the size of the liquidity needed by the bank, as it is important to understand the future changes that are projected in the budget of the bank and how these changes will impact the liquidity situation. The methods of prediction sources and uses of funds mentioned previously are useful in this area.

3 - Development of an early-warning system as it is necessary to develop a guidance system for early warning and risk indicators to enable the Department to identify the likelihood of liquidity pressure.

4 - Conducting tests to determine the circumstances that lead to financial needs and identifying the means provided by analyzing the income and values that are at risk. This is carried out through the practice risk management of the existing interest rates.

5 - Estimate the reaction of administration for each of the events expected in the circumstances of the economic crisis where it is necessary to form a team to manage the liquidity crises in the bank. The task of reporting to the Management Committee of the Assets and Liabilities (ALCO) and the Governing Council on their recommendations as how to manage liquidity under conditions of crisis economic development should also be adhered to..

6 - To document the procedures and examine the liquidity periodically. This is to eliminate the possibility of the loss of value of these procedures and documentation is considered important in the field of management control of liquidity and liquidity management operations and is also the reason for the use of certain measures and risk indicators.

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MALAYSIAN INTRA-INDUSTRY TRADE DETERMINANTS: COMPARISONS BETWEEN OIC AND NON-OIC TRADING PARTNERS

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Abstract

This paper investigates the determinants of intra-industry trade focusing on manufactured goods at SITC 3-digit level by using panel data analysis for the year 1995 to 2009. Country-specific determinants such as economic differences between countries, scale of economics, foreign direct investment inflows, geographical distance and trade imbalance are tested in the model. The analysis focuses mainly on intra-industry trade between Malaysia and its trading partners including OIC countries such as Turkey, Saudi Arabia, Iran, Pakistan and Indonesia. The results indicate that Malaysia's intra-industry trade is positively correlated with economic differences between countries, scale of economics and foreign direct investment inflows. The study also found the expected negative sign of geographical distances which confirms the hypothesis that trade decrease as the transportation costs increase. However, the intra-industry trade index between Malaysia and OIC countries are quite low compared to between Malaysia and the non-OIC countries. This paper concludes with discussion that more of appropriate and effective policies need to be formulated and implemented so as to generate more trade between Malaysia and the OIC countries.

Keywords: Intra-industry trade, manufactured goods, panel data, OIC countries

1.0 INTRODUCTION

Intra-industry trade is a simultaneous export and import of similar types of goods or services belonging to the same industry. The phenomenon of intra-industry trade received world's attention as early as in the 1960s. However, solid theoretical foundation explaining intra-industry trade came later in the 1980s and 1990s with the literature were broadly based on monopolistic competition framework.

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Intra-industry trade economic literature can be classified into two main groups. The first group focused on the intra-industry trade index measurement (see Grubel and Lloyd 1975) and the development of theoretical explanation of intra-industry trade which emphasize the role of product differentiation and increasing return to scale (see Krugman 1979, 1981 and Lancaster 1980). On the other hand, the second group (see Helpman and Krugman 1985, Stone and Lee 1985, Chemsripong et. al 2005 among others) focuses on the determinants of intra-industry trade in an econometric framework.

Greenway et. al. (1994) has group the studies of intra-industry trade determinants into two group namely country-specific studies and industry-specific studies. Country-specific studies explain intra-industry trade through macroeconomic variables such as per capita income, economic dimension, geographical distance, relative factor endowments and foreign direct investment. Meanwhile, industry-specific studies explain intra-industry trade through variables such as scale economies, product differentiation and firm's concentration ratio. Most empirical findings support the country-specific determinants compared to industry-specific determinants.

We have identifies several good reasons supporting the investigation on Malaysia's intra-industry trade particularly on manufacturing sector. Firstly, Malaysia is well known as one of the major trading country for manufactured products especially for chemical and chemical products, machinery, appliances and parts and electrical products. As pointed out by Marrewijk (2002) that the main characteristics of intra-industry trade is that intra-industry trade is particularly high for sophisticated manufactured products such as chemicals, machinery, and electrical equipment (which based on products differentiation and fragmentation). The second important empirical characteristics of intra-industry trade according to him is intra-industry trade is particularly high for very open countries where both imports and exports account for more than half of GDP; thirdly intra-industry trade is connected to foreign direct investment inflows; and finally intra-industry trade is related to preferential trade agreements. Malaysia has these characteristics, hence we perceive that it is relevant and significance to identify the determinants of intra-industry trade between Malaysia and her trading partners.

As for comparison, this study approach is to compare the intra-industry trade determinants between Malaysia and the OIC and non OIC trading countries using a balanced panel of manufactured products from 1995 to 2010. Following Shahbaz and Leitao (2010) in the static panel data models, pooled OLS, fixed-effects (FE) and random-effect (RE) estimators are used and the model is estimated in log-linear form. The rest of the paper is divided according to the following; literature review, research methodology, results and conclusion.

2.0 LITERATURE REVIEW

One of the most important characteristics which influence the volume of trade is the size of the economy. Helpman and Krugman (1985) pointed out that the larger an economy, the larger its' domestic market size and hence create greater possibilities to reap the economies of scale and increase the variety of products. A larger economy size also reflects a greater demand for foreign differentiated goods. They further pointed out that the share of intra-industry trade in manufactured goods tends to increase as the average market size of the two countries increase which is also due to the presence of economics of scale. Hence, this means that intra-industry trade tend to increase as the average economic size of two trading countries increase.

The similarity or difference in the size of economics of trading partners defines the ability of that country to produce differentiated products. Linder (1961) as noted in Shahbaz and Leitao (2010) among other interpret the difference level of income per capita as differences in demand structure i.e. consumers taste and preferences. It has been argued that as per capita income of two countries become equal, their tastes and preferences also become similar. Another view was pointed out by Helpman (1981) that a similar level of gross domestic products indicates the similar ability to manufacture differentiated products, hence if the size of economies of trading partners is similar they are likely to trade with each other.

Grubel and Lloyd (1975) and Greenaway and Milner (1986) among others had pointed out that in the presence of demand for different varieties of the same products with production subject to economies of scale, there may be a tendency for foreign direct investment and intra-industry trade to go hand in hand. On this ground then the association between the intensity of foreign investment and intra-industry trade is expected to be positive.

According to Grubel and Lloyd (1975) distance between trading partners serves as a proxy for costs of information necessary for trading non-standardized products. Therefore it is argued that distance will increase the transaction costs including insurance and transportation costs. Geographical closeness might also be a measurement of psychological and cultural similarities which have the possibilities of creating similar consumption patterns and increasing trade in differentiated products. Stone and Lee (1995) further noted that physical distance also acts as a natural trade barrier that deters trade proportionately more for closely substitutable products that for standardized products.

Measurement of intra-industry trade will be affected by the trade imbalance of a country (Grubel and Lloyd 1975). The greater the share of net trade, the smaller the share of intra-industry trade, therefore the Grubel-Lloyd index becomes smaller as the size of the trade imbalance increases. According to Clark and Stanley (1999) the estimated coefficient in the intra-industry trade regression equation will be biased if the trade imbalance is correlated with the explanatory variables. Hence the size of the trade imbalance is included in the analysis in order to control for any possible bias in the estimation.

Empirical investigation for the above mentioned country-specific determinants are massive and very rich. These studies include countries such as Australia (Matthews 1998 and Sharma 1999), Korea (Lee and Lee 1993), United States (Clark and Stanley 1999), Spain (Martin and Blanes 1999), Mexico (Ekanayake 2001), Thailand (Chemsripong et.al 2005), Turkey (Turkcan 2005), Portuguese (Faustino and Leitao 2007), Zimbabwe (Sunde et.a l 2009) and Pakistan (Shahbaz and Leitao 2010) among others. The empirical

findings from these studies show that the relationship between the trade index and the determinants are according to the theories described by the scholars. (Please refer table 1 in the appendix).

2.1 Malaysia's Intra-Industry Trade

Malaysian economy has always been trade dependent, influenced by both its major trading partners and the commodities prices. The rising share of manufactures in the total exports of Malaysia for more than three decades was proven to be a result of the growing volume of intra-industry trade flows.

Ariff (1991) as in Ariff and Chye (2003) estimated the intra-industry trade index at 3-digit SITC level for each of Malaysia's major trading partners with respect to manufactures over period from 1970 to 1987. The result indicate the rising indices at that particular period which shows significant increase in Malaysia's intra-industry trade with its major partners as early as the 1970s. The study identified a significant increased in Malaysia trade vis-a-vis the United States, the Northern Asian (NIEs) and the ASEAN partners. The growing importance of intra-industry trade during that period was attributed largely to the activities of MNCs. The MNCs operated in Malaysia had generated both exports and imports through their international investment and trading networks.

Min (1992), Thorpe (1993), and Duc (1994) as noted in Chemsripong et. al. (2005) had done similar analysis on Malaysia. Min (1992) examined the determinants of bilateral trade in manufactures between Asian developing countries namely China, Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan and Thailand and developed countries namely the United Kingdom and the United States. Thorpe (1993) also examined the determinants of intra-industry trade of three ASEAN nations namely Singapore, Malaysia and Philippines and their trading partners over the period 1970-1989. The result shows that the levels of bilateral trade between the countries appear to have risen not only with one another, but also with countries outside the region. Duc (1994) investigated the determinants of IIT between 10 Asia-Pacific region countries namely China, Hong Kong, Indonesia, Japan, Malaysia, Philippines, Taiwan, Singapore,

Korea, Thailand with the United States from 1980 to 1990. All these studies concluded that country characteristic factors such as income per capita and openness of the economy, capital endowment and economic size are important determinants of bilateral intra-industry trade between these countries.

Since 1996, some studies (see Menon 1996 and Khalifah 1996, 2000) had focused on the extent of intra-industry trade among ASEAN free trade area (AFTA) countries. Menon (1996) result shows that more than 75 per cent of the growth in Thailand's intra-ASEAN trade between 1986 and 1991 was due to intra-industry trade growth, while in Malaysia and Singapore the percentage was above 60 percent. For Indonesia and the Philippines, intra-industry trade growth accounted for almost half and one third of the growth in intra-ASEAN trade. This study concludes that not only intra-industry trade recorded rapid increased amongst ASEAN countries, but it also has became increasingly significant within these countries compared to with developed countries.

Khalifah (1996, 2000) investigates the extent of intra-industry trade in manufacturing sector and the changing structure of merchandise trade balance. The pattern of intra-industry trade show that Singapore's contribution is the highest followed by Malaysia, Thailand and Indonesia The result also shows that on top of other sectors, G-L index in the electronic sector increased from 28 per cent in 1990 to 45 per cent in 1997, and the electronic machinery sector sustained surpluses of between 4 to 6 per cent of total trade from 1992 until 1997. While the trade share of the primary sector decreased from 30 per cent of total trade to 16 per cent from 1990 to 1997.

Brulhart and Thorpe (1999) investigate the structure of East Asian trade flows over the high-growth period of 1970-1996. The result found that despite the different development levels of the four countries namely Korea, Malaysia, Indonesia and Philippines, the static intra-industry trade (Grubel-Lloyd index) and the marginal intra-industry trade has grown steadily over the period of study. In 2000, Brulhart and Thorpe again investigate the association between intra-industry trade and marginal intra-industry trade with employment changes in Malaysia between 1970 and 1994. The empirical

result showed that both trade indices exhibit continually increasing trends during the period studied. The steep and continuous increase in Malaysia's trade orientation represent by the total trade as a percentage of Malaysian GDP rose from 73.4 % in 1970 to 160.7 % in 1994. Hence shows that Malaysian trade expansions have gone hand-in-hand with an increase in the share of intra-industry trade.

As such we have calculate the intra-industry trade index for manufactured goods (SITC 5 to 8) and total all products (SITC 0 to 9), between Malaysia and non OIC trading partners as comparison to between Malaysia and OIC trading partners. The indices are as shown in Table 2 (please refer to the appendix).

3.0 RESEARCH METHODOLOGY

3.1 Intra-industry trade index measurement

The unadjusted Grubel-Lloyd (G-L) index is the most popular measurement and had been used by many empirical researchers. This method was introduced by Herbert G. Grubel and P.J. Lloyd in 1975. The index determines the extent of intra-industry trade using Standard International Trade Classification (SITC) at 3-digit level which measures the proportion of intra-industry trade in total trade rather than of the absolute amount of intra-industry trade itself. The IIT index is calculated as follows:

$$IIT_{ij} = [\, 1 - |X_{ij} - M_{ij}| / (X_{ij} + M_{ij})] \qquad (1)$$

where the subscript i denotes industry and the subscript j denotes country; X denotes exports and M denotes imports of the related industry and country respectively. The computed value of IIT_{ij} lies between 0 and 1. The closer the value of the index to 1 the greater is the degree of intra-industry trade.

3.2 Variables Description and sources

In the analysis we use intra-industry trade (IIT) index as the dependent variable and country-specific characteristics as explanatory variables. The intra-industry trade index between Malaysia and trading partner countries are calculated using trade data published by United Nation Comtrade Database (UNCTAD). The data set is annual and runs from

1995-2009. It consists of export from Malaysia and import to Malaysia from 8 OIC and 8 non-OIC partner countries, for manufactured goods at the 3-digit level Standard International Trade Classification.

The data for the explanatory variables is sourced from the World Bank and International Monetary Fund report, except the data for geographical distance's calculation which is sourced from CEPII (Geodesic Distance) website. As such, the explanatory variables are as follows:

1. Difference in economic size between trading countries – which is define as difference in gross domestic products $(PPP)^i$ in current international US dollars. The expected sign is positive.
2. Average economic between trading countries – which is define as average in gross domestic products (PPP) in current international US dollars. The expected sign is positive.
3. Foreign direct Investment - which is define as the foreign direct investment inflows in current international US dollars. The expected sign is positive.
4. A proxy for the geographical distance between trading countries - which is define according to Stone and Lee (1995) and Balassa (1986) as the average of the distances (in kilometres) between the two capital cities of both trading countries weighted by the size of the economy of the respective country. The expected sign is negative.
5. Trade Imbalance - which is define according to Stone and Lee (1995) as:

$$TIMB_j = [X_j - M_j] / (X_j + M_j)$$

where X_j is exports to country j and M_j is import from country j. So TIMB is approximately zero if trade with a country is balanced and one if the country either exports or imports exclusively. The expected sign is negative.

3.3 Model Specification

Following Shahbaz and Leitao (2010) and Faustino and Leitao (2007), the model is specified as follows:

$$LogIIT_{hjt} = \beta 0 + \beta 1LogDGDP_{hjt} + \beta 2LogAGDP_{hjt} + \beta 3LogFDI_{hjt} + \beta 4LogDIST_{hjt} + \beta 5TIMB_{hjt} + \varepsilon_{it} \quad (1)$$

where subscript h denotes 'home country' Malaysia, subscript j denotes each trading partner country individually and subscript t denotes year (t=1....15); IIT denotes the unadjusted Grubel-Lloyd index of manufactured goods at 3-digit level (SITC 5 to 8[ii] excludes 667 and 68); DGDP denotes the differences in per capita gross domestic products; AGDP denotes the average per capita gross domestic products; FDI denotes the Foreign Direct Investment inflows; DIST denotes the geographical distance between the two capital cities of the trading countries; TIMB denotes the proxies of trade imbalance; and Ɛìt denotes a random disturbance assumed to be normal and identically distributed (IID) ~ $(0, \sigma^2)$.

4.0 RESULTS

From the OLS regression estimation for non OIC countries, explanatory variables such as foreign direct investment, distance and trade imbalance are statistically significant with the directions as hypothesized in the previous section. R^2 (goodness-of-fit measures) for OLS estimation is 0.495 which indicate a quite high correlation between variables in the models. Although the coefficient computed represents statistically significant value, a potential problem that may arise in cross-sectional and time-series model is inefficient result attribute to heteroskedasticity and autocorrelation. As such, the test to identify these problems is conducted using the White's general test and Wooldridge test. The result failed to reject the null hypothesis of both test[iii] which produced chi^2 of 87.23 (p=0.000) and F (1,7) = 4.224 (p=0.000), respectively. Hence, the standard errors computed in the OLS estimation are biased and this will leads to bias in test statistics and confidence intervals.

The OLS coefficient estimate is also biased as the regression does not take into account the unobserved factors for country and time characteristics that are correlated with

variables in the model. Substantively, fixed effect and the random effect models are performed to study the causes of these changes. The statistic for Hausman test is $p = 0.000 < 0.05$, hence this leads to strong rejection of the null hypothesis that random effect provides consistent estimates and favours the fixed effect model. Fixed effects regression hold constant the average effects of each country over time and also control the average differences across countries in any observable or unobservable predictors such as product demand, price, taste and other factors. The fixed effect regression result in Table 3 (please refer to the appendix) shows that only distance and trade imbalance are statistically significant while differences in GDP, average GDP and foreign direct investment are not significant. Table 3 also shows the fixed effect regression result for OIC countries.

Result for OIC countries shows that the difference between per capita incomes which is used to evaluate the similarities in demand, taste and preference between trade partners; presents a statistically significant positive sign. This result is according to empirical studies by Chemsripong et al. (2005) and Faustino and Leitao (2009) which also found a positive sign. The findings also show a positive relationship between the index and the proxies for foreign direct investment which is consistent with Greenaway et al. (1994) findings.

5.0 CONCLUSION

The objective of the study was to analyse the determinants of intra-industry trade hence we adopt the methodology in previous studies by introducing the country characteristics into the gravity model. The econometrics estimations and the coefficient generated support the hypothesis as formulated. Difference in per capita income presents a positive impact on intra-industry trade which is consistence with the theory of differences in factor endowment while average per capita income as a proxy to describe economic dimension (in term of product differentiated and economies of scale) is proven to have positive influence on intra-industry trade and is also according to the literature. This study also found the expected negative sign of geographical distance to the literature which has then confirms the importance of distance in the gravity model.

The analysis of intra-industry trade pattern between Malaysia and OIC countries show that the trade extent are quite low compared to between Malaysia and the non-OIC countries particularly in the manufactured goods. Some of the reasons might be determine by the small sample size of the countries analysed and also the short duration of the period studied. However, we perceive that more of appropriate and effective policies need to be formulated and implemented so as to generate more trade between Malaysia and the OIC countries. For example, the policy related to priority and challenges of transport corridors (TC) among the OIC countries which is very significance in economic development and trade facilitation and the role of IDB group in facilitating trade among the OIC countries particularly on the issue of cross-border cooperation and roles of customs administrations.

Another important aspect of future research analysis is to focus on disentangle vertical intra-industry trade (VIIT) and horizontal intra-industry trade (HIIT). This distinction is important as pointed out by Kinnerup (2005); because the theories of both types of trade lead to contradictory hypotheses regarding the determinants however this approach was empirically under-researched previously due to lack of methods to delimit VIIT and HIIT from each other. Many empirical analyses had used total IIT as the dependent variable, hence as a consequent different econometric analyses had resulted in different conclusions. As such the findings of this paper can be improved if the econometric analysis or the measurement aspect is differentiated between vertical and horizontal intra-industry trade types.

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APPENDIX

Determinants	Expected Sign	Empirical findings
Average economic size (AGDP)	Positive	Matthers (1998) – positive Clark and Stanley (1999) - positive Ekanayake (2001) – positive Turkcan (2005) – positive Faustino and Leitao (2007) – positive Shahbaz and Leitao (2010) – positive
Difference in economic size (DGDP)	Negative/positive	Matthews (1998) – negative Martin and Blakes (1999) – negative Ekanayake (2001) – negative Turkcan (2005) – negative Shahbaz and Leitao (2010) – negative Chemsripong et al (2005) – positive Ferto and Soos (2008) – positive Leitao and Faustino (2009) – positive
Foreign direct investment inflows (FDI)	Positive	Martin and Blakes (1999) – positive Faustino and Leitao (2007) positive Shahbaz and Leitao (2010) – positive
Geographical distance between capital cities of trading partners (DIST)	Negative	Matthews (1998) – negative Martin an Blakes (1999) – negative Clark and Stanley (1999) – negative Ekanayake (2001) – negative Turkcan (2005) – negative Chemsripong et al (2005) – negative Sundae et al (2009) – negative Shahbaz and Leitao (2010) – negative
Trade imbalance (TIMB)	Negative	Ekanayake (2001) – negative Shahbaz and Leitao (2010) – negative

Table 2: G-L Indices for Intra-industry Trade between Malaysia and Selected Trading Partners

Year / Country	SITC 0 to 9				SITC 5 to 8			
	1995	2000	2005	2009	1995	2000	2005	2009
Non-OIC Countries								
United States	0.902	0.807	0.694	0.891	0.635	0.573	0.453	0.568
Singapore	0.781	0.789	0.754	0.766	0.904	0.972	0.970	0.915
Japan	0.613	0.853	0.892	0.999	0.502	0.862	0.848	0.827
China	0.934	0.966	0.827	0.949	0.935	0.673	0.717	0.845
India	0.796	0.546	0.432	0.633	0.783	0.632	0.613	0.984
OIC Countries								
Turkey	0.709	0.348	0.224	0.383	0.485	0.221	0.124	0.214
Qatar	0.949	0.612	0.720	0.752	0.970	0.412	0.536	0.90
Saudi Arabia	0.804	0.676	0.470	0.845	0.534	0.553	0.532	0.604
Iran	0.574	0.881	0.984	0.643	0.642	0.207	0.227	0.185
Kuwait	0.999	0.952	0.619	0.719	0.009	0.678	0.746	0.906
Oman	0.344	0.213	0.275	0.948	0.236	0.031	0.070	0.306
UAE	0.099	0.519	0.584	0.757	0.045	0.040	0.060	0.074
Association of South-East Asian Nations (ASEAN)	0.975	0.966	0.988	0.983	0.939	0.973	0.991	0.980
World	0.939	0.809	0.763	0.792	0.986	0.834	0.771	0.808

Source: Author's own calculation based on UNCTAD database (2010)

Note: SITC 0-9 (Total all products)

SITC 5 to 8 (All manufactured goods less SITC 667 and 68)

Table 3: Fixed effects Results for non OIC and OIC Trading Partners

Variable	FE[1] non OIC	FE[2] OIC
LogDGDP	0.1242	0.3816*
	(0.53)	(2.12)
LogAGDP	0.3807	0.0349
	(0.81)	(0.08)
LogFDI	0.0115	0.0451*
	(0.51)	(2.26)
LogDIST	-0.4813*	-0.2931
	(-2.07)	(-1.41)
TIMB	-0.7571***	-0.1420
	(-5.49)	(-0.83)
_cons	4.0261*	1.1832
	(2.48)	(0.77)
Observations	120	120

Notes: [1]t-values and [2]z-values are given in parentheses.

legend ; * p<0.05; ** p<0.01; *** p<0.001

DEBT ISSUES FROM ISLAMIC PERSPECTIVE ITS RELEVANCE TO ISLAMIC CAPITAL MARKETS IN NIGERIA

Auwal Adam Sa'ad[1]

Abstract

Different approach has been learnt from the narrated hadiths (traditions) of the Prophet Muhammad (SAW) concerning debt acquisition and its rulings. Some Prophetic traditions discourage debt while other traditions encourage it; the scholars of Islamic Jurisprudence from different Schools have demonstrate divergence of opinions on the issues concerning debt and its tradability under Shari'ah, this paper aims to analyze the issue according to the Maqasid Shari'ah and propose for a better application of Islamic Debt Securitization in Nigeria. The Nigerian first Sukuk issuance has come in a right time when most of the Islamic Financial Institutions experience several applications which some of them were criticized and such critics requires them to look for an alternative which I think will be a good chance for the Nigerian Financial Market to pick up for the success of its first Sukuk issuance which will be instigated within the year 2012. The paper will be proposing for better principles to be used by looking at the Malaysian and Middle Eastern experience on Sukuk issuances. The research will look at the Islamic Principles used by the Malaysian Institutions in structuring Sukuk and discussed issues such as Bay Inah and Bay al-dayn which has being extensively used by the Malaysian Financial Institutions, and will also look at their counterparts from the Middle East, and investigates the principles used by them such as Mudharabah and wakalah, and demonstrates issues which has being experience in its applications in other to proposed for a better Nigerian Emerging Islamic Financial Market.

1. Introduction

Different approach has been learnt from the narrated *hadiths* (traditions) of the Prophet Muhammad (SAW) concerning debt acquisition and its rulings. Some Prophetic traditions discourage debt while other traditions encourage it; the scholars of Islamic Jurisprudence from different Schools have demonstrate divergence of opinions on the issues concerning debt and its tradability under Shari'ah, this paper aims to analyze the issues on debt theories according to the *Shari'ah* and propose for a better application of

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Islamic Debt Securitization in Nigeria. The Nigerian first Sukuk issuance has come in a right time when most of the Islamic financial institutions were criticized and such critics requires them to look for the alternative or modifications. The paper proposes based on the Malaysian and Middle Eastern experiences a better approach on Sukuk issuances. The research focuses on Islamic Principles used by the Malaysian Institutions in structuring Sukuk and discusses issues such as *Bay Inah and Bay al-dayn* which has being extensively used by the Malaysian financial institutions, and their counterparts from the Middle East. The paper also discusses controversial instruments such as *Tawarruq al-Munazzam* and demonstrates criticism which is being experience in its applications; this will enable new players like Nigerian Emerging Islamic financial market to start with right footings for a more desirable outcome.

2. Literature Review

Definition of *Dayn* (Debt)

Dayn (Debt) is an Arabic word derived from the same root with *din* means submissiveness or disgrace. *Dayn* in Islamic Jurisprudence has various definitions, *Ibn Nujaim* defines *Dayn* as essential certain liability. *(Kuwait Encyclopedia of Fiqh, vol.21 p.102)* Based on this definition, *Dayn* includes assets and non asset such as *hajj, nazar* and fasting. It was narrated by *Bukhari* and *Muslim* that a woman came to the Prophet (SAW) and Said O the prophet of Allah my mother is dead and failed to perform fasting of a whole month, the Prophet (SAW) said: "what you think if she dies with a debt, are you going to pay for it? She said yes, the Prophet said the debt of Allah has more privilege to be paid up" *(Sahih al-bukhary, vol.3 p.46 Hadith 1953)*

Debt has been addressed negatively by Prophet *Muhammad* (SAW) in the pre-Islamic era, the Prophet refused to pray *Janazah* (funeral) for a person who dies with debt of three *Dinar, Abu Qatada* said O the Prophet of Allah, please pray for him and I will pay the debt on behalf of the deceased , then He prayed for him" *(Sahih Al-bukhary, vol.3 p.128 Hadith,2289)* However, after Islam has dominated most of the Arabian Peninsula,

and prosperity was all over the Islamic empire, the prophet peace be upon him demonstrates in another *Hadith* that, whoever dies and leaves wealth will be given to his heirs, but whoever dies with a debt I will be responsible. *(Sahih al-bukhary, vol.3 p.128 Hadith 2298)* These two different context enlighten to a parallel guidelines for the doctrine of debt in Islamic Law, which has an important role to play in determining the fate of Islamic debt securities as applied in the Islamic capital market, which are discussed in this paper.

The Concept of Debt According to the Prophetic Traditions

Different approach has been learned in the narrated *hadiths* of the Prophet (SAW) concerning debt under Islamic Law. Some prophetic traditions discourage debt while other traditions encourage it; here are the traditions which discourage debt, followed by the ones that encourage its practice.

Prophetic Traditions (Hadiths) which discourage debt

It was narrated that *Aisha* may Allah be pleased with her said: "The prophet (SAW) used to say: *"O Allah I always seek your protection upon sins and debt"* then one of the companions said how often you ask for the protection on debt, *then he said: "because when a person owes debt he speaks and lies and made vague promises". (Sahih al-bukhary, vol.1 p.221 Hadith,832) Abu Qatadah* may Allah be pleased with him said: "A person comes to the prophet of Allah and said O the prophet of *Allah* what you think if I am killed in a battle for the sake of *Allah*, do you think Allah will forgive me, the prophet said "*Yes*" when the person on his way out, the Prophet called him back and said: "*Yes except debt"* this is what *Jibril* has just said. *(Sahih Muslim vol.6 p.37 Hadith 4988)*

Muhammad bin Jahsh may Allah be pleased with him said: One day we were at the *Janazah* with the Prophet of *Allah*, He looked up to the atmosphere, and looked down later and said "blessings are from *Allah*, what *Allah* has revealed very severe? Then we kept quiet, we then leave for our homes, until the next day I ask Him what was revealed very severe? He said that's on debt, I swear with the one holding my soul, if a person will be killed for the sake of Allah, and then brought back and killed again and then brought

back and killed, while he owes debt, he will never enter *Jannah* (paradise) until it is paid for him" *(Sunan al-nasa'i, vol. p.201)*

Jabir May Allah please with him said: A man dies during the prophet's time and we prepared him and brought him to the Prophet for *janazah* prayers, he makes a step, then ask, did he owes debt? We said only two *dinar*, then he leaves, Abu *Qatadah* promised to pay the two *dinar*, the Prophet said *Allah* has waived the liability from the deceased. He said yes, and then he prayed for him. A day after, the Prophet asked *Abu Qatadah*, what about the two dinar? He said he just died yesterday, the other day the Prophet asked again, he said I already paid, and then he said, now that his skin got relief." *(Musnad Imam Ahmad bin Hanbal)*

Umar bin Khattab may Allah please with him said: "beware of a debt, because it begins with distress and ends with war" *(Muwatta sharh zarqa vol.20 p.75) Imam Al-Sarkasi* said: "Debt is a starting point of hostility especially in our time; it can cause the loss of lives and wealth, especially the debt on bankrupts". (Mabsut vol.20 p.88) *Muawiya* May Allah pleased with him said: "the slavery of a free man is *Dayn*" (Shuabil Iman vol.4 p.404) *Umar bin Khattab* May Allah please with him also said to *Humran, "O Humran* beware of Allah, do not die with a debt, because it would be taken from your good-deeds, no *dinar* no *dirham*" *(Musnad Abdurrazaq, vol.3 p.75)*

Prophetic Traditions (Hadiths) in favor of Debts

Some *hadiths were narrated in favor of debt,* It was narrated by *Muhammad Bin Ali who* said*: "Aisha* May *Allah* please with her, has taken a loan; they ask her why you borrowed? She said I heard the Prophet of *Allah* saying that whoever borrowed with a zeal to pay back, Allah will help him, and I am looking for such kind of help" *(Ahmad bin Hambal)* It was also narrated by *Ubaidillah bin Abdullah* bin *Utbah* that the wife of the prophet *Maimunah* May Allah be pleased with her owed a debt, then they ask her why you owed debt and you have no source of paying back? She replies: "I heard the

prophet of Allah saying that, "whoever owed debt and has the zeal to pay back, will be helped by Allah"(Sunan Nasa'i)[2]

Similaly, Abu *Hurairah* May Allah be pleased with him reported that the Prophet peace be upon him said "whoever owed people's money with intention to pay them back, the Almighty Allah will pay for him, but whoever owed it with an intend to waste it, the Almighty Allah will waste him too" (Sahih al-bukhari, vol.5 p.45) It was reported that *Abdullah* bin *Jafar* said, the Prophet of Allah said: "The Almighty Allah is always together with a person who owes debt until he pays back, if the debt is not what Allah has dislikes" he said *Abdullah bin Jafar* used to ask his storekeeper to borrow for him, he said I don't want to live a day without being with Allah, since I heard the *hadith* from the Prophet (SAW)" *(Umdat al-qari, vol.5 p.185)*

The practice of the Prophet (SAW)

Other *Hadiths* naratted how the Prophet of Allah owes debt by himself, it was reported by *Abu Rafi* May Allah be pleased with him said, "The prophet of Allah owed *Bakr*, when the camels of *Sadaqah* arrived, He ask me to pay back the *bakr* I checked around but I could not get it, unless elderly camel, the prophet said give him the elderly one, the best among you is who paid with better than what he owes" *(Muwatta Imam Malik Hadith No.5041) Imam Ibn Abdilbar* commented on this *hadith* and said: it could be learnt that lending is based on devotion, God-fearing and lawfulness, but lending is not allowed if it is based on squandering and unlawfulness.*(al-tamheed vol.4 p.69)* It was also reported by *Aisha* may Allah be pleased with her said "the Prophet of Allah bought a foodstuff from a Jew, and gave away his war dress as collateral" *(Sunan al-baihaqi, Hadith No.3692)*

It was narrated by *Abdullah bin Rabi'ah* May Allah please with him said: "the Prophet of Allah peace be upon him owed me forty thousand, and when he gets the money he paid it

[2]Albani said "the Hadith is pure with its various collections" Sheik Arnaud also said the hadith is pure, look at: *Al-Ihsan bi taqrid Ibn Hibban,* hadith 5041.

to me in cash and then said: May Allah puts his blessings in your wealth and family, and indeed the rewards of debt is praise and payment" *(Nasan'I, Jamiul Usul vol.4 p.464)*

Sale of Debt

Sale of debt has two different applications; firstly, where the debt is sold to the debtor. Secondly, is where it sold to a third party who has no connection with the debt. In the two applications it also depends on when the debt is sold on the spot or based on the installment plan. Firstly, selling debt based on installment plan it's called *bay kali bil kali,* the messenger of Allah (SAW) prohibits this type of transaction*. (Nailul autar, vol.5 p.156)* It is also reported that *Ulama* have a consensus that bay *dayn* bi *dayn* is prohibited no matter whether it is sold to the debtor or to the third party. *(Alfiqil Islami wa'adillatuh vol.5 p.89)* The example of selling debt to a debtor is where a party stated that I bought a kilo gram of wheat from you for a *dinar* and the payment and receiving the wheat would take place after a month. *(al-fiqhil Islami wa adillatuh p.89)* or where a party bought something from a seller for installment, and when the stipulated time elapsed and the buyer doesn't have the money to pay as scheduled, the buyer will then request from the seller to resell the subject matter for another time with additional cost, and buy the subject matter without collecting it, which is *riba,* based on the principle of "*increase the time in exchange with an increase of the price"*. However, if the debt is sold in another form such as selling debt of one thousand in exchange of goods, there is no prohibition because it is regarded as *sulh*. The example of selling debt to a third party is where a person said to another I sold you twenty kilo of wheat which I own, but it is now borrowed by so and so person for a specific price to be paid after a month. The sale is invalid because the subject matter could not be transferred to the buyer. *(Subulussalam vol.3 p.45)*

Sale of debt in cash on the spot, the scholars of Islamic jurisprudence have different opinion on this issue as follows:

Firstly: Sale of debt to debtor, the four Islamic scholars of Islamic jurisprudence legalized sell of debt to the debtor or giving out the *dayn* as gift to him, because the reason why

sale of debt for debt is not applicable is because of failure to transfer the sold debt to the buyer, but in this case there is no need of transferring the subject matter. *(Badai alsana'I, vol.5 p.90)* The example of this is where a debtor sells his debt to the creditor for a different or equivalent amount; this is permissible. *Ibn Umar* said that"I went to the prophet (SAW) and said O Prophet of Allah, I used to buy and sell camels at *Baqi*, and sell them for *Dinar* coins and I collect *Dirham* and sell for *Dirham* and collect *Dinar*, the Prophet said there is no problem if you collect them on their present value and departed without any remaining liability"*(Sunan Nasa'i Hadith No.6180)* that means the *Dinar* that he did not collect remains debt on the debtor, since the buyer doesn't have *Dinar* to pay for the camel he then collected *Dirham* according to its present value. However, *zahiriyyah* disapproved sale of debt to a debtor arguing that it includes an excessive risk, *Ibn hazam* said because it involves selling unknown item which regards it as spending people's wealth unjustly. *(al-muhallah vol9 p.7)*

Secondly, sale of debt to third party, the *hanafi* school of jurisprudence argued that since it is not applicable to sale something which cannot be delivered, then selling debt to the third party is also not applicable because of seller's inability to deliver the sold item, even if he laid a condition to deliver, because his condition is to be fulfilled by other person, which is invalid. *(al-bada'i al-sana'i vol5 p.90).* However, some scholars from *Shafii* School legalized sale of stable debt *Mustaqir*, to the debtor and third party before taking position, they argued that, in general the ability of paying debt will prevail since there is no objection from the side of the debtor.

However, if the debt is not stable such as debt based on *Salam* is not allowed to sale before taking position, because in Salam contract there is possibility that the debt might be lost, therefore the contract of sale will not be valid. *(al-fiqhil Islami wa'adillatuh vol.5 p.91)* But if the debt is a price of a sold item, then it is permissible to sell it before receiving it, with the conditions of executing the contract instantly, and sale it on its present value, this is according to *hadith Abdullahi bin Umar*. *Imam Annawawi* said: "Selling debt to third party is not applicable" However, the *Hanbali School* of jurisprudence in one of its two views of the *mazhab* legalized the sale of stable debt

mustaqir, to the debtor such as borrowed capital or dowry, and disapproved selling debt to third party together with donating debt to third party too, because donation *hibah* requires the existence of *hibah* item. It is also not applicable to sell a debt which is not stable *mustaqir* such as payment of lease property *Ijarah* before the duration stipulated for *Ijarah* and dowry before join-up and *Salam* contract before taking position. *(al-fiqhil Islami wa'adillatuh vol.5 p.91)*

The *Maliki* School of Jurisprudence legalizes sell of debt to third party with eight conditions which make it far away from *Garar* (excessive risk) *riba*, and other prohibitions such as sale of food-stuff before taking position, but these conditions were amalgamated in to two following conditions: Firstly: the sale of debt contract should not lead to the *riba* (interest) and *garar* (excessive risk) the sale contract should be effective on the things which could be sold legally before taking position, such as borrowed money and not food-stuff and should be sold and the price should be given on the spot and it should not be based on future payment to avoid selling debt for debt, and the price should be different from the debt sold or if it is the same then it should be equal, to avoid *riba* involvement, and the price should not be silver if the debt sold is gold. *(al-sharh al-kabir, hashiyat aldasuqi vol.3 p.63)*

Secondly: If the most probable anticipation is that the debt would be paid up, this is if the debtor is in the premises of the contract so as to know the debtor's ability or inability of paying the debt and the debtor agreed to have owed the debt owner, disputed debt is not eligible according to these conditions couple with the debt owed by a bankrupt and there shouldn't be hostility between debtor and debt buyer.*(al-sharh alkabir and hashiyat al-dasuqi vol.3 p.63)* So as to protect the interest of the debtor.

Sale of Debt According to Ibn Qayyim Al-Jauziyyah

Ibn Qayyim Aljawziyyah differentiate *Bay al-Dayn for Dayn (debt for debt)* from *Bay kali bil kali,* arguing that there is no Qur'anic verse or prophetic tradition (*Hadith*) which expressed the prohibition of *Bay al-Dayn bi Dayn* the *hadith* reported on this matter is on *Bay kali bil kali* which are different from each other. According to *sheik Ibn Qayyim bay*

kali bil kali is to sell a deferred *Dayn* which is not being received, and both the *Dayn* and its equivalent are postpone, such as to contract *Salam* with a deferred debt which is not in your custody, this type of debt selling is prohibited according to all Islamic Scholars. *(Ilamul muwaqqi'in an Rabbil Alameen, vol 2 p.)*

However, *Bay Dayn bi Dayn* according to *Sheik Ibn Qayyim* is different from this, he classifies it into three different applications as follows: *Bay Saqit bi Saqit (Sell of dropped debt with dropped one)* this type of debt called *al-Muqassah* is where a party owed a debt to another party and the partner also owed him equivalent amount of debt, both debts are dropped because there is no need of paying each other since every party owed the same amount to the other party. This type of debt will be discussed later in advance. *Bay saqid bi wajib (sell of dropped debt with mandatory)* is where a debt owner sells his debt to his debtor for a debt he owed him but different from the original debt, the first debt is dropped and the second one is sold with equivalent. *Bay wajib bi saqid (sale of mandatory debt with dropped debt)* is where a party entered into *Salam* contract of ten kilo grams of wheat in exchange of ten *Dirham* debt which he owed him. The first contract is eliminated with the effect of the second *Salam* contract which prevails. *(Ilamul Muwaqi'in an Rabbil Alameen, vol.2 p.9).*

Ibn Qiyyim said: consensus of opinion was reported on the invalidity of these applications; however, there is no consensus on it, our *sheik (Ibn Taimiyyah)* said that and he chooses its validity and that is the correct opinion since there is no any prohibition neither by its meaning nor its application and it is not *bay kali bil kali,* which the contract has not benefit both of the parties because both the sold debt and its equivalent are in deferred manner, but in *bay dayn bi dayn* each of the three applications, has a valid intention and value, this is clear in the issue of *Muqassa* because both debtors will be freed from debt liability, and this is a valid target anticipated by the lawgiver. In the last two applications one of the debtors is hurrying to free himself from liability and the other one is gaining from the sale contract, and if it is lawful for one of them to take the liability and the other one utilizes from the deal, such as in the contract of selling tangible item with debt, then it is lawful to free himself from the liability and move such liability

to another liability, and this is not *bay kali bil kali*, however it is *bay dayn bi dayn* which lawgiver did not prohibit neither its meaning nor its applications. However, general rules of Islamic jurisprudence facilitate its compatibility. *Hawalah* for example requires transferring debt from a debtor to a third party which is lawful, therefore if he moves his debt to another debt in which he is accountable then it is even more qualified to be accepted. *(Ilamul Muwaqi'in an Rabbil Alameen, vol.2 p.9)*

Al-Muqassah

Al-Muqassah in Arabic language means equality. *Sheik aldardiri* identifies *al-Muqassah* as waiving a debt that you owed a debtor in exchange with a debt he owes you on condition. *Ibn al-qayyim* defines it as dropping one of the two debts with its similar kind and quality. *(Ilamul muwaqqi'in Anrabbil Alameen, vol.1 p.321)(al-sharh al-kabir vol3 p.447) Al-muqassah* is endorsed by the consensus of Islamic scholars, their consensus is based on *Hadith* reported by *Abdullah Ibn Umar* said: "I went to the Prophet (SAW) and ask him I used to buy and sell camels at *Baqi*, and sell them for *Dinar* coins and I collect *Dirham*, and sell for *Dirham* and collect *Dinar*, the Prophet (SAW) said there is no problem if you collect them on their present value and departed without any remaining liability" the *hadith* legalizes the swap of original rate to another. *Al-muqassah* is only applicable on two debts; there is no *al-muqassah* between two properties *(Ain)* or between debt and property. There are two different types of *muqassah* as follows: *al-muqassah al-jabriyyah* (mandatory) and *al-muqassah al-ittifaqiyyah* (consensus).

Al-Muqassah Al-Jabriyyah

It is the type of *muqassah* which automatically waive liabilities of parallel debts acquired by two debtors to each other with similar value, amount, duration and postponement period, and it is not based on request of one or both parties. *Al-muqassah aljabriyyah* is accepted by the *Hanafi Shafii* and *Hanbali* Schools of jurisprudence under some conditions. However, the *Maliki* School did not approve this type of *muqassah* except if it is based on request or agreement between the parties. (*Al-Khattabi vol.4 p.539)* There are four conditions of *al-Muqassah al-jabriyyah.* Firstly, debts harmonizing, meaning that each party has to be a debtor and creditor to his partner at the same time. (Al-fiqhil Islami

wa'adillatuh, vol.6 p.242) Secondly, similarity of the debts, the two debts most shared similarity in kind, type and maturity. If the debts are of different kind, types and maturity or one of them is immediate and the other one is deferred, in these situations, the *al-muqassah* is not applicable according to the *Hanafi School* of law. However, according to *Maliki* School of law, if the diversity is in type, *al-muqassah* is applicable such as currency and goods or food. *Dinar* and *Dirham* are different types according to the *hanafi Shafii* and *Hanbali* schools, but in the case of *al-muqassah*, they are regarded as one type based on *istihsan* principle by *hanafis*, therefore variation of currencies that we have today will not prevent *al-muqassah* according to *Hanafi* School of jurisprudence.

However, according to *Shafii* and *Hanbali* Schools, currencies of different types are still regarded as different; therefore *al-muqassah* is not applicable if the debts are of different currencies. *(Al-fiqhil Islami wa adillatuh, vol.6 p.242)* Thirdly, diversity in the purpose of acquiring debt, it is not a valid condition for *al-muqassah* to have an identical source for the debts, such as debt through lending and debt through buying and selling. Furthermore, if one of the grounds of the debts is lawful such as trading and the other one is unlawful such as grabbing or both of them are unlawful, *al-musaqah* is applicable (Al-fiqhil Islami wa'adillatuh vol.6 p.242). Harmless deal should be applicable, it is a condition of *al-muqassah aljabriyyah* not to harm any of the two parties, for instance *al-muqassash aljabriyyah* is not applicable if one of the parties is a wife and the husband demanded *almusaqah* in exchange with a debt she owed him for compulsory expense in the time of hardship.

Fourthly, there should be no prohibitive activity in *al-muqassah aljabiriyyah*, such as separation before taking position of *Salam* contract, or using *Salam* capital before acquiring it, and failing to collect in the contract of currency exchange, or *ribawi* items which has to be hand to hand and so on.

Al-Muqassah Al-Ittifaqiyyah

Al-muqassah Al-Ittafaqiyyah, is another type of *al-muqassah* which is based on consensus of the parties, this type of *muqassah* is lawful if it did not contain any sanction according to *Shari'ah*, it is also allowed if the debts are of different types or identical, or

one of them is a debt and the other one is *Ayn* (material good) *(al-fiqhil Islami wa'adillatuh, vol.6 p.246).*

Prohibited Al-Muqassah

Almuqassah could be prohibited if it contradicts one of the conditions provided by Shari'ah, and this could be seen in various currencies exchange contracts, *Salam* capital, *Salam* material-good or if *riba* is detected in *al-muqassah* contract even if there is agreement between the two parties of *al-muqassah*. The prohibited *al-muqassah* is elaborated by *sheik wahba al-zuhaili* in five categories as follows:

1- *Al-Muqassah based on Al-Sarf* (currency exchange) if *al-muqassah* is based on debts acquired through the contract of exchange which is not finalized and the parties leave the place of contract then the contract of *al-muqassah* is prohibited. This is because the contract of exchange itself is prohibited due to the violation of its rules that it should be executed on the spot and hand to hand rules.

2- *Al-Muqassah* with *Salam* capital, the *Hanafi, Shafii* and *Hanbali* schools have a consensus that *Al-Muqasah* based on *Salam* capital for another debt is prohibited, it is identical whether the debt contract taken place before or after *Salam* contract, because *al-muqassah* here is paid in exchange of *Salam* debt which is not being acquired yet by the debtor. There must be a collection of the entire *Salam* capital at the place of contact.

3- *Al-Muqassah* with *Musallam Fih* (the goods used in exchange for Salam capital) *al-muqassah* is not applicable in *Musallam fihi*, the example is where a party entered into a *Salam* contract for a ten kilo of wheat in exchange of immediate ten *dirham* and the other party also entered into another *Salam* contract with his partner for another ten kilo of wheat in exchange of ten *dirham*, this is invalid because it is a sale of an item before taking position, none of them acquire the ten kilo of wheat, they only collect a debt on its behalf, and it is not permissible for each party to take anything except his *Salam* capital or *Musallam fihi*, if one of the debts is based on *Salam* and the other one is a debt originated from lending there will be no retribution on the spot, because one of them is deferred and the

other one is immediate, an immediate is better than deferred so there is no equality and *al-muqassah* means equality.

4- *Salam* capital after dismissal of *Salam*, *al-muqassah* is also invalid based on *salam* capital after dismissal, the ruling of *Musallam fihi* is applicable to the *Salam* capital after dismissal, except if it is being collectively obtained.

5- *Riba* suspicion, the Islamic scholars have consensus on the prohibition of anything which is *riba* suspicious, and any lending which facilitate to an increase is *riba* and it's prohibited. *(al-fiqhil Islami wa adillatuh, vol.6 p.250)*

Al-Hawalah

Al-hawalah in the Arabic language means transfer and change. Technically, *hawala* is a transfer of debt from a liability to another liability.(Tabyin al-haqa'iq vol.4 p.1171) *Al-hawalah* could be debt or other rights. Islamic scholars agreed upon the applicability of *hawalah* which is based on prophetic traditions, consensus and analogy. From the prophetic traditions, it is reported by *Imam Albukhari* and Muslim narrated by *Abu hurairah*, that the prophet (SAW) said: "An overlooking by a wealthy is persecution, and if one's right is transferred to a wealthy, he should follow" *(Sahih al-Bukhari, Hadith No.2287) al-hawalah* like *kafalah* (guaranty) because grantor and transferor have taken the responsibility and they are able to deliver, and both are ways to facilitate debt payment, and since *kafalah* is allowed *al-hawalah* will follow. *(Al-Mugni vol.7 p.56)*

There is divergence of opinion between scholars on the issue of *al-hawalah* whether it is a sale of debt, dependent contract or it's just a way of transfer of right and not a sale. Scholars from *Maliki*, *Shafii*, *Zahiri* and some of *hanafi* scholars of the opinion that *al-hawalah* is a sale of debt for debt, however they legalized it because people are in-need of it and its regarded as forgiveness by lawgiver that facilitate its application. *Sheik Ibn Rushd* of *Maliki* school indicates that, *al-hawalah* is a valid contract and exception from *bay dayn bi dayn.(Bidayaul Mujtahid wanihayatul Muqtasid, vol.2 p.229)* However, according to *Sheikul Islam bin taimiyah*, *Ibnul Qiyyim* and some *Shafii* scholars, *al-hawala* is not a sale contract and it is an execution of transferring of right and that's why the Prophet (SAW) did not indicates a sale contract in the *Hadith* what he mentions was

only the transfer of debt he said:" "*An overlooking by a wealthy is persecution, and if one's right is transferred to a wealthy, he should follow*" (MAj'mu fatawah Ibn Taimiyyah, vol.20 p.512)

Another opinion by *Hanbali School* and also the reliable opinion of *Hanafi School* is that *al-hawalah* is an Attachment contract *(Aqd Irfaq)* which is a separate contract and approved for a special reason, people are in-need of it and it is not connected to any other contract or actions. However, *al-hawalah* resembles *bay* (sale contract) but it is not a sale contact, it also resembles *Kafalah* (guaranty), *wakala* (egency) it has a feature of *tabarru* (donation) and *Muawabah*. (Exchange contracts) The rules of *Al-hawalah* could be varied according to the resembled contract.*(al-ashbah wal naza'ir Suyudi, p.461)* Scholars also varied on the issue of acceptance of *Muhal Ilayhi* of a debt owner whether it is *wajib* (Mandotary) or *Mandub* (recommended) or *Mustahab*, The H*anbali* scholars made it mandatory for the debt owner to accept and comply with the transfer, their opinion is based on the *hadith* "And if one's right is transferred to a wealthy, he should follow" and the Prophet instruction here is for *wujub* (mandatory).

However, the *Hanafi* school regarded it as *Mubah* (permissible) arguing that there are among the wealthy people who are overlooking and manipulating people's rights and properties, and this is a harm that lawgiver will not ask to be comply with, instead He will ask people to stay away from it. The *Shafii* and *Maliki* and the majority of scholars regarded *al-Hawalah* acceptance as *Mustahab* (recommended). *(Mugni al-Muhtaj, vol.2 p.193 and al-muhallah vol.8 p.108)*

Suftajah

The word *Suftajah* Persian used by Arabs and derived from the word *Suftah* means something regulated. This type of debt called *suftajah* because of its regulations and strains. Technically is where a party pays a debt to a wealthy in other to pay it to the third party in another town, the payment is based on debt and not based on trusteeship, so as to mitigate the risk of losing the morning while traveling. *(Rad al-Muhtaj, vol.21 p.254)* It has other different terminologies; such as *riq'ah*, *kitab* or *Sak* which is written by a debtor

to the creditor or his agent leaving in another town. *Suftajah* is classified into two: *(Qardun Mahadh)* pure-debt and *Hawalah* (transfer of Debt). *Qardun Mahadh* is where the contract of *Suftajah* being executed between creditor and debtor for the payment of debt liability. *Suftajah* based on *hawalah* is where the process of paying debt includes transfer of liability to a lender residing in the town of a debtor which owed the original lender. *(Encyclopedia of Fiqh Mua'malat vol.2 p.61)*

The scholars of Islamic jurisprudence have divergent opinions in regard to the acceptability of *Suftajah* into four different opinions as follows: Firstly: *Suftajah* is not applicable if the payment of the debt is conditioned to be paid in another town, because at that point it becomes a debt which causes a utility which is prohibited. However if it is not condition in the contract then it is permissible. Because giving out charity of the utility by a debtor to the lender is of good performance and it's recommended, this is the opinion of *Shafii* and *hanafi* schools. Secondly: *Saftajah* is not applicable except if there is a necessity, which is where if a debtor did not exercise *Suftajah* can lead to the lost of his wealth. Then it is permissible based on Shari'ah interest of protecting wealth which is favored than the corruptive debt which causes a utility, this is the opinion of *Maliki* School of Law. *(Encyclopedia of Fiqh Mua'malat vol.2 p.61)*

Thirdly: The *Hanbali* School of the opinion that *Suftajah* is not applicable if the contract includes a condition of transfer of debt to another town and it is costly to transfer it to that town. However, if the transfer of debt is not costly then it is allowed. Fourthly, *Suftajah* is applicable even if there is a condition that payment should be done in another town because there is no increase of the value of the debt since both parties have benefit and advantage compare to *Rahn* (Mortgage) this is another opinion of *Imam Ahmad bin Hanbal* and supported by *Ibn Qudamah, Abu Ya'ala* and *Ibn Taimiyah* from *Hanbali* School, and also supported by *Ibn Hakam* from *Maliki* School. *(Encyclopedia of Fiqh Mua'malat vol.2 p.62)*

This opinion might be favored because there is no increase to the debt itself it is only an advantage of having the money as a debt in which the debtor might use it to buy

something and sell in the town of lender, and another advantage for the debt payer in mitigating the risk of traveling the money to another place, since there is no *Riba* or oppress from both parties then it is allowed, Allah the Almighty said: *"And cooperate in righteousness and piety and do not cooperate in sin and aggression" (Qur'an, ma'idah verse 2)* and the contract of *Suftajah* is a cooperation in righteousness and piety and there is no sin and aggression then it is allowed.

Al-Ibra

Al-Ibra in Arabic language means clearance, redemption or to stay away from something, according to the Islamic Jurisprudence *Al-Ibra* is a voluntary drop of a debt on a debtor by a creditor. If the right or debt is not own by the creditor it is not regarded as *Ibra*. *(Encyclopedia of Fiqh Mua'malat vol.2 p.102)* Ibra has two different interpretations by the Islamic scholars; it contains the meaning of drop of the debt by creditor and the meaning of transfer of ownership of debt by the debtor. The scholars have divided based on these two interpretations. The *Hanafi* School upholds the meaning of drop of the debt and transfer of debt tenure to debtor, and based on this, the School stressed that *Ibra* is not applicable on *Ayn* (object) because the ownership of object cannot just be dropped, but instate it remain under the possession of its owner.

Ibra is also not applicable on sold objects, because the drop of its ownership is not acceptable. However, the *Maliki* school of the opinion that *Ibra* is a transfer of ownership which is based on *hibah* (endowment) principle; therefore it requires a statement of acceptance by the debtor. *(Al-Qarafi, Al-Furuq vol.2 p.111 and Hashiyat al-Dasuqi vol.4 p.99)* The *Shafii* School of the opinion that *Ibra* is an ownership given to the debtor on the debt under his custody, therefore both the debtor and creditor must be attentive to it, however some *Shafii* Scholars maintain that *Ibra* is a drop of debt tenure to a debtor. The *Hanbali* School of the opinion that *Ibra* is a drop of debt by creditor, and there is no objection for anybody to drop his right or make it endowment, the Prophet (SAW) talk to creditors to drop debt owed by *Jabir* (RA).*(al-Mugni vol.4 p.483) Ibra* is *Mandub* (recommended) because it is part of kindness that includes drop of debt owed by a debtor even if the debtor is not insolvent, Allah the Almighty said: *"And if debtor is in a hard*

time, then grand him time till it is easy for him to repay, but if you remit it by way of charity that is better for you did but know"(Qur'an Surat al-baqarah verse 280)

An Affirmation of creditor is the most crucial aspect of *Ibra* according to *Hanafi* School of law that means the creditor has to affirm clearly that he surrendered his debt to his debtor. However according to majority of Islamic scholars, four important things are crucial and must be apparent before actualization of *Ibra*, there must be a debtor, creditor, the statement and debt or right. Most of the Islamic scholars except *Malikis* are of the opinion that Ibra is not entitled to any acceptance or consent of debtor, because according to *Hanbali* and *Hanafi* Schools of thought Ibra is a drop of debt right or ownership, such as divorce it doesn't require acceptance of the woman, the only requirement is affirmation of husband likewise *Ibra. (Al-fiqhil Islami wa'adillatuh vol.6 p.205).*

The *Maliki* Scholars believe that *Ibra* needs the acceptance of debtor because it is a transfer of debt ownership, the acceptance should be done at the place of contract. The importance of this diversity is that according to the majority, if the creditor affirms that his debt is being given to the debtor, then there is no backward whether the debtor accept it or not the debt has being waved. However, according to *Maliki* School if the creditor wishes to get back his words it is applicable after the affirmation and before the acceptance of debtor or if the debtor rejected the offer. *(Al-fiqhil Islami wa adillatuh, vol.6 p209).*

3. Issues and Discussions Related to Nigeria's Islamic Capital Market

Development of Islamic Finance in Nigerian

Nigeria is committed to issuing its first *Sukuk*; the Securities and Exchange Commission (SEC) has licensed Lotus Capital PLC, the first Islamic Capital Market Operator. The successful initial offer of the Company is evidence of the growing popularity and acceptance of Islamic Finance by Nigerians as a value proposition. (Sanusi 17, June 2011). The Nigerian Treasury's Debt Management Office is working out how to issue

the country's debut sovereign Sukuk within the year 2012. The expats in the field argued that no country matters more in Africa (and possibly the world) than Nigeria on the Sukuk front outlining: the enormous Islamic population in Nigeria often cited as a source of tension or barrier to national unity may actually be an asset in solving the infrastructure problem due to the role that Islamic finance has played in addressing infrastructure problems in numerous nations. Nigeria's infrastructure Concession and Regulatory Commission is actively exploring this avenue. (Africa Prebrief, Dec.09, 2011) African Institute for Financial and Economic Management (WAIFEM) says Nigeria stands to benefit from over $1.4trillion worth of assets being controlled by approximately 500 Islamic banks all over the world.

Recipe for a successful Sukuk in Nigeria

Nigerian Sukuk market will be the most successful market if the players learnt from the countries which have being in the market for a long time. For example Malaysia has being in Islamic banking business since 1983 and a lot of changes have were observed throughout the three decades which is a tremendous experience that could be utilized by the Nigerian players to avoid any controversy or disputed mechanisms which might lead them to an unprecedented tragedy in their Sukuk issuance. The Malaysia Sukuk Market is now concentrating more on the equity based rather than debt based instruments which the application is been criticized inside and out Malaysia due to its controversial *Bay Inah* and *Bay Dayn* instruments. However, Malaysian scholars have followed the *Madhab* of *Imam Shafii* in his view of legalizing *Inah* transaction and the view of *Imam Ibn Qayyim* and *Sheik al-islam bin Taymiyyah* from the *Hambali* School of Jurisprudence which legalized *Bay Day* (Sale of Debt) but the majority opinions of the other schools have influence even some Malaysian Scholars and they decided to revisit the *Fatwah* on *Bay Inah* and *Dayn*. The Malaysian Scholar *Sheik Saufullah Rusli* Indicates that the application of Bay *Inah* and *Bay Dayn* is similar to the interest-bearing financial instruments, and they are against the views of the majority scholars of Islamic Jurisprudence. (Saiful Azahar Rusli, IJISF vol. 1 No.2) the author proposed the use of financing based on *Muqaradah* and *Musharakah* principles and regards them as genuine alternatives to *Bay Inah* and *Bay Dayn* instruments.

The issue of *Tawarruq Munazzam* as applied by the Middle Eastern Islamic Financial Institutions is also identified as non-Shari'ah compliance financial instrument. The OIC Fiqh Academy said that tawarruq munazzam was a "deception" which contained usury, calling into question deals in a market estimated to be worth over $100 billion. Islamic Institutions in Nigeria should adopt equity models like *Mudarabah, Musharakah and* agency instrument such as *Wakalah.* There is growing pressure for the industry to reduce its reliance on debt instruments. However, the slow shift toward more risk-sharing structures is also expected to expose investors to greater uncertainty, with returns on investments based on performance rather than guarantees. Islamic Financial Institutions in Nigeria should be ready to take extra risks, do extra jobs, and expand their functions rather than just providing funds.

4. Summary and Conclusion

Part of the narrated Prophetic traditions indicates that debt is an unwelcomed mechanism, but the other part emphasizes on the necessity of paying it back to the owner if owed, there is no clash between the two different approaches, the first approach is because of the negative effects of debt. Allah the Almighty, made it mandatory for all Muslims to maintain themselves and their families, therefore if there is necessity it is mandatory for someone to borrow in other to solve the immediate problem. However, such necessity will not change the effects of debt at all, that is why the Almighty Allah vowed to help and assist the person who borrowed and has the zeal to pay, and he will assist to prevent him from such effects. Therefore, all these *hadiths* point to the same direction. Some of the *hadiths* mentioned were based on statements of the Prophet (SAW) and some of them were based on his actions and practices.

According to the rules of Islamic Jurisprudence, the best approach in this situation is to integrate between the two different rulings when a diversification is experienced, and that will be applied by looking at the reasons why the Prophet himself engages in debt liability. Scholars of the Islamic Jurisprudence demonstrate their opinion on this issue.

Imam al-tahawi views that the prophetic traditions which discourage debt are mean for those who neglected the rules and owed debt which they could not afford to pay back. *(sharh Mushkilil Athar vol.11 p.66)* to emphasis on this view, it was narrated by *Abdullah bin Amr Ibn As,* May Allah please with him said, the Prophet of Allah (SAW) said: "Negligence could be found in three things, amongst them, negligence in debt". *Ibn Al-Munzir* said: there is no diversity between rulings that discourage loan, and those allowed it, because the discouraged loan is the one which includes bad intentions and willing not to pay. However, if a debt is excluded from such things then it is allowed. *(Sharh Mushkilil Athar, vol.11 p.67)*

Ibn Abdul Bar also said "the debt that will prevent a person from entering *Jannah* is the one which the person dies and have the means to pay, and did not leave any testimony for that" he also said: the scholars of Islamic jurisprudence have the consensus that witnessing debt (*wasiyyah*) is compulsory before death, the best thing is for someone to pay his debt during his lifetime, if he leaves its testimony and its equivalent he will not be prevented from entering paradise by Allah's willing, however if he dies without having the equivalent then it is on the Muslims ruler to pay for him" *Imam Al-Manawi* commented on the qualities of the debtor that deserves to be attended by Allah, is the one who has taken debt to solve a compulsory, recommended or lawful things, and he is willing to pay. *(Faidhul-Qadir, vol.2 p.265, Al-Istizkar vol.14 p.229).*

The development of Islamic Banking and Finance in Nigeria could be traced back to 1991 after the enactment of the Bank and Other Financial Institutions Act under the administration of General Ibrahim Badamasi Babangida. Section 23 from the Act recognizes banks based on profit and lose sharing, while Section 61 recognized a specialized Banks such as Banks that could be designated from time to time. The designated Non-Interest Banks in 2010 as specialized Banks are based on this provision, since the Islamic banks are a form of non-interest Banks. (BOFIA 1991) within 1993 to 1995 Muslim shareholders started to apply for Banking License to operate Islamic Banks, however due to non-compliance with the CBN requirement by the shareholders., their demand did not retain any significant development. In 1996, the Habib Bank PLC opened

a non-interest banking window offering a limited number of Shari'ah compliance product. In 2004, the clamor of the implementation of Islamic Banking renewed. However, due to the huge amount demanded as a requirement to operate a banking business in Nigeria, the demand was not successful.

The application of Islamic debt securitization applied by some Islamic Financial Institutions has been criticized by many Scholars in terms of its compliance with the Shari'ah Law principles on debt and its trading which leads to the uncertainty of the accuracy of the services provided by some Islamic Financial Institutions. However, in my humble opinion there should be some augmentations in regards to debt securitization. Islamic theories on debt as stipulated in this paper, should be strictly observed in other to invent rules which should be followed by our institutions in other to mitigate the risk associated to debt and provide the way out for the implementation of Islamic Debt securities, and illustrate the Islamic measures to be followed in dealing with its trading and other related issues. Therefore, the reason of the issuance of a Sukuk must be clearly understood and has to be clear in its objectives to solving a compulsory, recommended or lawful interest according to the Shari'ah.

WAGF-BASED ISLAMIC-IRANIAN MICRO FINANCE MODEL

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Abstract

The study presents a modified micro finance model on the basis of Wagf institution. In fact, by introducing the Wagf as an important and historic Islamic economics institution shows that it is possible to use different kinds of Wagf (including movable and immovable property Wagf, Wagf of stocks and cash, and Wagf Sukuk) in micro finance. In addition, Fighi permissibility of establishment of these institutes in Iran, as an Islamic country, is analyzed, focusing on the views of shiah scholars. The findings show that the Wagf institution in Islamic economics has the enough Fighi capacity to be considered as a source of income for micro finance institutes. It seems that the proposed model of this study will provide the Islamic countries with the chance to restore the positive economic role that Wagf had in the Islamic history.

Keywords: Waqf, micro finance, Islamic microfinance, Islamic economics, Iranian Islamic banking system.

1. INTRODUCTION

Undoubtedly, poverty and social injustice are considered disagreeable in Islam[5] and hence one of the important goals of Islamic system and thereof, Islamic economics is the

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removal of these cases. Therefore, in an Islamic society, it is necessary to arrange all economic relationships in such a way to lead to the fulfillment of Islamic goals. On the other hand, Islamic financing system as one of the dimensions of the comprehensive Islamic system is obliged to fulfill Islamic goals and cannot be indifferent or pay little attention to these goals. Therefore, it can be claimed that the effort in the direction of alleviation of poverty and strengthening justice and charity in the society are included as important goals of Islamic finance (Seddighi, 2004, Khan, 1997). So, Islamic banking should pay special attention to its social goals such as poverty alleviation and enabling low-income groups (Chapra, 1985).

On the other hand, looking into the international experiences in case of poverty alleviation shows that good practices have been achieved in extending financial services to low-income groups under the title of "micro finance". The main purpose of this kind of finance is providing services to those who cannot make use of banking services for various reasons. Strictly speaking, we can describe micro finance as a tool for extending various financial services to low-income groups, such as artisans, farmers and small contractors. Since these people have usually low credit worthiness, they are not attractive to banks and other traditional financial institutes. In addition, because of high supervision and assessment expenses in extending small loans, lack of collateral and probable default, banks and financial institutes usually do not go for extending small loans to these people (Kaleem and Ahmed, 2009, p 3).

It can be claimed that the main reason for the success and expansion of micro-finance is that this kind of financing is based upon two main elements which can be regarded as strong positive points of it. These points are: "group lending" and" inside peer pressure". By group lending we mean that in micro-finance structure, people are classified in

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[5]. There are many narrations Quran and Hadith in this regard. For example, Imam Sadigh[pbu] has narrated from the honorable prophet: "poverty is the threshold of blasphemy" (Koleiny, 1363 lunar year, vol. 2, p 417). In another narration honorable messenger orders: "poverty is worse than being murdered" (Majlessi, 1365 lunar year, vol. 47, p 72). Imam Ali[pbu] ordered: "grave is really better than poverty" (Koleiny, 1363 lunar year, vol. 8, p 21).

different groups by their own choice and loans are extended to these groups. The incentive structure of the loans is so designed that extending loan to each member of the group is conditioned to the paying back the loans obtained by other members of the group, and in this way, the challenge of providing collateral for poor people has been removed. By inside peer group we mean the regulations of structure of micro-finance is designed in such a way that each member of the group persuade each other to pay back the loan and therefore, there is no need of external enforcement (Mafi, 2008, p. 45).

The position of traditional micro finance institutes, which operate on the basis of extending interest bearing loans, is somehow between official financial markets (such as banks and financial institutes) and unofficial financial markets and therefore, they have some of the characteristics of both markets. For example, in comparison to official institutes, micro finance institutes provide better access to financial services for low-income groups and have more similarities with unofficial lenders; but on the other hand, they have lower costs in comparison with unofficial markets and therefore, they seek lower interest rates. Meanwhile, they have special method for replacing collaterals; they use group-pressure instead of collateral which is asked by official lenders. In this case, members of micro-finance groups, who have some similarities, guarantee each other and hence if one member defaults, the right of others to obtain loan will be postponed. In this way, group guarantee replaces collateral (which the poor do not possess and therefore they have no access to credit sources).

On the other hand, it is a reality that the micro finance practice has been growing in recent decades and according to available data, this special kind of finance has been applied in most developing (and some developed) countries[6]. As an example, Grameen bank of Bangladesh has started micro finance in 1976 as a pioneer and developed the job in three decades so that its founder, Professor Mohammad Younes, gained a noble prize

[6] Some of the researches have properly explained micro finance practices in different countries such as Bangladesh, Egypt, India, Pakistan, Malaysia, China, Jordan, Kirghizstan, Malaysia and other countries (Mafi, 2008, p. 3).

for his activities in micro finance. The study of released data shows that this institute has 113.5% increase in its extended loans and the amount of loans have been increased from 229.14 million US Dollars in 2001, to 448.41 million US Dollars in 2011 (Kaleem and Ahmed, 2011).

It is clear that the main challenge of full application of this practice in Islamic framework is the problem of interest (existence of interest and its high rate). In fact, traditional micro finance institutes obtain and allocate funds by paying and receiving interest and it seems that their interest rate is higher than prevailing interest rate in the economy. For example, some research conducted in Bangladesh show that even in this country, which is a pioneer in micro finance, most of financial institutes impose interest rate of 25% to 30% on poor people (Hassan and Alamgir, 2002; Sadeq, 2007). In addition, by studying the practices of some micro finance institutes, some research show that in addition to prevailing interest rates, these institutes receive additional indirect charges, which increases the interest rates asked by them up to %40 which is much higher than bank interest rate (Mannan, 2007).

It seems that the successful experience of micro finance has the capacity to be applied in Islamic banking framework. In fact, it is possible to make use of this tool after some adjustments for alleviation of poverty in Islamic countries; the goal which is among the social goals of Islamic finance system. Of course, one of the most important adjustments in applying traditional micro finance in Islamic context, is application of Islamic contracts (such as Gharz-al-hassan) and Islamic institutions (such as Wagf, Zakat, Khoms, Anfal and others) for mobilizing and allocating funds for Islamic micro finance institutes.

Although it is possible to use various Islamic economic institutions in micro finance, but because of the limitations, this study focuses only on one of these institutions which is Wagf and will briefly discuss related issues. After introducing theoretical model of establishment of Wagf-based micro-finance institution and describing fund mobilizing

methods, by applying analytical-descriptive method, this study will try to answer the following question: Regarding the views of Imamieh (Shi'ah) scholars, is it possible to establish Wagf-based micro finance institutes?

After introduction, we start with literature review and a short discussion of the history of Wagf in Islam and Iran will be added. Then, the theoretical model of establishment of Wagf micro finance institutes will be presented and then its Fighi permissibility will be discussed. The last section concludes for the presented discussion.

2. PRECEDENT RESEARCH

The review of available literature show that although there are several studies about Islamic micro finance in recent years (Toghiani, 1385 lunar year; Kahf; Habib, 2002; Mannan, 2007), but usually these studies are concerned with elimination of interest by Islamic contracts such as "installment sale", therefore, the concept of applying Islamic institutions, including Wagf, in micro finance, has been rarely considered by these studies. Here are some of these studies:

Arab Mazar and Motamed Farzin (2003) have put forward the new methods of micro-finance in enabling low income group, especially women. While comparing the characteristics of micro-finance methods of Bank Keshavarzi, this study has analyzed these credits in the framework of four plans implemented in this bank.

Motamed Farzin and Nematian (2004) have shown in their paper that although micro-finance is extended as a service by financial institutes, but also can provide gains for the institutes.

Hassanzadeh Et al (2006) have studied the effectiveness of micro-finance on alleviation of poverty and in-equality in different provinces of Iran by panel data method. The results

which use interest-free loans as a substitute for total extended micro-finance variable, shows that micro-finance can only alleviate poverty if the lower income group is well distinguished, and the credit is spent for job creation.

Hassan and Ashraf (2010) presented a model in their study in which Zakat and Wagf are mentioned as sources for micro finance. After explaining the characteristics of Zacat and Wagf and presenting a model, they show that the application of their model will reduce the challenges faced by interest bearing micro finance institutes (including viability of the micro finance institute).

After discussing economic, accounting and risk management challenges in his study, Habib (2007) shows that if micro finance institute is established by money Wagf and Qharz-al-hassan financing, it wouldn't face challenges facing traditional micro finance institutes (including credit risk, moral hazard, and economic viability).

As it is seen, rather economic dimensions and characteristics of micro finance institutes in case of application of Wagf have been discussed in these studies. Therefore, by presenting a more comprehensive model for mobilizing and allocation of fund and shari'ah feasibility of the model and explaining the economic necessity of establishment of these institutes in Iran and finally briefing challenges and providing solutions by reviewing traditional micro finance practices, this study makes a difference with previous studies and therefore have contribution.

3. WAGF INSTITUTION IN ISLAM AND IRAN: A HISTORICAL REVIEW

The word Wagf itself means stopping and from Figh point of view means keeping (maintaining) the principal asset and freeing the (usage) profit (First martyr, 1411 lunar year, vol. 2, p. 12). Wagf has been described as: "keeping the asset and giving the profit" in Iranian Civil Law (Civil Law, 2006, article 55). "Keeping the asset" means that the Wagf asset should not be transacted, donated, let or inherited. But "freeing the profit"

means the profit of the Wagf asset will be freed and separated from the main asset and is dedicated to the purpose of the Wagf.

Although the word "Wagf" is not mentioned in Quran, but in religious texts has been described as "charity" and "current charity" and therefore, we can relate all verses about charity to Wagf. The concept of "current charity" is also a proper explanation of Wagf. Since Wagf is a kind of no-retune help, it is considered as charity and since it is a permanent source of income, many generations can enjoy from it and therefore, the concept of "current" is adaptable to this concept (Bakhtiari, 2002, p. 5).
It seems possible to consider an economic definition for Wagf. This can be defined as "changing the utilization of sources from private exploitation to social exploitation for the present and future generations and using the benefits for many people". Therefore, development of Wagf as a non-government institution in Islamic economics decreases consumption and increases saving from one hand and these savings may change into investment from other hand. This capital can lead to produce personal commodities or social services for the time being and future and thereof, increase GDP. Because of charity nature, Wagf can strengthen social bases and cooperation spirit in the society which leads to the increase of social capital and total economic efficiency (Bakhtiari, 2002, p. 7).

Although it is not exactly known when, according to the shari'ah, Wagf became a law, but the first practical action of the messenger after immigration to Madineh was construction of Ghoba and Prophet Mosques according to Wagf institution[7]. Imam Ali [pbu] had Wagf his lands (the revenue of which amounted to 24000 Dinars) before he died. In addition, Wagf institution has a brilliant background in Islamic history (Ashkoury, 1998, p. 81).

[7]. It should be mentioned that Wagf has a pre-Islamic background. Imam Khomeini (1403 lunar year, vol. 1, p. 572) says in one of his books (Tahrir-al-vasileh) that "waghf is not a shari'ah concept, but it is a rational (intellectual) concept which is prevailing amongst religion and (perhaps) non-religion followers".

Wagf has a brilliant and long past record as well. While this institution has active background in different periods of time in the economy of Iran, but we can consider Safavid dynasty as the highest period of Wagf development in the country. At the end of Safavid dynasty, one could rarely find agricultural land or home which was not partly or wholly Wagf (Bakhtiari, 2002, p 12). Initially, Wagf in Iran was in the shape of land, garden and the like, but afterwards, happened more in real estate such as shops, commercial places and tools (such as mills, bakery shops, public bathes, coffee shops, chalk furnaces, weaving workshops, commercial ships, books, libraries and money) (Ashkoury, 1998, p 87).

In past history of Iran, many production activities were carried out by Wagf institution and many infrastructure installations and cultural and social institutions were made by Wagf of the people without government feeling any responsibility for building them. In fact, Wagf had many economic and social applications in the lives of the people. One of these cases was free-education which had significant effects on the society. Education today is one of the most important means affecting production of goods and services directly or indirectly and in many countries, including Iran, education expenditure is the highest expenditure in public expenditures which is paid by government at various levels. But this expenditure was paid through Wagf institution previously. Evidence show that various schools with different sizes were built through Wagf institution and education was free in the history of Islam (Saati, 1995, p 3).

In short, it can be concluded that Wagf had considerable role in production of goods and services and creation of job opportunities in the past, and many public goods and tasks, produced and carried out by modern governments today (which are one of the government challenges and so they try to privatize them by structural adjustment policies) were carried out by Wagf institution in Islamic societies (Bakhtiari, 2002, p7).

Wagf properties form a large portion of sources in our country even at the present time. Wagf belonging to the Astanegods of Imam Reza in various cities is just a sample of the

large share of Wagf in this country. According to the Vice President of Wagf and Charity Organization of Iran, the value of Wagf assets in the country amounts to 100 trillion Toumans (one hundred billion dollars) and had 840 milliard Rials of earning in 2008 which show its low turnover which is 8/10000 (Sarmayeh newspaper, March 16th, 2009, p 6)[8]. In spite of the large capacity of Wagf properties, the reality of the economy of Iran shows that Wagf doesn't have the previous position (especially in some periods) in solving economic difficulties. Of course, one of the reasons of this reality is the traditional and non-scientific management of Wagf properties and not taking the advantage of historic potential of Wagf capacity in implementing Islamic goals. Therefore, it seems necessary to make use of especial characteristics of Wagf, and by applying international experiences, present a proper model for reconstruction of the role of Wagf institution in the economy of Islamic societies. In other words, in addition to traditional methods of the Wagf and using the earned income in the direction of the benevolent people's goals, it is necessary to use new methods for absorbing and allocating funds. We try in this research, by applying practices of traditional micro finance at international level, to introduce a native (adapted) model to employ Wagf institute in micro finance.

4. WAGF-BASED ISLAMIC-IRANIAN MICRO FINANCE MODEL

Wagf micro finance institute is a non-profit institute which finances a main portion of its sources from Wagf properties. In other words, in mobilization main part of its activities, it enjoys from Wagf institution. In fact, a Wagf micro finance, for mobilization of funds (debt part of its balance sheet) makes use of Wagf institution and for allocation of resources (asset part of its balance sheet) of Islamic tools and therefore, it is different from interest-based micro finance institutes from various dimensions. In the following

[8]. Some researchers have rightly shown that Wagf turnover is much lower than similar non-Wagf assets. For example, Islamic scholar, Mr. Souri in his PhD thesis called: "The study of the position of profit making real estates: a case study of south of Tehran Wagf Department" shows that the earnings of Wagf real estates are low; or the rent of Wagf shops in Tehran Bazaar is lower than real rent (Souri, 2004).

section, we will review the characteristics of this kind of micro finance institute in two parts of allocation of resources and mobilization of funds.

4.1 Resources Allocation

As it was mentioned before, allocation of resources in traditional micro finance institutes is based on (Riba) interest bearing loans. But, regarding the prohibition of Riba in Islamic economics, it is necessary to use Islamic contracts in Islamic micro financing. These contracts (which are also used in Islamic banks) can be classified in four main groups which are: sharing contracts, transaction contracts with fixed return, transaction contracts with variable return, and gharz-al-hassan contract. The first three cases are particularly used for production and trade activities, and the fourth is usually used for consumption facilities. We will discuss these classes of contracts in the following (Mousavian, 2004, pp166-175):

- Fixed return transaction contracts: in this group of contracts the Wagf micro finance institute will finance an economic activity totally or partially; with the difference that the profit of economic activity is defined before starting the activity. Therefore, the future economic developments or changes of regarded economic plan do not affect the profit of the institute. These contracts are: selling by installment, debt purchase, and rental mortgage.

- Transaction contracts with variable return: in this group of contracts also the Wagf micro finance institute will finance an economic activity totally or partially. Because of the nature of these Islamic contracts, the profit earned by the institute is variable according to economic developments and relative prices in real market. In some cases, even there may be losses in which the institute will be sharing[9]. These contracts include forward deals and Joalah.

- Sharing contracts: in this case, the Wagf micro finance institute will finance an economic activity (production, trade or service) totally or partially and finally, the

[9]. It should be mentioned that usually the return of these Islamic contracts are practically fixed by some action and so they change into contracts with constant return (Moisavian, 2004, p 187). Therefore, we can consider second and third group as transaction contracts with constant return.

obtained profit will be divided between them according to the contract signed with the entrepreneur. In Iranian usury-free banking system[10] these contracts are: Civil partnership, Legal partnership, Mudarebah, Muzareah, and Musaghat.

- Gharz-al-hassan: In this contract, the institute finances needy families according to gharz-al-hassan contract and in return, receives only banking commission. The goal of these facilities is just fulfilling the consumption needs of the poor.

4.2 Mobilization of Funds

Traditional micro finance institutes mobilize funds through accepting interest bearing deposits on the basis of loan, or using outside sources (such as government or international donations)[11]. But Islamic micro finance funds can use Islamic contracts (including participation, transaction and gharz-al-hassan contracts) for absorbing deposits. In addition, they can make use of Islamic economic institutions (institutions such as Wagf, Khoms, Zakaat, Anfal, and others) for funding. In the proposed framework of this study, the main source of funding is considered to be Wagf of movable and immovable assets, shares, money and issuance of Wagf papers. Beside this, they can accept gharz-al-hassan deposits as a secondary source of fund. It should be mentioned that, since gharz-al-hassan contract is a possessory contract, and depositor transfers his possessory right of the fund to the micro finance institute to use it for charity purposes, mixing these two sources of funds do not create any problem for the institute.

5. FIGHI ISSUES OF WAGF-BASED ISLAMIC-IRANIAN MICRO FINANCE MODEL

[10]. It should be mentioned that the Islamic micro finance offered in this article is based upon Shia'h and Iranian usury-free banking model (Usury-free Banking Law). But we know this banking model is not the only model of banking of this kind. There are various banking models because of the existence of various Fighi differences among various Islamic groups. For example, while Mudarebah is a general and wide range contract according to Sunnite's Figh, it is only applicable to allocation of funds in commercial activities in shia'h Figh. In fact, in this case Mudarebah is a limited or pressed contract (Mousavian, 2004, p7). But it is possible to discuss the model explained in this article in the framework of other Islamic banking models. This will not cause major differences in our analysis.

[11]. Habib, 2002.

It is necessary to go through the study of mobilizing and allocation methods of funds. Regarding the allocation of funds, correct application of transaction, sharing and gharz-al-hassan contracts are permissible according to Figh and this issue has been explicitly mentioned in Usury-free Law (Mousavian, 2004, pp. 98-111). However, regarding the sources of funds for the Islamic micro finance institute, we need to have a short Fighi discussion. In fact, it is necessary to discuss the Figh rules regarding gharz-al-hassan deposits and also all four Figh source of raising fund from various sources (including Wagf of properties, shares, money in cash and Wagf papers) for micro finance institute. Of course, accepting deposit on the basis of gharz-al-hassan Islamic contract is completely according to shari'ah and even mostahab[12], and it does not need any further discussion; therefore, we will continue to discuss about the other sources.

The Fighi review of Wagf shows that in order to have a correct Wagf, four conditions should be fulfilled: the Wagf item should be real or original, it should be possessed by the one who do the Wagf, it should be durable itself and its profit can be possessed (Najafi, 1397 lunar year, p 13; First martyr, 1411 lunar year, p 87; Mohaghegh-e-Helli, 1403 lunar year, p 23). By making use of available Wagf literature, we will review these conditions for the four sources of Wagf funds in the following.

5.1 Property Wagf

One of the sources of funding of Wagf-based micro finance institute is receiving and using movable and immovable assets which have the above mentioned four conditions and are donated by benevolent people for helping the poor. In fact, the institute as the custodian receives the assets according to Wagf contract and commits to use the assets in the direction of solving problems of the poor.

Regarding the micro finance nature and its goals for helping the low income groups and solving the problem of poverty in the society, the Wagf micro finance institute can only cooperate with those consecrators who Wagf their possessions for solving poverty

[12]. According to shari'ah, mostahab is an action which is allowed and advisable.

problem. Therefore, those consecrators who have other goals such as helping mosques, repairing roads and bridges and the like, cannot cooperate with the proposed Wagf-based micro finance institute. Of course, as it was seen in the previous section, historically most Wagf have poverty alleviation goals.

It is also necessary to mention that these institutes can provide the chance for consecrators to Wagf their possessions in general, or for special group of poor people (such as poor workers); in the second case, the institute is obliged to use the donated possessions only for that special group. In addition, the institute provides the chance for donators to decide between consumption and non-consumption (production and trade)[13]; this is because, as we will notice in the next section, these institutes extend both kinds of loans.

5.2 Stock Wagf

Regarding the possibility of consecrating stocks, it should be mentioned that these assets have the before mentioned four pre-conditions for Wagf permissibility. In fact, stock is in the possession of its owner (second condition) and it is possible to use its profit with keeping the principal (third condition). But regarding the possibility of receiving and taking it into possession, we can say, traditionally and according to law (articles 39 and 40 of Iranian Commerce Law) it is possible to take the possession of the stocks. The only condition which may cause dispute is substance of the stock (Najafi, 1981, vol 28, p 14). Some studies on this subject show that by “stock”, we do not mean a piece of paper, but we mean part of real asset of a company which is represented by this piece of paper and is offered to people. Therefore, the condition of stock to be substance is also fulfilled (Mesbahi Moghaddam and Shokri, 2007, 916).

[13]. It is necessary to mention that consumption facilities means loans extended for fulfilling consumption needs (such as loan for purchasing a commodity for consumption). But production facilities are those loans which do not aim consumption, but are used as capital for production of goods or services.

According to the above discussion, it seems that consecration of stocks can also be considered as a source of financing Wagf micro finance institutes. In fact, benevolent people donate company stocks which they possess for charity purposes by making the Wagf institute as its administrator. Here again, donors should Wagf their possessed stocks for poverty alleviation purposes and can decide on extending production/consumption facilities and general/special group facilities.

5.3 Money Wagf

Regarding consecrating of cash money, the two pre-conditions of possibility of transaction and being in the possession of the donor are commonly acceptable. But, regarding the durability of the Wagf asset and its being "substance", Islamic scholars have different views. Some of them according to shari'ah, rightly believe that "keeping or durability of the original (value) asset" should be observed rather than "keeping or durability of the substance" (Mesbahi Moghaddam, et al, 2009, p 11). In other words, two kinds of "keeping" can be considered: one is keeping of the substance which is referred to commodities, and the other is keeping the value (purchasing power) of the Wagf asset, which is specialized to cash. Therefore, in consecrating commodities, durability of the commodity while its profit is used, is essential; but, keeping the value or purchasing power of cash money is essential. Therefore, regarding paper money which has no inherent value, if we could use it in such a way that its purchasing power is maintained, while it is creating benefit (such as keeping it in a fund and extending gharz-al-hassan loans to the poor), it is possible to Wagf the benefits (Saadat Far and Dadgar, 2007, p 16; Mesbah Moghaddam et al, 2009, p13). So, consecrating cash money can be explained as another source for Wagf micro finance institute. In fact, benevolent people consecrate their funds for God's sake and put an administrator to use its benefits in the way they ask for. The institute (administrator) uses these funds to finance consumption and production projects in such a way that it's purchasing power would not change. Here again, the consecrators should Wagf funds for helping the poor; they also have the choice to select between production and consumption facilities, and general or special use of funds.

5.4 Issuing Wagf Sukuk

Another method for absorbing funds by Wagf micro finance is issuance of Wagf papers. These kinds of papers are among the non-profit Islamic papers (non-investment sukuks). The possessors of Wagf papers are those people who want to Wagf their small or large assets for any reason (Soroush, 2008, p 5). It seems that Islamic micro finance institute at least can use two kinds of Wagf papers. The first kind is related to consecrating cash money which is correct if consecrating cash money is correct. The second kind of these papers is based upon consecrating commodities which can be called as “group Wagf papers”.

For issuing money Wagf papers the Wagf micro finance institute operates as institutor. In fact, by establishing an intermediary institution, the institute will issue cash money papers. In this kind of papers, the institute is obliged to spend the raised fund according to the Wagf agreement. Here again, the consecrators have to Wagf their money for poverty alleviation purposes and have the chance to Wagf their money in general, or for special group of people, and also for production or consumption purposes.

Another kind of Wagf Sukuk is Group Wagf papers. The main difference of these papers with money Wagf paper is that they are for capital goods. For example, a Wagf micro finance institute receives an application of buying a tractor from a group of farmers. After conducting preliminary studies and confirming the background of the group, the institute issues Wagf papers to raise fund. In fact, if the cost of this purchase is 100 units, the institute issues 100 Wagf papers and offers them to consecrators. By buying each paper, each consecrator consecrates a portion of the tractor. As it is seen from this example, these papers are based on the concept of group consecrating.

6. CONCLUSION, POLICY RECOMMENDATIONS AND FUTURE RESEARCH PERSPECTIVE

In fact, Islamic banking system in Iran and at global level has been focusing on its shari'ah and execution problems and has neglected its social, humane and Islamic goals such as alleviation of unjust social inequality and poverty. The practice of traditional micro finance can be used by Islamic banking with necessary adjustments and can help Islamic banks in fulfilling their tasks. In fact, micro finance practice can be introduced as another dimension of Islamic banking in the country.

The adapted micro finance model on the basis of Wagf institution is presented in this study. In fact, while presenting the proposed model and describing fund raising methods (including movable and immovable property Wagf, Wagf of stocks, money and paper Wagf) and also expressing allocation methods (transaction, sharing and gharz-al-hassan contracts), Fighi permissibility of establishment of these institutes were discussed. The findings show that the Wagf institution in Islamic economy has the enough Fighi capacity to be considered as a source of income for micro finance institutes. It seems that the proposed model of this study will provide the background for economic development of Islamic countries, including Iran. In fact, it will cause restoring the position of Wagf in the Islamic history in nowadays Islamic countries and Iran to some extent.

According to the theoretical analysis presented, the policy recommendation of this study is that institutions active in Wagf and micro finance in Iran, such as Wagf and Charity Organization, Islamic Economic Organization (which has the responsibility of supervision of gharz-al-hassan system), Central Bank (which is responsible for supervision of all active institutes of money markets of the country) and Imam Khomeini [pbu] Help Committee (which is responsible for alleviation of poverty and deprivation), try to improve the Wagf system of the country by establishment of Wagf micro finance institutes. These efforts can be one of the dimensions of Islamic banking system. In addition, from legal point of view, by amending the prevailing rules and regulations, it is possible to design Gharz-al-Hassan System in such a way that gharz-al-hassan institutes,

by meeting some conditions, be able to change into Wagf micro finance institute and in addition to extending consumption facilities, be able to offer group production facilities.

In this regard, we propose that rules and regulations concerning Wagf micro finance institutes must be introduced in Iran and then, by cultural activities through mass media and considering tax and other incentives, the necessary conditions for converting the present gharz-al-hassan funds into Wagf micro finance institutes be fulfilled. It is necessary to mention that there is no need for those gharz-al-hassan funds which convert into Wagf institutes to allocate a main portion of their sources to production/trade facilities; but they can allocate a small share of the sources for extending production facilities for a short time, and if this practice was successful, they can gradually increase these facilities.

The subjects described in this study can be expanded in different ways. Exactly speaking, future studies can answer the following questions:

1- Is Fighi-economic feasibility of development of the proposed model possible by using other Islamic institutions (in addition to Wagf), including gharz-al-hassan, anfal, khoms, zakat and other similar financial sources?

2- What are the risks facing Wagf micro finance institutes? What is the proper risk management model for these institutes?

3- What are the proper reserves in the proposed model for confronting probable challenges (such as inflation)?

4- What is the optimum model for establishment of Wagf micro finance? What are the convenient relation of these institutes with Islamic Economic Organization, gharz-al-hassan institutes, gharz-al-hassan bank, Islamic banks, Wagf Organization and the Central Bank?

5- What is the optimum model for assigning administrator and supervisor and defining their relation and characteristics?

6- What are the optimum supervision model for the activities of Wagf micro finance institutes and which organizations are responsible for it?

7- What is the optimum model of using traditional Wagf (which are Wagf with the aim of poverty alleviation)? How can we use the structure of the institute for guiding new Wagf?

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بسم الله الرحمن الرحيم

عنوان البحث: الوساطة المالية الإسلامية وأهميتها الاقتصادية (ماليزيا أنموذجا)

الباحث:

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الوساطة المالية الإسلامية وأهميتها الاقتصادية (ماليزيا أنموذجا)

ملخص البحث

يعتقد بعض الاقتصاديين الإسلاميين أن ارتفاع حجم نسبة تمويل البيوع الائتمانية في المصارف الإسلامية يتعارض مع خصوصيتها الاستثمارية، وقد كَثُرت هذه الانتقادات في الآونة الأخيرة حتى وصل الأمر إلى حد التشكيك في أهميتها كوساطة إسلامية. ولذا حاولنا إبراز بعض النقاط الاقتصادية المهمة التي قد تضيق هذا الخلاف، كمدى مشاركة التمويل الإسلامي في رفع الناتج الإجمالي المحلي، وفي جمع المدخرات، ومدى قدرته على توليد النقود من خلال عملياته الائتمانية. وقد قام الباحثان بعملية تحليلية شاملة للنظام المصرفي الإسلامي الماليزي كنموذج لمعرفة مدى تأثيره في هذه الجوانب الاقتصادية، وخصوصا أن نسبة تمويل القائمة على البيوع فاقت 96%. وقد أكدت النتائج بأن تمويل النظام المصرفي الإسلامي الماليزي كان له علاقة إيجابية وإحصائية بنمو الناتج الإجمالي المحلي الماليزي، كما استطاع النظام المصرفي الإسلامي منافسة قروض النظام الربوي الماليزي للقطاعات المهمة التي شاركت في هذا الناتج الإجمالي، وحسب حصته السوقية، كالزراعة والتصنيع، والتعدين والتحجير، والبناء، ناهيك عن عدم وجود علاقة إحصائية بين عرض النقود، والتضخم على اعتبار أن بيوع الائتمانية من أهم أساليب زيادة العرض النقدي.

ISLAMIC FINANCIAL INTERMEDIATION AND ITS ECONOMIC SIGNIFICANCE: THE CASE OF MALAYSIA

Many Muslim economists believe that the increase of debt based financing products of Islamic banks contradicts the very function of these financial institutions, i.e investment. This has exposed Islamic banks to a lot of criticism, casting doubt on whether these institutions are really Islamic financial intermediaries. The researchers tried to bridge the gap between the opponents and proponents of debt based products by looking at the economic value of these products in the Malaysian Islamic banking system. The researchers focused on three variables, the ratio of debt based products to GDP, the role of debt based products in deposit attraction and the ability of these products to create money. The two researchers, in view of 96% of total financing are based on sale, have conducted a comprehensive analysis of the Malaysian Islamic banking system and its impact on the three variables under study, especially in The study has shown a positive correlation between debt-based products and the Malaysian GDP, proving that these products have covered several sectors including agriculture, industry, mines, and

construction. The study has also shown a negative correlation between debt-based products on the one hand and money supply and inflation on the other.

1- مقدمة

يعتبر التمويل الائتماني للبنوك الإسلامية أي (بيوع المداينات) من أهم أساليب التمويل، حيث يلجأ المستهلك للائتمان القائم على تلك البيوع لسد حاجاته الاستهلاكية، أو لمواجهة نفقاته الطارئة، كما يلجأ المستثمر عادة إلى الائتمان لتمويله مشاريعه أو لتوسيعها، وتلجأ الدولة كذلك للائتمان لتمويل مشاريعها التنموية، أو لسد عجزها. ولما كان تمويل البنوك الإسلامية قائما في الغالب على الائتمان عن طريق أساليب بيوع المداينات، حظيت هذه البيوع باهتمام الباحثين، وتضاربت آرائهم بين موسع ومضيق ومانع لتلك البيوع.

وتكمن مشكلة البحث في تَنَامي عدد المتَبَنِين لانتقادات بعض الاقتصاديين في دعوتهم إلى الحد من أساليب التمويل القائمة على البيوع (المرابحة، والبيع بثمن آجل، والسلم، والاستصناع) والتي تشكل أكبر نسبة تمويل. وقد ظهر ذلك جليا في مطالبة مجمع الفقه الإسلامي الدولي مثلا في دورته الخامسة بعدم التوسع في بيع المرابحة[1]، إضافة إلى أن هذا التمويل يشجع الاستهلاك ويتعارض مع خصوصيتها الاستثمارية القائمة على أساس المضاربة والمشاركة[2]، ناهيك عن الأخطاء التطبيقية في ممارسة بيع المرابحة المصرفية.[3] ويتفق

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[1] السالوس، علي، **موسوعة القضايا الفقهية المعاصرة** (بيروت: مؤسسة الريان، وقطر، دار الثقافة، ومصر، مكتبة الترمذي، ومصر، مكتبة دار القرآن) ص 711.

[2] الحصين، صالح، **حولية البركة**، بحث المصارف الإسلامية مالها وما عليها، ع6، 2004، ص 36، و38، وبحث عطية السيد فياض، **العوائق والأخطاء في عمل المصارف الإسلامية، كتاب الوقائع** (تنظيم كلية الشريعة والدراسات الإسلامية، الإمارات ط2، :المتحدة ج2) ص 619- 621، ويوسف كمال، **المصرفية الإسلامية الأزمة والمخرج** (دار النشر للجامعات المصرية 1416هـ، 1996م) ص95.

[3] شحاته، حسين، **التمويل بالمرابحة كما تقوم بها المصارف الإسلامية بين الواجب والواقع**، الموقع الالكتروني: http://islamfin.go-forum.net/t1292-topic

الباحثان مع هذه النظرة عموما إذا كانت في بيئة استثمارية إسلامية شاملة، ومع قوانين وسياسة ائتمانية تحترم خصوصية المصارف الإسلامية من طرف البنك المركزي.

كما يعتقد الباحث أن هذه الانتقادات لا تأخذ بعين الاعتبار أهداف الوساطة المالية الكلية والشاملة[4]، حيث يجب أن تبحث المشكلة ضمن إطارها الكلي، كمدى تأثير الوساطة المالية في بعض جوانب الاقتصاد الكلي، مثل الناتج الإجمالي المحلي، والتضخم، وقدرتها على جمع المدخرات التي تسهم في التنمية الاقتصادية. ومن جهة أخرى فإن أساليب التمويل البيعي ليست كلها موجهة للاستهلاك، فبالرغم مثلا من أن بيوع الآجال فاقت 96% من حجم تمويل المصارف الإسلامية الماليزية إلى أن الائتمان الاستهلاكي لم يحصل إلا على نسبة 40% تقريبا بين (2006-2010) في تمويل النظام المصرفي الإسلامي الماليزي[5]، ولذا فإن الحكم على كفاءة المصارف الإسلامية، أو محاولة تصويبها ينبغي أن يأخذ هذه المعايير الاقتصادية الشاملة.

واعتمد الباحث على منهجية التحليل الاقتصادي النظري المبني على استقراء أقوال الاقتصاديين حول أهمية الوساطة المالية عموما، وعلى التحليل الإحصائي الشامل للنظام المصرفي الإسلامي الماليزي بالاستعانة بإسهامات الاقتصاديين في أبحاثهم المعاصرة في الحكم على كفاءة المصارف الإسلامية من التقارير البنكية.

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[4] وقريب من هذا المعنى يقول أحدهم: (لم يتناول علماء الشريعة القضية في إطارها الكلي من حيث حاجة المجتمع لخدمات مالية أصبحت ضرورة في الاقتصاد الحديث الواسع، ولكن النظر إليها في إطارها الضيق وكيف يتسنى لمنشأة مالية صغيرة هي المصرف الإسلامي أن تدير نفسها وفق القواعد الفقهية المعروفة.) صديقي، المصارف الإسلامية المبدأ والتصور، مجلة الاقتصاد الإسلامي (جدة: جامعة الملك عبد العزيز، م10، 1998م) ص 55.

[5] استخرج الباحثان هذه النسبة من تقرير البنك المركزي، والائتمان الاستهلاكي يشمل Purchase of passenger cars, Personal use, Credit card, Purchase of consumer durables راجع التقرير، الموقع الالكتروني: http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.17.1.xls و http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.19.1.xls

ولذا فإن أهمية البحث تتمثل في كونه محاولة لتضييق الخلاف الحالي بين الاقتصاديين المعاصرين حول أهمية التمويل الإسلامي القائم على المداينات، من خلال إبراز حجم تأثير تمويل النظام المصرفي الإسلامي الماليزي كمثال في هذا البحث في بعض جوانب الاقتصاد الكلي، أي الناتج الإجمالي المحلي، وكذا تأثير قنوات النظام المصرفي الإسلامي الماليزي في جمع المدخرات، وفي مدى مشاركته عن طريق عرضه للنقود بمفهومه الضيق (M1) والواسع (M2) وعلاقة ذلك بالتضخم. ومعرفة تطور أصوله، ونسبة تمويله لأهم القطاعات التي شاركت في الناتج المحلي الإجمالي، كالزراعة والصناعة، والتحجير والتعدين، والبناء، خصوصا أن نسبة التمويل القائمة على بيوع الآجال فاقت 96% في ماليزيا مثلا، يكون هذا أدعى إلى محاولة التفهم لعملها التنموي، ويخفف من حدة انتقاد البعض عليها، ويحاول هذا البحث الإجابة على الأسئلة التالية:

1- هل التمويل الإسلامي الماليزي القائم غالبا على بيوع الآجال يساهم في دفع النمو الاقتصادي، وتحديدا ما مدى تأثير التمويل في الناتج الإجمالي المحلي الماليزي ؟
2- ما مدى أهمية قنوات النظام المصرفي الإسلامي في جمع المدخرات، والتخصيص الأمثل للموارد، ومشاركته في عرض النقود (M2, M1) وعلاقته بالتضخم ؟
3- هل شارك النظام المصرفي الإسلامي الماليزي في تمويل أهم قطاعات، كالزراعة والصناعة، والتحجير والتعدين، والبناء، وبِنِسَب مقبولة ؟
4- هل استطاع النظام المصرفي الإسلامي منافسة النظام المصرفي الماليزي الربوي، وحسب حصته السوقية في تمويل أهم القطاعات التي ساهمت في رفع الناتج المحلي الإجمالي الحقيقي الماليزي؟

وقد تم تقسيم البحث إلى مبحثين، مبحث نظري يبين علاقة الوساطة المالية بالنمو، من خلال اختلاف الاقتصاديين حول مدى أهمية تطور الوساطة المالية في دفع النمو، ومن خلال قنوات تأثير الوساطة المالية في النمو أي (العرض النقدي، وجمع المدخرات، والتخصيص الأمثل للموارد) ومبحث ثاني يبرز أثر كل من حجم أصول وتمويل النظام المصرفي الإسلامي الماليزي على بعض المتغيرات، كالناتج الإجمالي المحلي الحقيقي الماليزي، وكذا معرفة نمو أصول وتمويل النظام المصرفي الإسلامي الماليزي، وقدرته على جمع

المدخرات، وصِيغ وأهم أهم قطاعات الاستثمار، ثم محاولة إبراز مدى تأثير عرض النقود على التضخم في ماليزيا على اعتبار أن بيوع المداينات هي أحد أساليب زيادة العرض النقدي.

2- علاقة الوساطة المالية بالنمو الاقتصادي

2-1 اختلاف الاقتصاديين حول أهمية الوساطة المالية في عملية دفع النمو

لا يزال الخلاف قائما بين الاقتصاديين حول مدى أهمية الوساطة المالية أي (تأثير التطور المالي للبنوك) في دفع النمو الاقتصادي، حيث يرى بعض وجود علاقة إيجابية سببية بين الوساطة المالية والنمو الاقتصادي، منهم (baghot1873)، وشومبيتر (Schumbeter1911)، وباتريك (Patrick 1966)، وجولد سميث (Goldsmith 1969)، وشو (Show1973)، وماكينوك (Mckinnon 1973).[6] بينما شَكَك روبنسن (Robinson 1952) ولوكس (lucas 1988) في إيجابية هذه العلاقة.[7]

وفي محاولة لحسم هذا الخلاف النظري اتجهت أنظار المعاصرين إلى الأبحاث التطبيقية للإثبات أو نفي العلاقة السببية بين التطور المالي للبنوك أي (تأثير الوساطة المالية) والتنمية الاقتصادية، مثل دراسة جولد سميث (Goldsmith 1969) لـ 35 دولة نامية، حيث أكدت على وجود علاقة سببية إيجابية بين الوساطة المالية

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[6] جميل، أحمد، **الدور التنموي للبنوك الإسلامية**، رسالة دكتوراه غير منشورة (جزائر: كلية العلوم الاقتصادية، 2005، 2006م) ص 34، والقدير، خالد بن حمد، **تأثير التطور المالي على النمو الاقتصادي في المملكة العربية السعودية** (السعودية: جامعة الملك عبد العزيز، الاقتصاد والإدارة) م18، ع1 ص 5.

[7] القدير، خالد، تأثير التطور المالي، مرجع سابق، ص 6، 7، و Franklin Allen and Hiroko Oura, Sustained Economic Growth and The Financial System, P 2, http://finance.wharton.upenn.edu/~allenf/download/Vita/sustained.pdf

(التطور المالي) والنمو الاقتصادي.[8] ودراسة كينغ وليفاين (King ,Leviene)، والتي تعتبر من أكبر الدراسات التطبيقية لكونها شملت 77 دولة نامية بين فترة 1960- 1989م) وخَلُصت إلى فرضية وجود علاقة بين التطور المالي والنمو الاقتصادي.[9]

ومن بين الدراسات التطبيقية الحديثة التي أظهرت إيجابية هذه العلاقة دراسة عرفان، وسليمان، و آخرون حول مدى تأثير القطاع المالي على النمو (GDP) في باكستان بين (1975-2008)[10] ، ودراسة (Guglielmo Maria,Christophe Rault) بين (1994-2007)[11]، ودراسة (Dimitris k. Christopoulos, Efthymios G.Tsionas، وآخرون) لعشرة دول متقدمة[12]، ودراسة أيضا (Andrus oks) بين (1992- 1999)[13]، ودراسة (Durmus Özdemi and can Erbil) بين 1995- 2007 لعشر بلدان عضوة في الاتحاد الأوروبي مع تركيا، وقد دعمت الدراسة فرضية وجد علاقة إيجابية بين التحرير المالي والنمو الاقتصادي.[14] ودراسة (Chee Keong, Zulkornain Yusop،

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[8] Asli Dermirgüç-Kunt and Ross Levine, Financial Structure and Economic Growth, 2001 Massachusetts Institute Of Technology, P 4.

[9] Valpy FitzGerald, Financial Development And Economic Growth, P 8, http://www.un.org/esa/policy/backgroundpapers/fitzgerald_draft.pdf,

Franklin Allen and Hiroko Oura, Sustained Economic Growth and The Financial System, P 100, http://finance.wharton.upenn.edu/~allenf/download/Vita/sustained.pdf, والقدير، خالد، تأثير التطور المالي، مرجع سابق، ص7، 8.

[10] الموقع الالكتروني: http://www.eurojournals.com/ejss_11_3_07.pdf.419 ، الملخص، ص

[11] الموقع الالكتروني: http://www.wbiconpro.com/234-Rault.pdf.1 ، الملخص، ص

[12] الموقع الالكتروني: http://web.ku.edu/~intecon/Courses/Econ915/papers/finance- growth_jde04.pdf ، الملخص، ص 1.

[13] الموقع الالكتروني: http://www.mtk.ut.ee/doc/febawb8.pdf .29 ،28 ص ،

[14] الموقع الالكتروني: http://www.ecomod.org/files/papers/778.pdf... ص ،

وآخرون) على سوق الأوراق المالية الماليزية بين 1978- 2000.[15] ودراسة خالد بن محمد القدير[16] بعنوان "تأثير التطور المالي على النمو الاقتصادي في المملكة العربية السعودية"، وخَلُصت الدراسة إلى وجود علاقة توازنية طويلة الأجل بين التطور المالي بمقاييسه المختلفة ومعدل النمو.

ومن بين الدراسة السلبية التي لم تدعم وجود العلاقة السببية دراسة (Kevin H Zhan) لدول شرق آسيا بين (1987- 1999)[17]، ودراسة لإبراهيم العمر بعنوان "الدور التنموي لخدمات الوساطة المالية في النظام المصرفي في المملكة العربية السعودية" بين (1980-2005) واستخدم فيها نموذج بارو ومارتين (Barro, Martin) وأكدت الدراسة بأن قطاع الخدمات الوساطة المالية لم يظهر الفاعلية المطلوبة في الاقتصاد السعودي أي أنه لم يكن له أثر إيجابي في النمو الاقتصادي خلال فترة الدراسة.[18]

2-2 قنوات تأثير الوساطة المالية في النمو الاقتصادي

لاشك أن الموارد المالية من أهم العناصر المؤثرة في عملية النمو الاقتصادي، وبأن محددات هذا النمو تعتمد على تفاعل بعض العناصر كرأس المال، والعمل، والمواد الأولية، والتقنية. ويعتبر العرض النقدي، وتعبئة الموارد المالية للتنمية، والتخصيص الأمثل للموارد من أهم المؤثرات في عملية النمو الاقتصادي كالآتي:[19]

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[15] ، ص 178. http://129.3.20.41/eps/mac/papers/0307/0307010.pd الموقع الالكتروني:

[16] والقدير، خالد، تأثير التطور المالي، مرجع سابق، ص 3.

[17] ، الملخص، ص 1.http://www.karyiuwong.com/confer/Sea00/papers/zhang-s0.pdf الموقع الالكتروني:

[18] ، ص 23، 24. http://iefpedia.com/arab/?p=1923 الموقع الالكتروني:

[19] أبو زيد، عبد المنعم، **الدور الاقتصادي للمصارف الإسلامية بين النظرية والتطبيق** (القاهرة: المعهد العالمي للفكر الإسلامي، ط1، 1996م) ص 28، و36، 37، وشابرا، عمر، **نحو نظام نقدي عادل**، ترجمة سيد محمد سكر (أمريكا: المعهد العالمي للفكر الإسلامي، ط2، 1410 هـ، 1990م) ص 252، وفليح حسن خلف، **النقود والبنوك** (الأردن: جدارا للكتاب العالمي، عالم الكتب الحديث، ط1، 2006م) ص 276، 277، ويسري، عبد الرحمان، بحث **دور المصارف الإسلامية في تعبئة الموارد المالية للتنمية**، من كتاب البنوك الإسلامية ودورها في تنمية اقتصاديات المغرب العربي (المغرب: ندوة المعهد الإسلامي 1398

2-1-1 العرض النقدي: إن النقود في الاقتصاد المعاصر كالدم الذي يجري في الشرايين، فبدونها لا يوجد إنتاج أو تبادل سلع، فهي وسيط للتبادل، ومقياس للقيمة. وعملية توليد النقود هي عملية تلقائية تقوم بها البنوك والمصارف معتمدة بذلك على ودائعها، وعلى السحب اليومي للودائع الجارية،

والذي لا يتجاوز غالبا 10%. وقد درج الكثير من الباحثين على أن قبول الودائع، وثقة الأفراد في الالتزام المصرفي بالدفع عن طريق الصكوك (الشيكات)، وكذا توظيف الاحتياطات الإضافية يُمكنها من زيادة العرض النقدي.[20]

ولما كانت الزيادة في النمو المتوقع للمعروض النقدي تساعد في تخفيض كلفة التمويل، وهو ما يعني رفع معدل رأس المال، رأى ماريني وغيره أن نمو العرض النقدي له تأثير حقيقي على النشاط الاقتصادي.[21] بينما يرى البعض الآخر أن توليد النقود من طرف البنوك التجارية، والذي يعني التأثير في زيادة العرض النقدي يتعارض مع ما ذهب إليه أصحاب المذاهب، كالإمام الشافعي، وأحمد، ومالك، من أن إصدار النقود خاص بسلطة الحاكم، وبأن الوسائل النقدية التي تفرضها البنوك المركزية على البنوك التجارية غير كافية.[22] ولذا مال البعض إلى ضرورة إقرار احتياط نقدي يبلغ 100% من قيمة أرصدة الحسابات الجارية المفتوحة لدى البنوك التجارية وإيداعها لدى البنك المركزي.[23]

للبحوث والتدريب، ط2، 2000م) ص 127، والمشهراوي، أجمد، **تقييم دور المصارف الإسلامية في التنمية الاقتصادية في فلسطين**، رسالة ماجستير غير منشورة، جامعة غزة، قسم إدارة الأعمال، 2003، ص 53.

[20] العمر، إبراهيم، **النقود الائتمانية** دورها وآثارها في اقتصاد إسلامي (السعودية: دار العاصمة للنشر والتوزيع، ط1، 1414هـ) ص 298، وشابرا، محمد عمر، **نحو نظام نقدي عادل** (أمريكا: المعهد العالمي للفكر الإسلامي، ط2، 1990م) ص 258، وخلف، فليح حسن، **النقود والبنوك** (الأردن: جدارا للكتاب العالمي، 2006م) ص 430، أبو زيد، محمد عبد المنعم، **الدور الاقتصادي**، مرجع سابق، ص 37.

[21] العمر، إبراهيم، **قدرة النظام المصرفي على الحد من ظاهرة الفقر**، ص 14.الموقع الالكتروني: http://mpra.ub.uni-muenchen.de/18804/1/_ae_ae_ue_ue_ae_ae_ue_.pdf ،

[22] فهمي، حسين، **أدوات السياسة النقدية** (جدة: المعهد الإسلامي للتنمية، بحث رقم 63، 2006م) ص 91، 92.

[23] خان، محسن، وميراخور، عباس، **الإدارة النقدية في اقتصاد إسلامي**، مجلة الاقتصاد الإسلامي (جدة: جامعة الملك عبد العزيز، م14، 2002م) ص 12، و فهمي، حسين، **أدوات السياسة النقدية**، مرجع سابق، ص 109.

ويخلص ثلاثة من أهم الاقتصاديين الإسلاميين أن الجهاز المصرفي له آلية قوية للتوسع النقدي، منهم عمر شبرا عن طريق استعمال الودائع المشتقة من قبل المصارف أي التي تنتج من الاحتياطي الجزئي، وصديقي عن طريق الائتمان الذي يترتب عليه توليد نقود جديدة، ومنان الذي رأى بأنها عملية ضرورية للمجتمع لكونها تدعم النشاط الاقتصادي، وتعمل على استقرار الأسعار، وتساعد على التخصيص الأمثل للموارد، واعتبر أن القول بوجوب احتفاظ المصارف باحتياطي 100% هو نوع من الاكتناز المنهي عنه في الشريعة الإسلامية.[24] وقد عزا البعض جواز توليد النقود إلى عمر شابرا، وصديقي، ومحمد أحمد، ومحمد عزيز، وعبد الرحمن يسري، وأحمد النجار، وأكرم خان، وكوثر الأبجي، ومحمد عبد المنعم عفر.[25]

ثم إن عملية توليد النقود في المصارف الإسلامية تخضع لنفس مقومات التوليد في البنوك الربوية، والمثال التالي يشرح عملية التوليد:

أ- التوسع في الائتمان = $\frac{\text{الوديعة الأصلية}}{\text{نسبة الاحتياطي القانوني}}$

ب- الودائع المشتقة = $\frac{\text{الوديعة الأصلية} \quad \text{قيمة الاحتياطي}}{\text{نسبة الاحتياطي القانوني}}$

ت- مضاعف الائتمان = $\frac{1}{\text{نسبة الاحتياطي القانوني}}$

وإذا كان الاحتياطي مثلا 10% فإن التوسع في الائتمان (التوليد) سيكون كالآتي:

الودائع المشتقة $= \frac{100-1000}{\frac{10}{100}} = 900 \times \frac{100}{10} = 9000$

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[24] Siddiqi Muhammad Nejatullah, Impact of Islamic Modes of Finance on Monetary Expansion, *JKAU: Islamic Econ.*, Vol. 4, pp. 37-46 (1412 A.H./1992 A.D.) p 46. العمر، إبراهيم، **النقود الائتمانية**، مرجع سابق، ص 306، و

[25] السبهاني، عبد الجبار، **الموقف من النقود المصرفية ومشروعية توليدها في اقتصاد إسلامي**، مجلة الاقتصاد الإسلامي (جدة: مجلة جامعة الملك عبد العزيز، م10، 1998م) ص 26.

مضاعف الائتمان $= \frac{1}{\frac{10}{100}} = 1 \times \frac{100}{10} = 10$

بيد أن المتمعن في أساليب بيوع المداينات يدرك أن التسرب النقدي يكون فيها كبيرا لأنه العوض عن السلع التي ستباع، ولذا رأى بعض الباحثين[26] أن المصارف الإسلامية وبنظامها القائم على المشاركة في الأرباح، وتغليب الودائع الادخارية أو الاستثمارية يقلل من فرص توليدها للنقود، والمثال الآتي يشرح ويبين الفارق الواضح مع وجود التسرب النقدي إذا كان مثلا 20% كالأتي:

مضاعف الائتمان $= \frac{1}{\text{نسبة الاحتياطي + نسبة التسرب}} = \frac{1}{\frac{20}{100}+\frac{10}{100}} = 1 \times \frac{100}{30} = 3.33$

فإذا كانت الوديعة مثلا 1000 فإن التوسع سيكون 1000 × 3.33 = 3330 بدلا من 10000 لو كان التسرب صفرا مثلا.

2-1-2 تعبئة الموارد المالية للتنمية الاقتصادية وتوظيفها: لقد غدت الموارد المالية من أهم عناصر التنمية الاقتصادية، فالمشاريع الاقتصادية الكبيرة التي تساعد في دفع النمو باتت محتاجة إلى دعم مالي متنامي نظرا لمنافسة الشركات العالمية التي تحاول فرض سيطرتها، وهو ما يستدعي وجود رؤوس أموال لمحاكاة هذا التطور الاقتصادي العالمي. فغدت الحاجة إلى وجود وساطة مالية أمرا ضروريا.

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[26] أبو زيد، محمد، **الدور الاقتصادي**، مرجع سابق، ص 42، وشاهين، على عبد الله، **العوامل المؤثرة في توليد النقود المصرفية من منظور نظام نقدي إسلامي** (فلسطين: الجامعة الإسلامية، غزة) م15، ع2، الملخص، ص 607، والقنطقجي، سامر، **أنموذج عرض النقود من وجهة نظر الاقتصاد الإسلامي**، ص 14، الموقع الإلكتروني:

http://iefpedia.com/arab/?p=19292

ويرى البعض[27] أن هناك محددات نظرية، أو فروضا أساسية تساهم في نمو قدرة المصارف الإسلامية في تعبئة الموارد، كالاتجاه الرسمي في التطبيق الكامل للشريعة الإسلامية، ونضج الوعي والالتزام بالأهداف الاقتصادية الإسلامية، ومحاولة الحد من المعاملات المصرفية الخارجية مع البلدان التي تتمسك بالنظام الربوي، وكذا وجود كفاءات بشرية قادرة على أداء مهام العمل المصرفي في إطار الأهداف الاقتصادية والظروف الواقعية.

2-1-3 التخصيص الأمثل للموارد: لا ينحصر عمل الوساطة المالية في جمع الفوائض المالية (المدخرات) بل يتجاوز ذلك إلى ضرورة البحث عن قنوات استثمارية ترجع بأكبر عائد ممكن. ولذا ينبغي توجيه المدخرات إلى المشاريع ذات الكفاءة العالية التي تحقق أكبر قدر من الأرباح. وقد عُرف التخصيص بأنه "تلك الطريقة التي يتم بها استخدام الموارد المتاحة بحيث يتولد من هذا الاستخدام أكبر قدر ممكن من الأرباح."[28]

ويزعم أصحاب النظرية التقليدية أن سعر الفائدة هو الذي يقوم بتخصيص الموارد، فالفائدة عندهم هي الآلية لمعادلة الطلب بالعرض، ولذا رأى أصحاب النظرية الكلاسيكية أن المدخرات دالة لسعر الفائدة، وزعموا أن سعر الفائدة هو الذي يوازن بين الادخار والاستثمار.[29] بينما رأى كينز[30] أن الادخار ليس دالة لسعر الفائدة، بل هو دالة للدخل القومي، أي أن الادخار يتغيّر بتغيّر الدخل القومي، إضافة إلى عوامل

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[27] يسري، عبد الرحمان، بحث **دور المصارف الإسلامية في تعبئة الموارد المالية للتنمية**، من كتاب البنوك الإسلامية ودورها في تنمية اقتصاديات المغرب العربي (المغرب: ندوة المعهد الإسلامي للبحوث والتدريب، ط2، 2000م) ص 130.

[28] الحطاب، كمال، **الاستخدام الأمثل للموارد الاقتصادية من منظور إسلامي**، والاجتماعية (الأردن: مجلة اليرموك، سلسلة العلوم الإنسانية، م13، ع4، 1997م) ص 69.

[29] كمال، يوسف، **كيف نفكر استراتيجيا** (القاهرة: دار التوزيع والنشر الإسلامية، د. ت) ص229.

[30] كمال، يوسف، **المصرفية الإسلامية، الأساس الفكري** (القاهرة: دار النشر للجامعات المصرية، ط1، 1416هـ، 1996م) ص52،53، ويسري، عبد الرحمن، **دور البنوك الإسلامية في التنمية الاقتصادية**، مجلة الاقتصاد الإسلامي، دبي، ع 292، ص400.

ثانوية تحمل الإنسان على عدم الإنفاق، كالعوامل الذاتية مثل البخل، أو الاحتياط، أو عوامل موضوعية كالتغير في الأرباح وسعر الخصم، والعادات والتقاليد. واعتبر موديجلياني الأستاذ بجامعة كمبردج أن سن التقاعد والشيخوخة هو الذي يدفع الناس إلى الادخار لحاجتهم إليها في المستقبل.[31] ومالت دراسات أخرى إلى القول بأن الشك في الدخل المستقبلي يزيد من الادخار، وهو ما توصل إليه فيشر، وبولدنج، وغيرهما.[32] بينما خَلُص بعض الاقتصاديين الإسلاميين إلى أن الادخار دالة للدخل والاستهلاك، وضعف القول بوجود ترابط كبير بين الفائدة والادخار حتى في البلدان الصناعية.[33]

وقد أعرب الكثير من الاقتصاديين أن ثمن الفائدة لا يؤدى إلى التخصيص الأمثل للموارد، وبأن رأس المال الحالي قد أسيء تخصيصه مثل أنزلو كونراد، وجونسون[34]، ورالف الذي ذهب إلى أن معدل الفائدة لم يكن مناسبا لقرارات الاستثمار، ولا يصلح أن يتخذ قاعدة دائمة[35]، ناهيك أن الواقع العملي كذبها ورفضها، فالفائدة ظاهرة نقدية تتحدد بالعرض والطلب وهي ظاهرة قصيرة الأجل لا تتصل بكفاءة المشروع ولا بربحه.[36] ولذا يرى (Arne Bigsten) أن النظام المصرفي الذي مال إلى تعزيز التوزيع غير العادل لرأسمال.[37]

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[31] كمال، يوسف، **المصرفية الإسلامية، الأساس الفكري**، مرجع سابق، ص54.

[32] نديم الحق وعباس ميراخو، **السلوك الادخاري في نظام اقتصادي خال من الفائدة الثابتة**، مجلة جامعة الملك عبد العزيز الاقتصاد الإسلامي، المجلد 4، 1412هـ، 1992م)، مركز النشر العلمي جامعة الملك عبد العزيز، السعودية، ص48، 49.

[33] صديقي، محمد نجاة الله، **بحوث في النظام المصرفي الإسلامي** (جامعة الملك عبد العزيز، ط1، 2003م) ص100، وعمر شابرا، **نحو نظام نقدي**، مرجع سابق، ص150.

[34] شابرا، عمر، **نحو نظام نقدي**، مرجع سابق، ص 145.

[35] المرجع السابق، ص 146.

[36] يوسف، كمال، **كيف نفكر إستراتيجيا**، مرجع سابق، ج2، ص 249.

[37] شابرا، عمر، **الإسلام والتحدي الاقتصادي**، (أمريكا: المعهد العالمي للفكر الإسلامي، مكتب المعهد في الأردن، ط، 1416 هـ، 1996م) ص 388.

جدول رقم (1) يبين نسبة الفائدة على الودائع الثابتة للبنوك التجارية الماليزية ومعدل عائد الودائع النظام المصرفي الإسلامي الماليزي

البنوك والمؤسسات المالية	2007	2008	2009	2010
الودائع الثابتة للبنوك التجارية الربوية				
معدل عائد ودائع 3 أشهر	-	3.13	2.08	2.72
معدل عائد ودائع 12 أشهر	-	3.68	2.56	2.94
والودائع الاستثمارية للنظام المصرفي الإسلامي				
معدل عائد ودائع 3 أشهر	3.07	2.89	2.34	2.96
معدل عائد ودائع 12 أشهر	3.7	3.45	3.01	3.04

تقرير بنك نقارا، 2010، ص 51-52، الموقع الالكتروني:
http://www.bnm.gov.my/files/publication/msb/2010/9/ebook_9.pdf

يظهر من خلال الجدول رقم (1) أن الفائدة الربوية وعوائد الودائع الاستثمارية للنظام المصرفي الإسلامي كانت متقاربة في ماليزيا، وكان ينبغي أن تكون عوائد النظام المصرفي الإسلامي كبيرة كي يتمكن من رفع معدل ودائعه، وهو ما يعني توسيع مجال الاستثماري، خصوصا أن تقارب النسبتين يُفضي بالعملاء إلى تفضيل البنوك الربوية لأن عائدها ثابت، وعوائد النظام المصرفي الإسلامي غير ثابتة.

3- تقييم أثر النظام المصرفي الإسلامي الماليزي على بعض المتغيرات الاقتصادية

قد سبق القول بأن الوساطة المالية تأثر في عملية النمو عن طريق بعض القنوات، كزيادتها للمعروض النقدي، وقدرتها على جمع المدخرات، وتخصيصها الأمثل للمواد. وتتفرع عن هذه العناصر بعض المؤشرات والمعايير القياسية، كمعيار الادخار، وحجم الموارد الإجمالية، والموارد الذاتية ومعدل نموها، وكذا مؤشر أساليب التوظيف، ونسبة توظيف المال في القطاعات الاقتصادية المهمة. وسنأخذ النظام المصرفي الإسلامي الماليزي وبعض البنوك االربوية الماليزية كنموذج لدراسة تلك المؤشرات كما في المطالب التالية:

3-1 أثر حجم أصول وتمويل النظام المصرفي الإسلامي الماليزي في الناتج المحلي الإجمالي الحقيقي الماليزي

من أجل بيان أثر كل من أصول وتمويل النظام المصرفي الإسلامي المالي في الناتج الإجمالي الماليزي بالأسعار الجارية استخدام الباحثان البرنامج الإحصائي المسمى (spss) لإثبات أو نفي هذا التأثير أو هذه العلاقة إحصائيا، وقد قسمنا بيانات حجم أصول وتمويل النظام المصرفي الإسلامي تقسيم ربع سنوي اعتمادا على بعض الأبحاث السابقة [38]، وبيانات التقسيم موجودة في الملحق (1) أما الناتج الإجمالي فهو مقسم في تقرير البنك المركزي.

حدول (2) بيانات قبل التقسيم بين (2001-2009)

السنة	حجم أصول النظام المصرفي الإسلامي بالمليون رنجت (x1)	حجم تمويل النظام المصرفي الإسلامي بالمليون رنجت (x2)	الناتج الإجمالي الحقيقي بالمليون رنجت (y)
2001	60,244.5	28,317.6	352,579
2002	68,967.9	36,719.8	383,213
2003	83,105.2	48,613.9	418,769
2004	95,033.9	57,841.3	474,048
2005	111,823.5	67,364.6	522,445

[38] Hammed s. AL- BAZAI,"The Role of Money in Saudi Arabia , ",j.kau:Econ .& Adm .(1999).VOL.13.No. 1, pp37.

$$1st\ quarter = 0.05469X_{t-1} + 0.2347X_{t} - 0.03906X_{t+1}$$

$$2nd\ quarter = 0.00781X_{t-1} + 0.26563X_{t} - 0.02344X_{t+1}$$

$$3rd\ quarter = -0.02344X_{t-1} + 0.26563X_{t} + 0.00871X_{t+1}$$

$$4th\ quarter = -0.03906X_{t-1} + 0.23437X_{t} + 0.05469X_{t+1}$$

574,441	78,518.3	131,908.6	2006
642,049	89,867.6	156,810.8	2007
740,907	107,721.8	192,682.3	2008
679,687	134,973.5	233,656.3	2009

تقرير البنك المركزي الماليزي 2005، الملحق، ص 61، والموقع الالكتروني:
http://www.bnm.gov.my/files/publication/msb/2010/9/xls/3.4.2.xls

تم فحص الارتباط الذاتي بين المتغيرين المستقلين، ودلت النتائج على وجود ارتبط ذاتي (Correlation) عال وقوي بقيمة (0.996) بين حجم الأصول وحجم التمويل[39]، وهو ما يفرض علينا تحليل البيان على شكل نموذجين، أو أخذ أحد المتغريين والاكتفاء بنموذج واحد، ولذا سيتم بيان أثر تمويل النظام المصرفي الإسلامي في الناتج الإجمالي المحلي الماليزي كالآتي:

جدول (3) نتائج تقدير اثر حجم تمويل النظام المصرفي الإسلامي على الناتج الإجمالي الحقيقي الماليزي

المتغير المعتمد (التابع) هو الناتج المحلي الإجمالي الحقيقي

المتغير المستقل	قيمة المعلمة Unstandardized coefficient (B)	اختبار T-test	قيمة P-value	اختبار F-test	قيمة معامل التحديد R^2	قيمة معامل التحديد المعدل $\overline{R}^2$
الثابت (b_0)	64958.199	13.044	0.000	225.158 (0.000)	0.869	0.865
X1 : حجم تمويل النظام المصرفي الإسلامي	3.764	15.005	0.000			
$y = b_0 + b_1(x_1)$ $y = 64958.199 + 3.764(x1)$						
المصدر: إعداد الباحثان بالإستاد إلى البرنامج الإحصائي (spss)، رجع البيانات في المحلق (4)						

أظهرت نتائج تقدير الانحدار الخطي (Linear Regression) حسب الجدول (3) بأن F-test بلغت 221.206، وقيمة P- Value =0.000، وهو ما يشير إلى أن النموذج ذو دلالة

[39] راجع الملحق رقم (4).

إحصائية، كما أن قيمة معامل الارتباط بلغت R^2 =0.869، وهذا يشير إلى أن المتغير المستقل، أي (حجم تمويل النظام المصرفي الإسلامي الماليزي) يفسر المتغير التابع أي (الناتج الإجمالي المحلي الماليزي) بنسبة 86.9%، ولذا فإنه من خلال النتائج الواردة في الجدول أعلاه حول أثر المتغير المستقل على المتغير التابع كانت على النحو التالي:

إن إشارة معلمة مرونة إجمالي تمويل النظام المصرفي الإسلامي الماليزي بالنسبة للناتج الإجمالي الحقيقي متوافقة النظرية الاقتصادية التي تؤكد على أن التطور المالي للبنوك يساهم في دفع النمو الاقتصادي كما سبق بيانه في الدراسات السابقة.[40] وقد دل تحليل النموذج بأن F- test بلغت 221.206، وقيمة P- 0.000 Value = كانت أصغر من 0.05، إضافة إلى أن قيمة t-test = 13.044 كانت موجبة. وهذا يشير إلى أن المعلمة ذات دلالة إحصائية أي أنه كلما زاد التمويل الإسلامي برنجت واحد فإن ذلك سيؤدي إلى زيادة الناتج الإجمالي الحقيقي بـ 3.764 رنجت.

3-2 نمو أصول النظام المصرفي الإسلامي والمؤسسات المالية الربوية الماليزية:

إن معرفة نمو أصول البنوك والمصارف الإسلامية يوضح لنا مدى قدرتها كوساطة مالية في ممارسة عملية الاستثمار بأريحية أكثر وتوسيع مجالها الاستثماري، ولذا فإن تطور أصول البنوك والمصارف دليل على كفاءتها الاقتصادية. ناهيك على أنه يساعدنا في قياس الفكر النتظيري للمصارف الإسلامية، من كونها الأقدر على تطوير أصولها، وودائعها، ووسائل تمويلها مقارنة بالبنوك الربوية الماليزية، وهذا ما فَرض علينا عقد مقارنة تحليلية بين النظام المصرفي الإسلامي الماليزي، وبعض المؤسسات المالية التنموية الماليزية الربوية كالآتي:

[40] انظر من البحث ص 6.

3-2-1 نمو أصول النظام المصرفي الإسلامي: يشمل النظام المصرفي الإسلامي الماليزي مصارف إسلامية، ومؤسسات مالية ربوية مشاركة في برنامج الصيرفية الإسلامية.[41]

جدول (4) يوضح نمو أصول النظام المصرفي الإسلامي بالمليون رنجت

السنوات	2000	2001	2002	2003	2004	2005
إجمالي الأصول	47,068.0	60,244.5	68,967.9	83,105.2	95,033.9	111,823.5
التغير السنوي	%30	%28	14.47%	%20.50	14.35%	%17.66

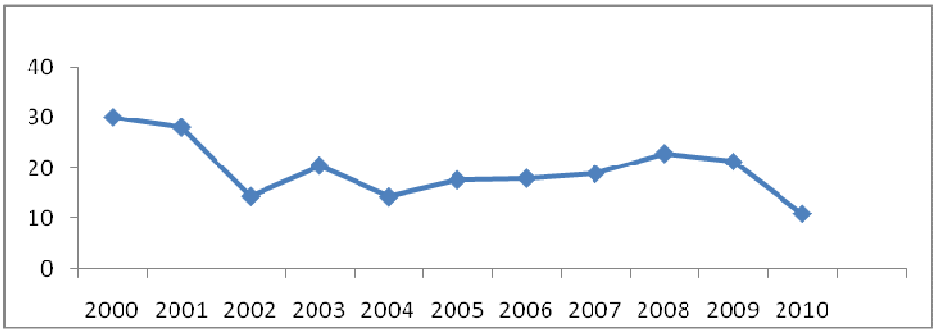
المصدر: تقرير بنك نقار الماليزي، 2000، ص 153، وتقرير 2005، الملحق، ص 61، استخرج الباحث التغير السنوي من التقارير.

جدول (5) يوضح نمو أصول النظام المصرفي الإسلامي بالمليون رنجت

السنوات	2006	2007	2008	2009	2010
إجمالي الأصول	131,908.6	156,810.8	192,682.3	233,656.3	259,397.0
التغير السنوي	%17.96	%18.87	%22.87	%21.26	%11.01

المصدر: الموقع الالكتروني http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.7.1.xls، استخرج الباحث التغير السنوي من التقارير.

شكل بياني (1) يوضح نسبة نمو أصول النظام المصرفي الإسلامي الماليزي



يؤكد الجدول (4، 5) والرسم البياني (1) أن أصول النظام المصرفي الإسلامي الماليزي شهدت تطورا ملحوظا بين (2000-2005)، وذلك بالرغم من انخفاض معدل نسبة النمو، حيث نمت من 47.1 بليون رنجت عام 2000م، إلى 111,823.5 عام 2005 ، وبمعدل نسبة نمو قدرها 20% بين

[41] راجع الملحق (1).

(2000-2005)، وهي نسبة جيدة تؤكد كفاءة النظام المصرفي الإسلامي الماليزي. وأما بين (2006-2010) فقد ارتفعت الأصول من 131,908.6 بليون رنجت عام 2006 إلى 259,397.0 بليون، وبمعدل نسبة نمو 18.39%. وهي نسبة كذلك جيدة رغم انخفاضها عن معدل نسبة النمو بين (2000-2005)، ونخلص من هذا إلى أن النظام المصرفي الإسلامي الماليزي كان ينمو بمعدلات سنوية ممتازة أقلها كانت 11% عام 2010، وأكثرها 30% عام 2000م كما هو مبين في الجدولين (4-5)، وبهذا يؤكد النظام المصرفي الإسلامي كفاءته الاقتصادية وقدرته منافسة البنوك الربوية الماليزية.

جدول (6) يوضح حجم أصول النظام المصرفي الإسلامي الماليزي إلى إجمالي النظام المصرفي الماليزي بالمليون رنجت

	2000	2001	2002	2003	2004	2005
حجم أصول النظام المصرفي الماليزي	659,006.0	692,571.8	735,189.6	815,989.9	881,670.8	958,545.6
حجم أصول النظام المصرفي الإسلامي	47,068.0	60,244.5	68,967.9	83,105.2	95,033.9	111,823.5
النسبة	% 7.14	%8.7	%9.38	%10.18	%10.77	%11.66

المصدر: خاص بأصول النظام المصرفي الإسلامي الماليزي بين (2000-2005) تقرير بنك نقار الماليزي، 2000، ص 153، وتقرير 2005، الملحق، ص 61، استخرج الباحث التغير السنوي من التقارير.

جدول (7) يوضح حجم أصول النظام المصرفي الإسلامي إلى إجمالي النظام المصرفي الماليزي بالمليون رنجت

	2006	2007	2008	2009	2010
حجم أصول النظام المصرفي الماليزي	1,092,914.4	1,221,429.1	1,337,978.2	1.426,206.4	1,508,676.2
حجم أصول النظام المصرفي الإسلامي	131,908.6	156,810.8	192,682.3	233,656.3	259,397.0

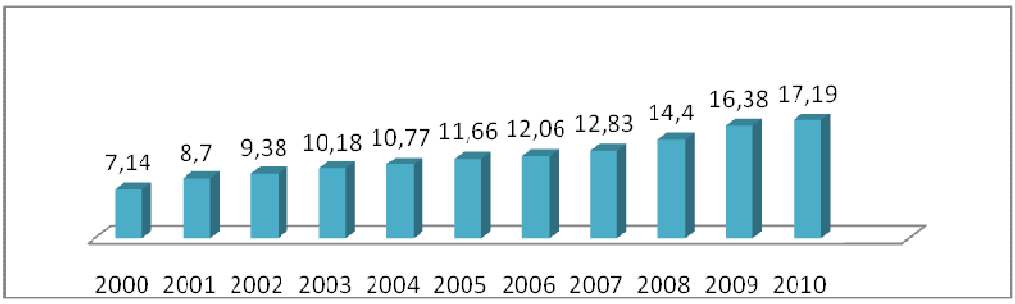
النسبة	%12.06	%12.83	%14.40	%16.38	%17.19

المصدر: أصول النظام المصرفي الماليزي بين (2000-2010) الموقع الالكتروني:

http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.7.xls

http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.7.1.xls خاص بالنظام المصرفي الإسلامي بين (2006- 2010)، استخرج الباحث التغير السنوي من التقارير.

شكل بياني رقم (2) يوضح نِسَب أصول النظام المصرفي الإسلامي الماليزي إلى إجمالي أصول النظام المصرفي الماليزي بين (2000-2010)



استطاع النظام المصرفي الماليزي حسب الجدول (6، 7) والشكل البياني (2) تطوير نسبة أصوله إلى أجمالي أصول النظام المصرفي الماليزي بالرغم من ضعفها في بداية السنوات الخمس، حيث نمت النسبة من 7.14% عام 2000م إلى 17.19% إلى نهاية شهر تسعة عام 2010. أي أن أصوله نمت نسبتها بمعدل 10% تقريبا من سنة (2000- 2010) وهو ما يبرز نسبيا كفاءته الاقتصادية.

3-2-2 تقييم الموارد المالية طويلة الأجل: تعد الموارد المالية طويلة الأجل من أهم المتغيرات الأساسية المؤثرة في النشاط الاقتصادي التنموي، ومن المفترض أن تكون نسبة هذه الموارد كبيرة في البنوك الإسلامية ذات الطابع الاستثماري، ناهيك على الاعتماد عليها في مواجهة مخاطر الاستثمار، ويمكن حساب هذه النسبة كالآتي:

نسبة حقوق الملكية إلى إجمالي الموارد= رأس المال المدفوع+ الاحتياطات+ الأرباح المحتجزة/ إجمالي الموارد[42]، والجداول التالية توضح هذه النسبة في المصارف المذكورة. كما أن تقييم تلك الموارد يؤكد لنا مدى قدرة المصارف على دخول مجال الاستثمار طويل الأجل لدفع النمو الاقتصادي.

جدول (8) يوضح نسبة حقوق الملكية للنظام المصرفي الإسلامي الماليزي بالمليون رنجت (System Islamic Banking)

السنة	رأس المال والاحتياطات	إجمالي الموارد	نسبة حقوق الملكية إلى إجمالي الموارد	نسبة حقوق الملكية إلى إجمالي الموارد على أساس سنة 2000م%
2000	2,526	47,069	5.36	100
2001	3,434	58,929	5.82	108.58
2002	4,703	68,070	6.90	128.73
2003	6,784	82,196	8.25	153.91
2004	7,436.5	95,033.9	7.82	145.89
2005	10,051.7	111,823.5	8.98	167.53
2007[43]	12,961.6	79,153.8	16.37	305.41
2007[44]	14,059.4	122,027.6	11.52	214.92
2008	14,403.3	123,726.8	11.64	217.16
2009	14,886.6	152,271.8	9.77	182.27
2010[45]	20,810,2	212,708.8	9.78	182.46
المعدل			9.29	

المصدر: تقارير البنك المركزي الماليزي، 2001، ص 150، و 2003، ص 196، و 2005، الملحق ص 62، و الموقع الالكتروني: http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.9.1.xls، استخرج الباحث نسبة حقوق الماكية، ونسبة حقوق الملكية على أساس 2000 من التقارير.

[42] دوابة، **دور الأسواق المالية**، مرجع سابق، ص 32، المشهراوي، أحمد، **تقييم دور المصارف**، مرجع سابق، ص 82، 83.

[43] الشهر الأول من 2007. .

[44] إلى شهر 12 من 2007.

[45] إلى غاية شهر 9

يؤكد الجدول (8) بأن معدل نسبة حقوق الملكية للنظام المصرفي الإسلامي كله كان ضعيفا، بيد أن تطور نسبة حقوق الملكية إلى إجمالي الموارد على أساس سنة 2000 طول العشر سنوات يؤكد كفاءته الاقتصادية.

جدول رقم (9) يوضح نسبة حقوق الملكية للمؤسسات المالية التنموية الربوية الماليزية إلى إجمالي الموارد بالمليون رنجت[46] (Development Financial Institution)

السنة	حقوق الملكية	إجمالي الموارد	نسبة حقوق الملكية إلى إجمالي الموارد%	نسبة حقوق الملكية إلى إجمالي الموارد على أساس سنة 2000م%
2000	6,314.2	61,362.2	10.29	100.00
2001	6,906.7	68,065.8	10.14	98.54
2002	7,905.4	72,446.4	10.91	106.02
2003	9,4241	79,090.4	11.91	115.74
2004	10,543.8	91,449.9	11.52	111.95
2005	12,616.4	100,144.4	12.59	122.35
2006	15,091.1	113,562.1	13.28	129.05
2007	17,767.8	128,770.4	13.79	134.01
2008	23,057.2	144,429.2	15.96	155.10
2009	24,029.1	164,709.2	14.58	141.69
المعدل			12.49	

المصدر: تقارير البنك المركزي الماليزي 2004، الملحق، ص 66، و 2005، الملحق، ص 68، و http://www.bnm.gov.my/files/publication/fsps/en/2009/zcp07_table_A.13.pdf, P10.، استخرج الباحثان نسبة حقوق الملكية، ونسبة حقوق الملكية على أساس 2000 من التقارير.

من خلال بيانات الجدول (9) تبين أن معدل نسبة حقوق الملكية في المؤسسات التنموية الربوية كان أكبر من معدل النظام المصرفي الإسلامي، حيث بلغ 12.49 %، وهو معدل دون المتوسط يساعد

[46]. أسماء المؤسسات المالية التنموية الربوية الماليزية في الملحق (3).

في توسيع استثمارها. كما يلاحظ أيضا ارتفاع نسبة حقوق الملكية على أساس سنة 2000 عدا سنة 2001، وهو ما ينم عن كفاءتها الاقتصادية.

3-3 نمو حجم التمويل المصرفي الإسلامي الماليزي

رأى الكثير من المهتمين بقضايا النمو الاقتصادي إدراج الوساطة المالية في نماذجهم ومعادلاتهم باعتبارها أحد عوامل ومحددات التحليل الكلي، مثل غرينوود (Greenwood)، وجزفانيك (Jovanovic).[47] وأكد بنسيفنكا وسميث (Bencivenga,and smith) على دور المصارف في تأمين السيولة.[48] ولذا رأى صولو ساون (Solow Sawan) وفقا لنموذجه ولمدرسته النيوكلاسيكية أن الزيادة في معدل الاستثمار ستؤدي إلى رفع معدل النمو الاقتصادي لفترة محدودة[49]، وهو ما جعل أحد الباحثين يضيف على نموذج صولو مؤشر خدمات الوساطة المالية (f)[50] ولما كان حجم التمويل الإسلامي أحد العناصر المؤثرة في الناتج الإجمالي تَطَلَب منا ذلك معرفة تطور هذا النمو كالآتي:

جدول رقم (10) يوضح حجم تمويل النظام المصرفي الإسلامي الماليزي بالمليون رنجت

السنوات	2000	2001	2002	2003	2004	2005
إجمالي التمويل	20,891.0	28,317.6	36,719.8	48,613.9	57,841.3	67,364.6
التغير السنوي	%52.22	%35.5	29.6%	32.4%	%19	%16.5

المصدر: تقرير بنك نقار 2000، ص 153، و2005 الملحق، ص 61، استخرج الباحث التغير السنوي من التقارير.

[47] Sustained economic .p 97.

[48] العمر، إبراهيم بن صالح، **قدرة النظام المصرفي على الحد من ظاهرة الفقر**، ص 9، الموقع الالكتروني: http://mpra.ub.uni-muenchen.de/18804/1/_ae_ae_ue_ue_ae_ae_ue_.pdf

[49] قبور، نور الدين، **أثر السياسة المالية على النمو الاقتصادي، الجزائر أنموذجا**، رسالة ماجستير غير منشورة (جامعة فرحات عباس، سطيف، كلية العلوم الاقتصادية وعلوم التسيير، 2007-2008م) ص 55.

[50] العمر، إبراهيم، **الدور التنموي لخدمات الوساطة**، مرجع سابق، ص 11.

جدول رقم (11) يوضح حجم تمويل النظام المصرفي الإسلامي الماليزي بالمليون رنجت

السنوات	2006	2007	2008	2009	2010
إجمالي التمويل	78,518.3	89,867.6	107,721.8	134,973.5	154,610.1
التغير السنوي	%16.5	14.4%	%20	%25.3	%14.5

المصدر: الموقع الالكتروني: بين (2006-2010)،
http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.18.1.xls، استخرج الباحث التغير السنوي من التقارير.

حظي التمويل المصرفي الإسلامي الماليزي حسب الجدولين (10، 11) بنمو ممتاز، رغم تراجع نسبة النمو طوال العشر سنوات، حيث ارتفع حجم التمويل من 20 بليون رنجت عام 2000م، إلى 28 بليون إلى67 بليون عام 2005، وبمعدل نسبة نمو قدرها 30.87%، وهي نسبة ممتازة تؤكد كفاءة وقدرة النظام المصرفي الإسلامي الماليزي على تطوير تمويله كما هو موضح في الجدول (10، 11). واستمر نمو حجم التمويل من 78 بليون إلى 154 بين (2006-2010)، وبمعدل نسبة نمو قدرها 18.14%، وهو ما يدل بكل وضوح على الكفاءة الاقتصادية للنظام المصرفي الماليزي رغم تراجع نسبة النمو، كما أن هذا النمو يساعد على توسيع النشاط الاستثماري.

3-4 بيان مدى قدرة النظام المصرفي الإسلامي الماليزي وبعض المؤسسات الربوية الماليزية في جمع المدخرات

إن جمع المدخرات هي المهمة للوساطة المالية،[51] ولذلك أعرب الكثير من المهتمين بالاقتصاد أن جمع المدخرات مع حسن توظيفها كفيل بحل المشاكل المالية لكثير من المشاريع التي تدخل في خطط التنمية،

[51]: حسن عبد الله الأمين، **تقنيات المال والاقتصاد المعاصرة من منظور إسلامي** (دار التجديد للطباعة والنشر والترجمة، ماليزيا ط1، 1422هـ، 2002م) ص 23، 24، على السالوس، **المعاملات المالية المعاصرة في ميزان الفقه الإسلامي** (مكتبة الفلاح، الكويت: ط1، 1406هـ، 1986م) ص 223، أحمد الرشيدي، **عمليات التورق وتطبيقاتها الاقتصادية في المصارف الإسلامية** ط1، 1425هـ، 2005م) ص 116، 117.:(دار النفائس، الأردن

والتي قد يلجأ انعدامها إلى الاقتراض الخارجي الذي سَببَ الأزمات للدول المقترضة.[52] وكذا إمكانية لجوء الحكومة أو البنك المركزي إلى استعمال الودائع الجارية للمصارف والبنوك والمؤسسات المالية في تغطية عجزها المؤقت لدى الاقتصادي عمر شابرا.[53] كما أن الادخار كان وراء تحقيق معدلات نمو عالية للكثير من الدول[54]، بينما رأى البعض بيان أهمية الادخار فعنون له عنوانا سماه "دفع الاستهلاك لأسفل من أجل دفع الاستثمار لأعلى"[55]. والجداول التالية توضح حجم المدخرات للنظام المصرفي الإسلامي الماليزي، والمؤسسات المالية التنموية الماليزية الربوية.

جدول رقم (12) يوضح حجم نسبة ودائع النظام المصرفي الإسلامي الماليزي

السنة	نسبة الودائع الجارية %[56]	نسبة الودائع الادخارية %[57]	نسبة الودائع الاستثمارية %[58]
2005	17.62	11.33	53.14

[52] درويش، جستينة، وآخرون، **تطبيق القوانين المستمدة من الشريعة الإسلامية على الأعمال المصرفية** (جامعة الملك عبد العزيز، السعودية: ط1، 1419هـ، 1998م) ص 9، 10، وشابرا، **الإسلام والتحدي**، مرجع سابق، ص 367، 368.

[53] صديقي، **بحوث في النظام المصرفي**، مرجع سابق، ص 95.

[54] على القري، **آفاق جديدة في المصرفية الإسلامية** (حولية البركة،ع 5) ص 185.

[55]) **الصراع على القمة مستقبل المنافسة الاقتصادية بين أمريكا واليابان**، ترجمة أحمد فؤاد Head to Head لسترثارو (عالم المعرفة، الكويت: ع 204، كانون الأول 1995م) ص 147.

[56]) 12 تشمل الودائع الجارية ولشهر RM Demand deposits, FX Demand deposits(

[57]) 12 تشمل الودائع الادخارية ولشهر RM Saving deposits, FX Saving deposits(

[58] 12تشمل الودائع الادخارية ولشهر RM Special investment deposits, FX Special investment deposits, RM General investment deposits, FX General investment deposits)

2006	20.69	11.18	49.58
2007	20.44	11.11	47.18
2008	17.12	10.17	44.78
2009	16.28	9.59	49.58
2010	14.89	9.07	48.18
المعدل	17.84	10.40	48.74

المصدر: تقرير بنك نقارا الماليزي 2005، الملحق ص 67، استخرج الباحث النسبة من التقريرين، الموقع الالكتروني:
http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.24.1.xls

من خلال الجدول (12) يتضح أن معدل نسبة الودائع الجارية قد بلغ 17.84% وهو معدل مقبول، لولا انخفاض النسبة من 20.69% إلى 14.89% عام 2010، والذي ينم عن التراجع النسبي للكفاءة الاقتصادية. وأما الودائع الادخارية فقد كان معدل نسبتها تحت المتوسط، حيث لم يتجاوز 10.40%, عكس الودائع الاستثمارية التي كان معدل نسبتها جيدا، حيث بلغ 48.74%، بيد أن تراجع نسبة الودائع من 53.14% عام 2005م إلى 48.18% عام 2010م يشعر بضعف الكفاءة الاقتصادية للنظام المصرفي الإسلامي.

جدول رقم (13) يوضح نسبة حجم ودائع المؤسسات المالية التنموية الربوية (Development Financial Institution)

السنة	الودائع المقبولة بالمليون رنجت	نسبة المقبولة إلى إجمالي الودائع %	إجمالي الموارد
2005	54,084.7	54.15	99,867.9
2006	60,402.2	53.19	113,562.1
2007	76,067.9	59,07	128,770.4
2008	79,542.8	55.07	144,429.2
2009	95,581.6	58.03	164,709.2
المعدل		55.90	

تقرير 2005، الملحق، ص 68، و2009، الملحق، ص 10، استخرج الباحث النسبة من التقارير، الموقع الالكتروني:

http://www.bnm.gov.my/files/publication/fsps/en/2009/zcp07_table_A.13.pdf

يبين الجدول (13) أن معدل نسبة الودائع المقبولة في المؤسسات المالية التنموية الربوية كان مقبولا، حيث بلغ 55.90 % كما أن هذه النسبة ظلت عموما في ثبات نسبي عدا 2007، و2009، واللتان شهدتا ارتفاعا للنسبة.

3-5 الأهمية النسبية لصيغ الاستثمار

رغم أن المصارف الإسلامية لا تخرج عن كونها وساطة مالية إلا أن منهجها وأساسها يختلف عن منهج البنوك الربوية انطلاقا من أسسها الشرعية[59]، ومن أهم مقاصد الشريعة الإسلامية حفظ المال وتوزيعه بالعدل بين الناس.[60] بيد أنه لابد من الإشارة قبل أي تحليل إلى عدم وجود اتفاق مسبق بين المنظرين حول كيفية تقييم عمل البنوك الإسلامية لعدم وجود معايير متفق عليها، حيث ينتقد البعض تبني المصارف الإسلامية وسائل تمويلية شبه مضمونة كالمرابحة، والسلم وغيرها.[61] في حين عدَّ البعض هذا انتصارا للمصرفية التي أوجدت طرقا تمويلية إسلامية تلبي حاجات العملاء[62]، بينما رأى البعض بيان أهميتها الاقتصادية في قدرتها على جمع المدخرات، وتطوير أصولها، وضرورة توزيع تمويلها على معظم الأساليب ونسب

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[59] أبو زيد، **الدور الاقتصادي**، مرجع سابق، ص 18، إبراهيم العمر، **النقود الائتمانية دورها وأثرها في اقتصاد إسلامي** (دار العاصمة للنشر والتوزيع، السعودية: ط1، 1414ه) ص 209، 210.

[60] الآمدي، **الإحكام**، تحقيق سيد الجميلي (دار الكتاب العربي، بيروت، ط1) ج3، ص 300، أبو إسحاق الشاطبي، **الموافقات**، تحقيق عبد الله دراز (دار المعرفة، بيروت، د.ت.ط) ج2، ص 10، يوسف الشلبي، **الخدمات الاستثمارية في المصارف وأحكامها في الفقه الإسلامي** (دار ابن الجوزي، السعودية، ط1، 1425ه، 2005) ج1، ص 70، 71، حمدي عبد العظيم، **دراسات الجدوى الاقتصادية في البنك الإسلامي** (المعهد العالمي للفكر الإسلامي، القاهرة، ط1، 1417ه، 1996م) ص 77.

[61] صالح الحصين، ، **بحث المصارف الإسلامية مالها وما عليها، حولية البركة**، ع6، 2004، ص 36، و38 ، وبحث عطية السيد فياض، **العوائق والأخطاء**، مرجع سابق، ص 619- 621، محمد نجاة صديقي، **بحوث في النظام المصرفي**، مرجع سابق، ط2، 1416ه، 1996م) :ص 250، يوسف كمال، **المصرفية الإسلامية الأزمة والمخرج** (دار النشر للجامعات المصرية ص95.

[62] على القري، **آفاق جديدة في المصرفية الإسلامية** (حولية البركة، ع5، ط1) ص183، و184.

متقاربة،كالمضاربة، ومشاركة وغيرها، وكذا إلى ضرورة تمويل القطاعات المهمة كالصناعة، والزراعة وغيرها.[63] ولذا فإن محاولة الجمع بين الضوابط الشرعية للتمويل والتفهم لمهام الوساطة المالية يكون أقرب للعدل.

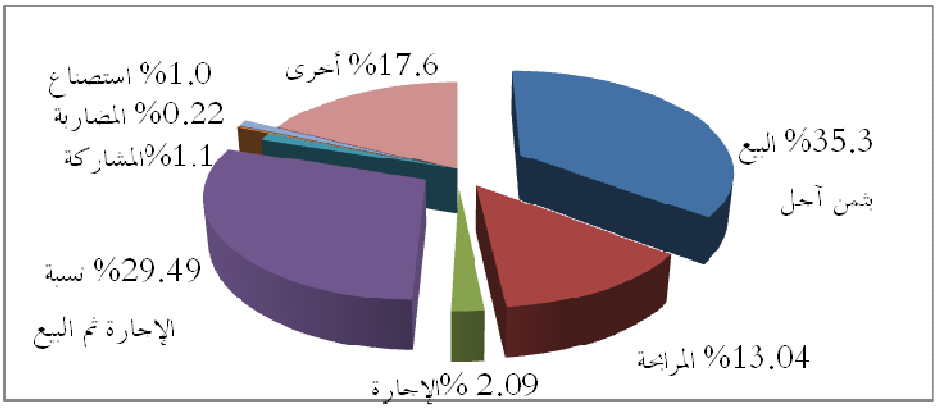
جدول رقم (14) يوضح الأهمية النسبية لصيغ الاستثمار للنظام المصرفي الإسلامي

	نسبة البيع بثمل آجل	نسبة المرابحة	نسبة الإجارة	نسبة الإجارة ثم البيع	نسبة المشاركة	نسبة المضاربة	نسبة الاستصناع	أخرى
2006	40.7	7.22	1.03	29.26	0.2	0.2	0.7	20.7
2007	37.0	11.35	1.35	30.22	0.4	0.1	0.9	18.5
2008	33.0	15.15	2.65	30.44	1.08	0.3	1.3	16.0
2009	32.1	17.25	3.02	29.18	1.76	0.3	1.1	15.2
2010	33.7	14.22	2.41	28.33	2.53	0.2	1.0	17.5
المعدل	35.3	13.04	2.09	29.49	1.15	0.22	1.0	17.6

المصدر: استخرج الباحث النسبة من التقرير، الموقع الالكتروني:

http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.18.2.xls

شكل بياني (3) يوضح نِسب صيغ الاستثمار للنظام المصرفي الإسلامي الماليزي



[63] محمد أبو زيد، **الدور الاقتصادي للمصارف**، مرجع سابق، ص 27، و43، أشرف محمد دوابه، **دور الأسواق المالية في تدعيم الاستثمار طويل الأجل**، (دار السلام مصر: ط1، 1427م، 2006م) ص31، و68، محمد البلتاجي، **الندوة الدولية، نحو ترشيد مسيرة البنوك الإسلامية**، (الإمارات، دبي، 3-5 سبتمبر، 2005م) ص20، عبد الحميد البعلي، **الاستثمار والرقابة الشرعية في البنوك والمؤسسات الإسلامية دراسة فقهية وقانونية ومصرفية**، (مصر: مكتبة وهبة، ط1، 1411هـ، 1991م) ص 135.

من خلال الجدول (14) والشكل البياني (3) تبين أن البيع بثمن آجل حاز على أكبر معدل للنسبة التمويل، حيث بلغ 35.5%، ثم 29.49% لصيغة إجارة ثم البيع، والمرتبة الثالثة حصلت عليها المرابحة على معدل 13.4%، وحصلت الإجارة على 2.09%. وأما معدل نسبة تمويل المشاركة فلم يتجاوز 1.1%، وعليه فإن جل تمويل النظام المصرفي الإسلامي كان قائما على التمويل البيعي أي أننا إذا طرحنا نسبة المضاربة والمشاركة، والإجارة فإن التمويل البيعي سيفوق 96% من إجمالي التمويل.

3-6 الأهمية النسبية للاستثمار في قطاعات المهمة

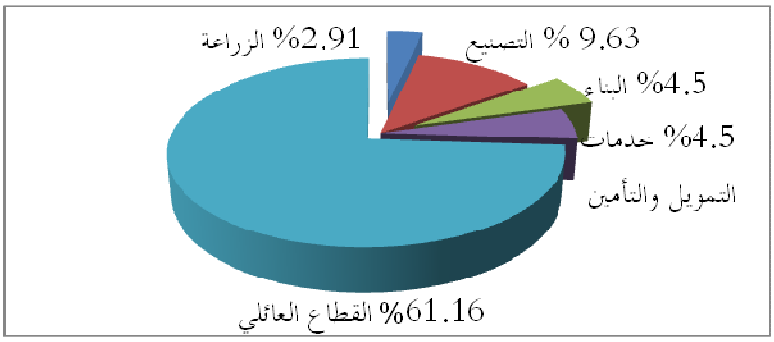
لا شك في أن توزيع المصرف لمحفظته الاستثمارية حسب أهمية كل قطاع دليل واضح على حرصه لاستيعاب معظم القطاعات، فهل يا تُرى استطاعت المصارف الإسلامية الماليزية تغطية معظم تلك القطاعات، وبنسب تتناسب مع أهمية كل قطاع؟ وضمن حجم حصتها السوقية، هذا ما سيوضحه لنا التحليل التالي:

جدول (15) يوضح نِسَب أهم قطاعات التي حازت على تمويل النظام المصرفي الإسلامي الماليزي

	نسبة الزراعة	نسبة التصنيع	نسبة البناء	نسبة خدمات التمويل والتأمين والأعمال	نسبة المقتنيات المنزلية	إجمالي التمويل
2005	3.5	11.2	4.9	3.0	_	67.364.6
2006	3.81	10.67	4.28	3.95	64.11	78,518.3
2007	2.91	11.06	5.05	4.45	61.38	89,867.6
2008	2.60	9.98	4.83	5.53	58.67	107,721.8
2009	2.47	7.69	4.30	4.94	59.43	134,973.5
2010	2.21	7.18	3.49	5.16	62.24	154,610.1
المعدل	2.91	9.63	4.5	4.5	61.16	

المصدر: تقرير بنك نقارا الماليزي 2005، الملحق، ص 65، والموقع الالكتروني:
http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.19.1.xls، استخرج الباحث النسب من التقارير

شكل بياني (4) يوضح نِسَب أهم قطاعات التي حازت على تمويل البنوك الإسلامية الماليزية



تبين من خلال الجدول (15) والشكل البياني (4) أن القطاع المقتنيات المنزلية حصل على أكبر معدل لنسبة التمويل، حيث بلغ معدل النسبة 61.16%، ثم جاء بعده قطاع التصنيع بمعدل 9.63%، ثم تلاه قطاع البناء بمعدل 4.5%، وأخيرا مجال الزراعة بمعدل 2.91%. ويمكن القول إن مجال التصنيع حصل على معدل دون المتوسط بالمقارنة مع إجمالي التمويل، وحصل قطاع الزراعة على معدل ضعيف.

جدول رقم (16) يوضح نسبة حجم تمويل القطاعات المهمة للنظام المصرفي الإسلامي إلى إجمالي قروض القطاعات للنظام المصرفي الماليزي

	نسبة مجال الزراعة	نسبة التعدين والتحجير	نسبة التصنيع	نسبة البناء	المقتنيات المنزلية Household sector
2006	22.13	3.46	12.66	10.81	15.14
2007	18.75	6.20	13.30	14.06	15.40
2008	17.57	12.96	13.16	15.05	17.40
2009	17.49	22.50	12.71	15.81	18.56
2010	17.45	27.17	13.75	14.39	20.21

المصدر: تقرير بنك نقارا الماليزي، الموقع الالكتروني:

http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.19.1.xls، والقروض النظام المصرفي الماليزي الربوي، الموقع الالكتروني الموقع الالكتروني:

http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.20.xls، استخرج الباحث النسب من التقارير

جدول رقم (17) يوضح نسبة حجم تمويل النظام المصرفي الإسلامي الماليزي إلى إجمالي قروض النظام المصرفي الماليزي بالمليون رنجت (الحصة السوقية للنظام المصرفي الإسلامي)

السنوات	2006	2007	2008	2009	2010
إجمالي تمويل النظام المصرفي الإسلامي	78,518.3	89,867.6	107,721.8	134,973.5	154,610.1
إجمالي قروض النظام المصرفي الماليزي	593,014.0	644.237.1	726,545.7	783,507.3	854,604.7
النسبة	13.24	13.95	14.82	17.22	18.09

المصدر: الموقع الالكتروني:http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.18.1.xls،
وللقروض الربوية http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.18.xls

من خلال الجدولين (16، 17) تبين أن نسبة حصة تمويل النظام المصرفي الإسلامي من إجمالي قروض النظام المصرفي الماليزي للقطاعات بلغت 13.24% عام 2006م، وقد ركز النظام المصرفي الإسلامي في تمويله على قطاع الزراعة الذي بلغت نسبة تمويله 22.13%، وعلى القطاع المقتنيات المنزلية بنسبة تمويل 15.14%. بينما حاز قطاع التصنيع على بنسبة 12.66%، ثم قطاع البناء على بنسبة10.81%، وهما نسبتان مقبولتان بالنظر إلى حصته السوقية، وأما نسبة التحجير والتعدين فقد كانت نسبة هذا القطاع ضعيفة، حيث لم تتجاوز 3.46%.

وأما عام 2007م، فقد استطاع النظام المصرفي تغطية معظم القطاعات وبنسب مقبولة تتناسب مع حصته السوقية التي قاربت 14% كما هو موضح في الجدول (17) عدا قطاع التحجير والتعدين الذي كانت نسبه تمويله ضعيفة، والتي لم تتجاوز 6.2%. واستمر النظام المصرفي في تغطيته لجميع القطاعات عام 2008، وحسب حصته السوقية التي بلغت 14.82%، حيث ركز النظام المصرفي في تمويليه على مجال الزراعة وعلى المقتنيات المنزلية بأكثر من 17%، بيمنا حازت القطاعات الأخرى على نِسَب جيدة أي بين (15%، و13%).

وشهدت الحصة السوقية ارتفاعا من17% إلى 18%، بين (2009، 2010م) واستطاع النظام المصرفي الإسلامي تمويل جميع القطاعات المهمة، وبنسب بعضها ممتاز والبعض الآخر بنسب مقبولة، حيث لوحظ ارتفاع نسبة تمويل التحجير والتعدين بشكل ملحوظ من 22% إلى 27%، أما باقي القطاعات فقد كان تمويلها مقبولا. ونَخلُص من هذا بأن النظام المصرفي استطاع منافسة قروض النظام المصرفي الماليزي المقدمة للقطاعات، واستطاع أيضا توزيع التمويل واستيعاب معظم القطاعات، وبنسب عموما جيدة، وحسب حصته السوقية، مما يدل وينم عن كفاءته الاقتصادية.

3-7 مدى تأثير عرض النقود على التضخم

إن زيادة المعروض النقدي من طرف البنوك يساهم غالبا إذا لم يكن مدروسا في زيادة التضخم، وقد سبق ذكر مساهمة البنوك عبر عملياتها الائتمانية في زيادة التضخم. ولما كان هناك جدل بين الباحثين الإسلاميين[64] حول مدى مشاركة وسائل التمويل البيعي في زيادة التضخم، حيث يرى البعض أن البيوع الائتمانية تساهم في زيادة التضخم، يرى البعض الأخر أن التمويل الإسلامي الائتماني الإسلامي القائم على بيوع المداينات لا يؤدي إلى التضخم لأنه عوض عن سلع عينية خاضعة للعرض والطلب.

ولذا حاول الباحثان الكشف عن العلاقة الإحصائية بين عرض النقود وبمفهومه الضيق والواسع (M1، M2) وبين التغير السنوي للتضخم باستخدام البرنامج الإحصائي (spss) لنفي أو تأكيد تلك العلاقة. وقبل بدأ التحليل تم فحص الارتباط بين المتغيرتين المستقلين (M1، M2) وتبين أن نسبة الارتباط كانت ضعيفة، حيث لم تتعد بنسبة 0.332، وسيحاول هذا النموذج كشف العلاقة بين المتغيرين المستقلين (M1، M2) والمتغير التابع (التغير السنوي للتضخم) كالآتي:

جدول رقم (18) يوضح التغير السنوي لعرض النقود (M1، M2) والتغير السنوي للتضخم

[64] الموقع الإلكتروني: http://isegs.com/forum/showthread.php?t=1292

2005	2004	2003	2002	2001	2000	
8.5	11.9	14.6	10.3	3.2	5.0	التغير السنوي لعرض النقود (M1) (%)
15.4	25.4	11.1	5.8	2.2	5.2	التغير السنوي لعرض النقود (M2) (%)
3.1	1.4	1.2	1.8	1.4	1.6	التغير السنوي للتضخم (%)

المصدر: تقرير بنك نقارا، 2003، الملحق، ص 35، وص 39، 2005، الملحق، ص 43. و2006، الملحق، ص 29، و2006، الملحق، ص 36, و 2005، الملحق، ص 47.

جدول رقم (19) يوضح التغير السنوي لعرض النقود (M1، M2) والتغير السنوي للتضخم

2010	2009	2008	2007	2006	
11.7	9.8	8.3	19.6	13.7	التغير السنوي لعرض النقود (M1) (%)
3.99	9.5	13.4	9.5	17.11	التغير السنوي لعرض النقود (M2) (%)
1.7	0.6	5.4	2.0	3.6	التغير السنوي للتضخم (%)

المصدر: تقرير بنك نقارا، الملحق، ص 2010، الملحق، ص 20، وص 28، وبالنسبة لـ M2 ، عام (2006- 2007) فقد استخرج الباحث التغير السنوي من الموقع الالكتروني:

http://www.bnm.gov.my/files/publication/msb/2010/9/xls/1.3.xls

جدول رقم (20) نتائج تقدير اثر نسبة التغير السنوي لعرض النقود (M1، M2) على نسبة التغير السنوي للتضخم

المتغير المعتمد (التابع) هو نسبة التغير السنوي للتضخم

قيمة معامل التحديد المعدل $\overline{R}^2$	قيمة معامل التحديد R^2	اختبار F-test	قيمة P-value	اختبار T-test	قيمة المعلمة Unstandardized coefficient (B)	المتغير المستقل
-0.124	0.104	0.464 (0.645)	0.163	1.535	1.869	الثابت (b_0)
			0.705	-0.393	-0.042	M1
			0.365	0.960	0.069	M2
$y = b_0 + b_1(M1) + b2(M2)$						
$y = 1.869 - 0.042(M1) + 0.069(M2)$						
المصدر: إعداد الباحث بالإستاد إلى البرنامج الإحصائي (spss)، راجع بيانات الملحق (5)						

يُظهر الانحدار الخطي (Linear Regression) للنموذج أن تقدير أثر نسبة التغير السنوي لعرض النقود (M1) و (M2) على نسبة التغير السنوي للتضخم، حيث كانت النتائج تشير إلى أن قيمة اختبار F-test=0.464، وقيمة (0.645) =P-value، وهو ما يؤكد أن النموذج ليس ذو دلالة إحصائية. كما أن قيمة معامل التحديد بلغت 0.104، وهو ما يعني أن المتغيرات المستقلة تفسر المتغير التابع (التغير السنوي للتضخم) بما نسبته 10.4%. ومن خلال النتائج الواردة في الجدول أعلاه أي حول أثر المتغيرين المستقلين (M1,M2) على المتغير التابع كانت النتائج على النحو الآتي:

1- إن إشارة معلمة نسبة التغير السنوي لعرض النقود (M1) غير متوافقة مع نظرة بعض الاقتصاديين الذين يرون أن الزيادة في عرض النقود يؤدي إلى التضخم، وقد تبين أن أثر نسبة التغير السنوي لعرض النقود (M1) على نسبة التغير السنوي للتضخم ليست ذات دلالة إحصائية، حيث بلغت قيمة T- -0.393 test=، وقيمة (0.705) =P-value، وهي أكبر من 0.05، أي أنه كلما زادت نسبة التغير السنوي لعرض النقود (M1) بمقدار واحد فإن ذلك سوف يؤدي إلى انخفاض نسبة التغير السنوي للتضخم بمقدار 0.042.

2- إن إشارة نسبة معلمة التغير السنوي لعرض النقود (M2) غير متوافقة مع نظرة بعض الاقتصاديين الذين يرون أن الزيادة في عرض النقود تؤدي إلى التضخم، وقد تبين أن أثر نسبة التغير السنوي لعرض النقود (M2) على نسبة التغير السنوي للتضخم ليست ذات دلالة إحصائية، حيث بلغت قيمة T- 0.960 test=، وقيمة (0.365) =P-value، وهي أكبر من 0.05، أي أنه كلما زادت نسبة التغير السنوي لعرض النقود (M2) بمقدار واحد فإن ذلك سوف يؤدي إلى ارتفاع نسبة التغير السنوي للتضخم بمقدار 0.069.

الملاحق

الملحق رقم (1)

للفترة 2000 -2010

بعد تقسيم البيانات إلى ربع سنوي[65]

السنة	حجم أصول النظام المصرفي الإسلامي (x1)	حجم تمويل النظام المصرفي الإسلامي (x2)	الناتج الإجمالي الحقيقي (y)
2001:1	14019.6469	6354.3941	52296.047
2001:2	14753.74004	6824.4507	52410.918
2001:3	15500.18302	7352.1485	52914.538
2001:4	16052.88184	7828.9993	53145.332
2002:1	16235.44872	8267.9677	53904.411
2002:2	16842.46693	8835.5311	54449.208
2002:3	17631.65849	9513.543	55342.743

[65] Hammed s. AL- BAZAI,"The Role of Money in Saudi Arabia , ",j.kau:Econ .& Adm .(1999).VOL.13.No. 1, pp37.

$$1st\ quarter = 0.05469X_{t-1} + 0.2347X_{t} - 0.03906X_{t+1}$$

$$2nd\ quarter = 0.00781X_{t-1} + 0.26563X_{t} - 0.02344X_{t+1}$$

$$3rd\ quarter = -0.02344X_{t-1} + 0.26563X_{t} + 0.00871X_{t+1}$$

$$4th\ quarter = -0.03906X_{t-1} + 0.23437X_{t} + 0.05469X_{t+1}$$

55885.167	10158.6283	18355.87994	2002:4
56811.857	11158.607	19564.62076	2003:1
57608.585	11844.2918	20386.27896	2003:2
58760.81	12556.3959	21286.37197	2003:3
59519.54	13122.7051	21980.88354	2003:4
53659.188	13602.786	22481.65381	2004:1
57460.482	14165.0329	23271.76363	2004:2
64594.752	14811.6204	24269.85165	2004:3
73770.768	15341.5765	25142.63325	2004:4
100186.406	15906.8875	26290.02953	2005:1
109773.868	16505.3303	27353.95348	2005:2
117244.578	17222.153	28625.0056	2005:3
121169.882	17823.126	29710.1309	2005:4
116110.468	18602.1865	30949.54579	2006:1
117677.334	19276.437	32236.5778	2006:2
119916.119	20060.5366	33783.56065	2006:3
121307.041	20685.9317	35123.57532	2006:4
123809.568	21178.478	36491.40546	2007:1
125438.299	21959.7595	38167.38586	2007:2
127598.144	22969.3185	40239.97805	2007:3
128696.076	23886.6499	42137.19227	2007:4
131325.039	24925.1006	44671.90338	2008:1
132105.55	26152.2289	46929.98803	2008:2
133019.705	27683.2644	49541.70057	2008:3
132491.325	29118.2305	51812.58385	2008:4
129523.763	31530.5152	55244.88178	2009:1
129303.823	33070.2573	57490.70605	2009:2
130264.758	34674.6658	59808.99773	2009:3
130768.052	35881.7521	61422.27832	2009:4

الملحق (2) النظام المصرفي الإسلامي الماليزي:

1- البنوك الإسلامية:

Report bank Negara 2005. p16.

Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad, Commerce TIJARI Bank Berhad, Hong Leong Islamic Bank Berhad, Kuwait Finance House (Malaysia) Berhad, RHB ISLAMIC Bank Berhad.

إلى نهاية شهر 9، 2010

Affin Islamic Bank Berhad, Al Rajhi Banking & Investment Corporation (Malaysia) Berhad, Alliance Islamic Bank Berhad, AmIslamic Bank Berhad, Asian Finance Bank Berhad, Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad, CIMB Islamic Bank Berhad, EONCAP Islamic Bank Berhad, Hong Leong Islamic Bank Berhad, HSBC Amanah Malaysia Berhad, Kuwait Finance House (Malaysia) Berhad, Maybank Islamic Berhad, OCBC Al-Amin Bank Berhad, Public Islamic Bank Berhad, RHB ISLAMIC Bank Berhad, Standard Chartered Saadiq Berhad.

2- المصارف المشاركة في برنامج الصيرفية الإسلامية:

Report bank Negara 2005, p18,19.

Commercial Banks:

Affin Bank Berhad, Alliance Bank Malaysia Berhad, AmBank (M) Berhad, Citibank Berhad, EON Bank Berhad, HSBC Bank Malaysia Berhad, Malayan Banking Berhad, OCBC Bank (Malaysia) Berhad, Public Bank Berhad, Southern Bank Berhad Standard Chartered Bank Malaysia Berhad.

3- شركات التمويل: (Finance Company)

Southern Finance Berhad.

4- بنوك استثمارية: (Merchant Banks)

Affin Merchant Bank Berhad, Alliance Merchant Bank Berhad, AmMerchant Bank Berhad, Commerce International Merchant Bankers Berhad.

5- بيوت خصم: (Discount Houses)

Abrar Discounts Berhad, Affin Discount Berhad, Amanah Short Deposits Berhad, CIMB Discount House Berhad, KAF Discounts Berhad, Malaysia Discount Berhad, Mayban Discount Berhad.

6- المؤسسات المالية التنموية التي تقدم تسهيلات مصرفية إسلامية: Development Financial Institutions Offering Islamic Banking Services:

Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Bank Pembangunan Malaysia Berhad, Bank Pertanian Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad.

الملحق (3) المؤسسات المالية التنموية الربوية :

From (2001-2005) report bank Negara annex p68.

Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia, Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji. Prior to 1 October 2005, data include Bank Industri & Teknologi Malaysia Berhad and Malaysia Export Credit Insurance Berhad and exclude SME Bank.

From (2005-2009) Report bank Negara

Refers to Bank Pembangunan Malaysia Berhad, Bank Kerjasama Rakyat Malaysia Berhad, Bank Simpanan Nasional, Export-Import Bank of Malaysia Berhad, Bank Pertanian Malaysia Berhad (Agrobank), Bank Perusahaan Kecil & Sederhana Malaysia Berhad (SME Bank), Malaysian Industrial Development Finance Berhad, Sabah Development Bank Berhad, Borneo Development Corporation (Sabah) Sendirian Berhad, Borneo Development Corporation (Sarawak) Sendirian Berhad, Credit Guarantee Corporation Malaysia Berhad, Sabah Credit Corporation and Lembaga Tabung Haji.

http://www.bnm.gov.my/files/publication/fsps/en/2009/zcp07_table_A.13.pdf.p10.

الملحق (4)

Correlations

		totalassets	totalfinance
Total assets	Pearson Correlation	1	.996**
	Sig. (2-tailed)		.000
	N	36	36
Total finance	Pearson Correlation	.996**	1
	Sig. (2-tailed)	.000	
	N	36	36

**. Correlation is significant at the 0.01 level (2-tailed).

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Change Statistics					Durbin-Watson
					R Square Change	F Change	df1	df2	Sig. F Change	
1	.932[a]	.869	.865	1.235016E4	.869	225.158	1	34	.000	.429

a. Predictors: (Constant), totalfinance

b. Dependent Variable: GDP

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	3.434E10	1	3.434E10	225.158	.000[a]
	Residual	5.186E9	34	1.525E8		
	Total	3.953E10	35			

a. Predictors: (Constant), totalfinance

b. Dependent Variable: GDP

Coefficients[a]

Model		Unstandardized Coefficients		Standardized Coefficients	t	Sig.	Collinearity Statistics	
		B	Std. Error	Beta			Tolerance	VIF
1	(Constant)	64958.199	4980.067		13.044	.000		
	Total finance	3.764	.251	.932	15.005	.000	1.000	1.000

a. Dependent Variable: GDP

الملحق (5)

Correlations

		M1	M2
M1	Pearson Correlation	1	.332
	Sig. (2-tailed)		.318
	N	11	11

M2	Pearson Correlation	.332	1
	Sig. (2-tailed)	.318	
	N	11	11

Model Summary[b]

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.322[a]	.104	-.120-	1.445156	2.225

a. Predictors: (Constant), M2, M1

b. Dependent Variable: inflation

ANOVA[b]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1.938	2	.969	.464	.645[a]
	Residual	16.708	8	2.088		
	Total	18.645	10			

a. Predictors: (Constant), M2, M1

b. Dependent Variable: inflation

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95% Confidence Interval for B		Collinearity Statistics	
	B	Std. Error	Beta			Lower Bound	Upper Bound	Tolerance	VIF
1 (Constant)	1.869	1.218		1.535	.163	-.939-	4.678		
M1	-.042-	.107	-.139-	-.393-	.705	-.288-	.204	.890	1.124
M2	.069	.071	.341	.960	.365	-.096-	.233	.890	1.124

a. Dependent Variable: inflation

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ASYMMETRIC MARKET REACTIONS TO SUKUK ISSUANCE

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Abstract

The study seeks to investigate whether market reacts asymmetrically to the issuance of selected sukuk in Malaysia for the period 2009-2011. A total of 45 companies are selected and data on the date of issuance, issuers, issue size in million and tenor in years for each company are sourced from Securities Commission Malaysia (SC) and Datastream. The study employs event study methodology using cumulative average abnormal return (CAAR) on symmetric and asymmetric events ranging from immediate to 106-day event windows based on the reaction of the FTSE Hijrah Index and Dow Jones Islamic Index to the announcement of sukuk issuance. The results indicate that there are significant and asymmetric market responses towards sukuk issuance over longer event windows. In other words, there is a small non-negative wealth effects of sukuk issuance. The findings would be useful to sukuk issuers and decision-makers while making financing decisions to ensure robust and sustainable Islamic capital market.

Keywords: Sukuk; event-study; asymmetric, FTSE Hijrah Index, DJ Islamic Index

1. Introduction

Factors that affect shareholders wealth is one of the central issues in finance. Financing decisions, which are to determine how much and what type of debt and equity should be issued to raise capital are among the factors affecting shareholders wealth. The empirical evidence on conventional bond indicates that pure equity offers have a relatively large negative effect while issues of straight debt have a small non-negative wealth effect. On the other hand, convertible securities, having both debt and equity features, have negative wealth effects that lie in between those observed for equity and straight debt (Abhayankar and Dunning, 1999).

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The recent 2008 global financial crisis increase the need for risk diversification within the financial system. Sukuk, or Islamic bond, is an alternative for risk diversification and are the most active Islamic debt market financial instrument to date. They are investment certificates with both bond and stock-like features issued to finance trade or the production of tangible assets. Due to the rapid expansion of Islamic financial instruments, the sukuk market has become an important avenue for fund raising and investment activities. The global outstanding volume of sukuk exceeded USD90 billion in 2007 and is expected to reach USD200 billion by 2010. Issuance quadrupled from USD7.2 billion in 2004 to nearly USD39 billion by the end of 2007, and was up from USD336 million in 2000 (Moody's, 2007, 2008). More than 50% of the USD26.1 billion of sukuk issued in 2009 originated in Malaysia (MIFC, 2010). Malaysian sukuk represent about half of the total stock of Malaysian corporate bonds (Jobst et al., 2008).

The main contribution of the present paper is to examine the asymmetric wealth effects of sukuk issuance after the recent 2008 post-crisis period in Malaysia. This is motivated by three key factors affecting sukuk industry. First, regained market confidence after the restructuring of the high profile sukuk in Dubai after the 2008 crisis. Second, investors are avoiding the riskier markets of United States and Europe. Third, positive economic growth and favourable debt dynamics in the two most important sukuk issuing regions of the Gulf countries and Malaysia has attracted investors to the Islamic capital market. This paper adds to the literature since the empirical work on asymmetric effects of sukuk is relatively few. The remainder of the paper is organized as follows. Section 2 discusses the related literature. Section 3 highlights the research method. Section 4 discusses the findings and the final section concludes the discussion.

2. Literature Review

Definition of Sukuk

Sukuk is an Arabic name for financial certificates, which in economic terms are akin to conventional bonds. Unlike conventional bonds, sukuk need to have an underlying tangible asset transaction either in ownership or in a master lease agreement. It

represents ownership of underlying assets, usufructs (benefits), services, or investment. The money that a sukuk holder gets represents a share in the profit of the underlying asset. The Securities Commission Malaysia (SC) defines sukuk as a financial document or certificate which represents the value of an asset evidencing an undivided pro rata ownership of an underlying asset.

Theoretical Framework and Literature Review

Capital structure irrelevant theory was first introduced by Modigliani and Miller in 1958. They assumed that under perfect market condition, the capital structure of the firm is irrelevant. However, later they proposed that with corporate taxes, shareholders wealth would increase with the increase in debt usage due to the interest tax shield benefit of debt (Ibrahim and Minai, 2009). However, under imperfect market, models based on the idea of an optimal structure emphasise trade-offs between debt and equity; the corporate tax advantage of debt versus the costs of financial distress. On the other hand, asymmetric information and cash flow effects model assumed that managers have better information than outsiders about the firm's value. Myers and Majluf (1984) develop a model in which external financing has a negative effect on common stock prices. When raising external funds, managers tend to issue securities in ascending order of risk (or in a 'pecking order') to preserve the wealth of shareholders. Summarizing the arguments, the effect of new financing may be positive, neutral or negative, depending on how the implied changes in cash flow interact with the changes in leverage implied by the type of security issued (Smith, 1986).

There are limited studies that examine the wealth effects of sukuk. Cakir and Raei (2007) examine the risk-reduction advantages of issuing sovereign *sukuk*. Using a sample of sovereign *sukuk* and eurobonds from the same issuer, the authors estimate and compare value-at-risk (VaR) for a portfolio that includes both instruments to a pure Eurobond portfolio. They find that the VaR is reduced when *sukuk* are added to the portfolio of fixed-income securities, demonstrating that these investment certificates create diversification benefits for investors. However, Godlewski, Turk-Ariss and Weill (2011) take an opposing view, suggesting that there is no significant market reaction to conventional bond issues, but a significant negative stock market

reaction to *sukuk* issues. The researchers explain the different stock markets reactions to two factors. First, investors expect that an adverse selection mechanism encourages less-healthy companies to prefer sukuk over conventional bond financing. Second, investors may take the view that even if companies issuing sukuk may have been shut out of the conventional bond market, they can still take advantage of excess demand for *sukuk* from Islamic banks.

Other recent studies include Ibrahim and Minai (2009) who found that the market reaction is significantly positive during event windows [-3, 0] and [-3, 3] during the announcements of Islamic debt issuance for the period 2000-2006 in Malaysia. The finding implies that the positive reaction is not due to investors' preference for Islamic compliant activities, but it is due to similar factors found in studies on conventional bonds. Ameer and Othman (2010) find significant negative abnormal returns near the announcement days and the responses are asymmetrical to different types of bonds issuance announcements in Malaysia over the period 2001-2007. Modirzadehbami and Mansourfar (2011) report a significant negative abnormal return occurs one day before announcement date in a sample of 45 listed companies on Bursa Malaysia involved in issuing of Islamic debts during 2005 to 2008. Mohd Ashhari et al. (2009) indicate that there is a wealth effect on the announcement of Islamic bond issues for the period 2001 to 2006 in Malaysia. In short, the literature suggests that stock market reactions to sukuk issuance are mixed and inconclusive.

3. Research Method

Following the literature, the study employs a standard event study methodology to estimate abnormal returns around the event date for the selected sukuk issues. The sample period (2009−2011) contains 45 events for *sukuk*, where 15 companies are selected in each year. The following data are collected from each company: date of issuance, issuers, issue size in million, and tenor in years. Data of closing prices from FTSE Hijrah Shari'ah Index and Dow Jones Shari'ah Index are collected based on daily date from the DataStream database.

The present study defines returns using this formula: Return = [P(t)-P(t-1)]/P(t-1)], where P is the stock market daily price at closing using FTSE Hijrah Shari'ah Index and Dow Jones Islamic Index. We examine all symmetric and asymmetric events of 1-day, 3-day, 4-day, 5-day, 8-day, 11-day, 21-day, 35-day, 36-day, 91-day and 106-day event windows and calculate average abnormal daily returns. The cumulative average abnormal returns (CAARs) are calculated by summing daily excess returns over the respective event windows. The announcement date is the issue date of sukuk. We perform t-test as in equation (3) and z-test as in equation (5) below to investigate the statistical significant of the cumulative average abnormal returns ($CAAR_t$).

For the purpose of the study, market is hypothesized to react positively to the announcement of sukuk issues. This is due to firstly, cheaper financing costs since sukuk has higher liquidity due to wider investor base encompassing of both Muslims and conventional investors. Second, there is higher demand for Shariah compliant stocks since 85% of total securities listed in Bursa Malaysia are Shariah compliant. Third, funds raised from the Islamic debt instruments are used to finance new activities hence sukuk represent a new asset class (Ibrahim and Minai, 2009).

The performance of stock prices of firms on certain days is measured based on equation (1) below:

$$AR_{it} = R_{it} - (\alpha_{it} + \beta_i R_{mt}) \qquad (1)$$

where; AR_{it} = Abnormal returns for firm i at time period t

R_{it} = Actual returns for firm i at time period t

R_{mt} = Returns on market portfolio in period t

α_i = The constant average returns of stock i

β_i = Beta estimate of stock

α and β are estimated using market model which relates the given sukuk to the return of market portfolio. The return on the FTSE Hijrah Shariah Index and Dow Jones Islamic Shariah Index are used as a proxy of market returns. They are calculated by

running regression of sukuk returns against the market returns. After estimating the abnormal returns for each firm, the abnormal return for all of the firms on each day of the event window are then aggregated and averaged as (2); where *N* is equal to the number of firms in the sample:

$$AAR_t = \frac{1}{N}\sum_{t=1}^{N} AR_{it} \quad (2)$$

The t-test for AAR_t is estimated as (3)

$$t\text{-}test = CAAR / \delta\,(CAAR) \quad (3)$$

where AAR_t = Average abnormal return of period t

δ = Standard deviation of average abnormal return over the estimation window

To observe the cumulative effects, the cumulative abnormal returns ($CAAR_{t,+t2}$) are computed as (4) below:

$$CAAR_{(-t1,+t2)} = \sum_{=t1}^{=t2} AAR \quad (4)$$

$CAAR_t$ is a more precise representative of the longer term effect on share prices from bond offering announcements. The z-test for the $CAAR_t$ is given as (5):

$$z\text{-}test = CAAR / \delta^{2}\,(CAAR) \quad (5)$$

The standard deviation of CAAR is defined as (6); where *N* is the number of days in the *CAAR* statistics:

$$\delta(CAAR) = \delta(AAR)\sqrt{N} \quad (6)$$

4. Results

The study collected data from the total of 45 companies that issue sukuk for the period 2009 - 2011 where data are publicly available. Table 2 summarizes the descriptive analysis with respect to total amount of issuance (in million), the minimum and maximum issue size, standard deviation and the tenor of sukuk issuance by the selected companies. In 2009, total issuance is worth RM34,829 million where Pengurusan Air SPV Berhad issued the highest amount of sukuk amounting to RM20,000 million on November 5, 2009 for the tenor of 30 years. Sime Darby Berhad was the second largest issuance company who issued with RM4,500 million on 16th November 2009, 20 year tenors. Meanwhile, the UMW Holdings Berhad issued the lowest amount of RM55 million, 5 year tenors. The tenor ranges from 4 to 30 tenor years with the largest standard deviation for issue size as compared to 2010 and 2011.

Table 2: Descriptive Statistics on the Selected Companies that Issued Sukuk

Year	Total Issue (RM) Million	N	Issue Size (RM) Million			Tenor (years)	
			Min	Max	Std. Deviation	Min	Max
2009	34,829	15	55	20000	5027.10	4	30
2010	36,139	15	114	7000	2133.34	5	30
2011	10,638	15	5	3000	895.62	1	17

Source: Authors' calculation.

In 2010, there was a slight increase in total issuance to RM36,139 compared to the previous year. The AmBank (M) Berhad issued the highest amount of sukuk worth with RM7,000 million on 25th March 2010, 30 tenor years while CJ Capital Pvt. Ltd. issued the lowest 10-year sukuk worth RM114 million in July 2010. The tenor years ranges from 5 to 30 years for the 15 sukuk issued with standard deviation of 2,133.34 for the issue size.

The sukuk issued in 2011 are much smaller in size, registering a mere RM10,638 million based on the data collected. Govco Holdings issued the highest amount in sukuk RM3,000 million for a 10 tenor years, followed by Aman Sukuk with RM2,265 million 7-year sukuk issuance. Pins Capital Sdn Berhad issued the lowest amount in sukuk with RM5 million for a 1 year tenor in November 2011. There is a noticeable

shorter range of tenor ranging from the minimum of one year and the maximum of only 17 years. The standard deviation for issue size is also much smaller at 895.62, reflecting the cautionary attitude of the investors due to the uncertainty in the Eurozone area.

FTSE Hijrah Shari'ah Index and Dow Jones Islamic Index Returns

Table 3 displays the results of market reactions towards sukuk announcement based on the FTSE Bursa Malaysia Hijrah Shariah Index for the selected companies, 2009-2011. There are a total of 20 event windows covering both symmetric and asymmetric events with the event dates ranging from immediate to 3-months pre and post-announcement period. The results indicate positive market reactions to sukuk announcement for all event windows.

Based on the t-tests conducted, there are six significant results in asymmetric events as compared to four significant results in symmetric events. For the z-tests, there are five significant results in asymmetric events compare to three significant results in symmetric events. There are more significant results at 0.05 level at longer event windows. This is probably due to the buy and hold strategy of sukuk holders and the thin secondary market.

Table 3: Abnormal Returns of Sukuk during Announcement Dates on FTSE Bursa Malaysia Hijrah Shariah Index, 2009-2011.

No	Event Window	CAAR	t-test	z-test
1	[0,0]	0.4006	5.422***	1.6306*
2	[-1,+1]	0.0451	1.473	1.0685
3	[-2,+2]	0.0458	1.481	1.0642
4	[-5,+5]	0.0481	1.513	1.0565
5	[-10,+10]	0.0510	1.611	1.1306
6	[-17,+17]	0.0564	1.737*	1.189
7	[-45,+45]	0.0828	2.567**	1.7679**
8	[-53,+53]	0.0856	2.675**	1.8580**
9	[-1,+2]	0.0458	1.500	1.0902
10	[-2,+1]	0.0451	1.455	1.043
11	[-2,+5]	0.0474	1.494	1.0464
12	[-5,+2]	0.0466	1.500	1.0739
13	[-15,5]	0.0533	1.704	1.2093
14	[-5,+15]	0.0496	1.545	1.0697
15	[-30,+5]	0.0633	1.983*	1.3810*
16	[-5,+30]	0.0584	1.783*	1.2095
17	[-30,+60]	0.0837	2.499**	1.6568**
18	[-60,+30]	0.0812	2.553**	1.7827**
19	[-90,+15]	0.0766	2.412**	1.6868**
20	[-15,+90]	0.0905	2.719***	1.8155**

Note: *, ** and *** denote significance at the 0.10, 0.05 and 0.01 levels respectively.

Meanwhile, Table 4 shows the results of CAAR for each event window based on the Dow Jones Shariah Index stock market reactions to sukuk issuance for the period under study. The table indicates positive results on cumulative average abnormal return in all event windows except on the 106-day event. There are ten event windows showing positive and significant results based on the t-tests. The z-tests indicate 15 events with positive and significant results and only five positive but insignificant results.

Similar to the FTSE Hijrah Shariah Index results above, both t-test and z-test show that there are more significant results for the asymmetric event windows compared to symmetric event windows and the significant results are mostly found during longer event periods.

Table 4: Abnormal Returns of Sukuk during Announcement Dates on Dow Jones Shariah Index, 2009-2011.

No	Event Window	CAAR	t-test	z-test
1	[0,0]	0.4015	5.4359***	1.6357*
2	[-1,+1]	0.0031	0.6953	3.4025
3	[-2,+2]	0.0079	1.3476	5.1081
4	[-5,+5]	0.0173	1.8620*	4.4408
5	[-10,+10]	0.0172	1.1152	1.6053*
6	[-17,+17]	0.0274	1.3568	1.4960*
7	[-45,+45]	0.1141	3.1164***	1.8915**
8	[-53,+53]	0.1015	2.5642**	1.4391*
9	[-1,+2]	0.0053	0.9023	3.4367***
10	[-2,+1]	0.0058	1.1526	5.0809
11	[-2,+5]	0.0184	2.2605**	6.1737
12	[-5,+2]	0.0070	0.8217	2.1575**
13	[-15,5]	0.0176	1.4581	2.6773***
14	[-5,+15]	0.0276	1.6704	2.2482**
15	[-30,+5]	0.0501	2.4988**	2.7709***
16	[-5,+30]	0.0521	2.3510**	2.3581***
17	[-30,+60]	0.1254	3.4080***	2.0591**
18	[-60,+30]	0.0990	2.6820**	1.6145*
19	[-90,+15]	-0.0006	-0.1931	-1.2616*
20	[-15,+90]	0.1406	4.1851***	2.7686***

Note: *, ** and *** denote significance at the 0.10, 0.05 and 0.01 levels respectively.

Therefore, the results support the hypothesis that market react positively to the sukuk announcement post 2008 crisis in Malaysia. However, not all events show significant reactions, especially in the shorter horizons. These can be attributed to two reasons. First, there is a leakage of information to the market before the Islamic debts announcements. Second, there is increase awareness among investors regarding sukuk having common features with equity instead of conventional bond. For both indexes, the significant results based on both t-test and z-test are more likely in during longer event days.

To see the trend of the market reactions, the results are plotted and shown in Figures 1-6 below. Figures 1-3 demonstrates the trend for Dow Jones Islamic Shariah Index for the symmetric and asymmetric cases. For the symmetric event windows, the reactions are minimal during the shorter horizon, peaked in 91-day event and continue to decline afterwards.

Figure 1: Cumulative Average Abnormal Return (CAAR) for Symmetric Event Windows on Dow Jones Shariah Index (2009-2011).

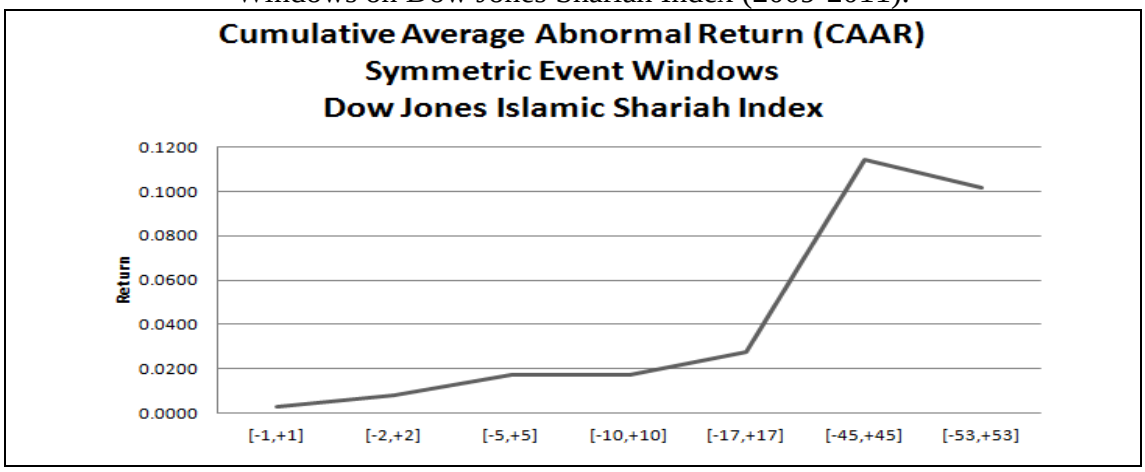


Figure 2: Cumulative Average Abnormal Return (CAAR) for Asymmetric Event Windows (Skewness to Positive) on Dow Jones Shariah Index (2009-2011).

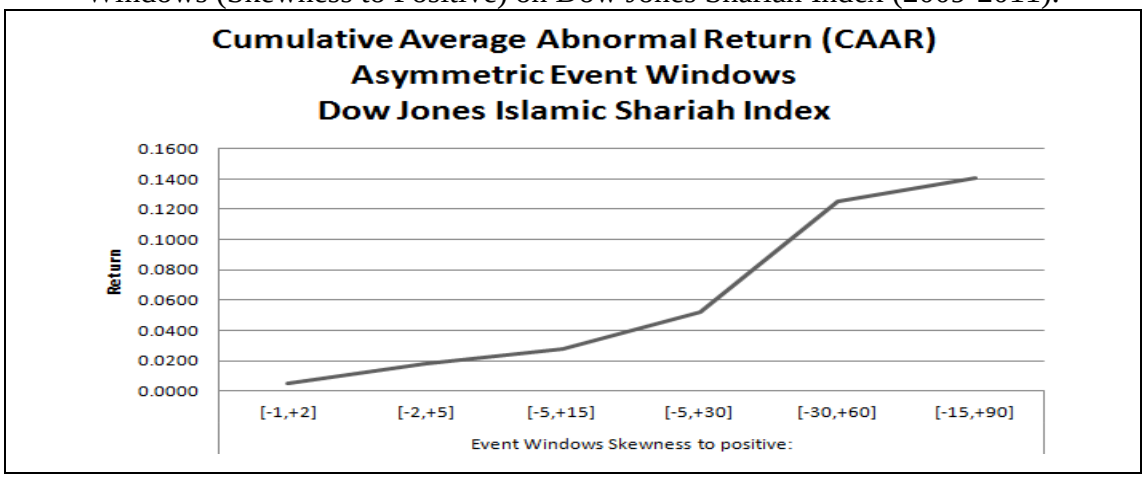


Figure 3: Cumulative Average Abnormal Return (CAAR) for Asymmetric Event Windows (Skewness to Negative) on Dow Jones Shariah Index (2009-2011).

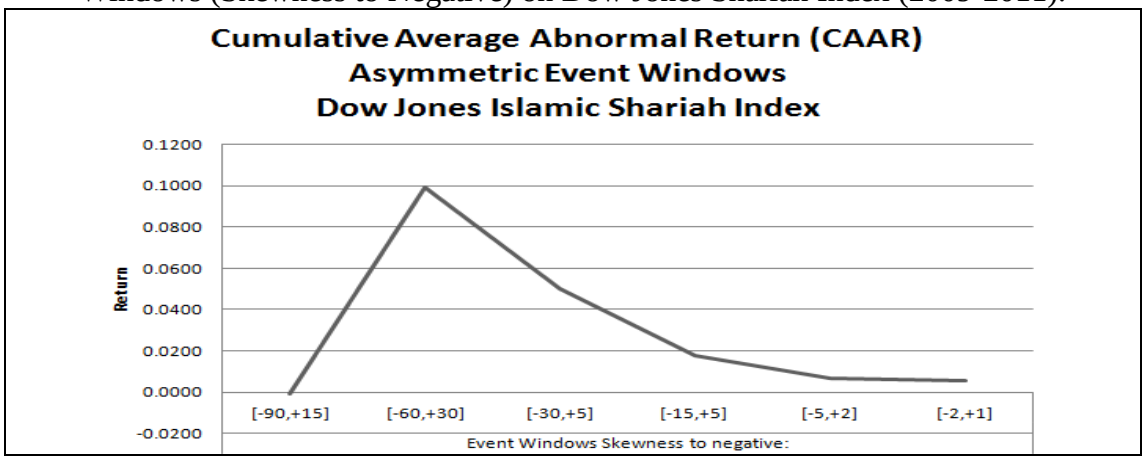


Figure 2 shows asymmetric events that skew to positive (more days after event of issuance) with an increasing trend, but asymmetric events that skew to negative (more days before event of issuance) show decreasing value of CAAR, which peaked at 91-day event window. Based on the results, the market changes the direction of reactions after 3 months and past information is important. In other words, there is a long memory process.

On the other hand, Figure 4 - 6 shows the results of CAAR on FTSE Hijrah Shariah Index. Based on the same analysis as above, symmetric events and asymmetric events that skew to positive (more days after event of issuance) show increasing value of CAAR, but asymmetric events that skew to negative (more days before event of issuance) show decreasing value of CAAR. The turning point is 91-day event based on the trend in Figure 6. The absolute value of CAAR at the starting point is also higher than that of Dow Jones Shariah Index.

Figure 4: Cumulative Average Abnormal Return (CAAR) for Symmetric Event Windows on FTSE Hijrah Shariah Index (2009-2011).

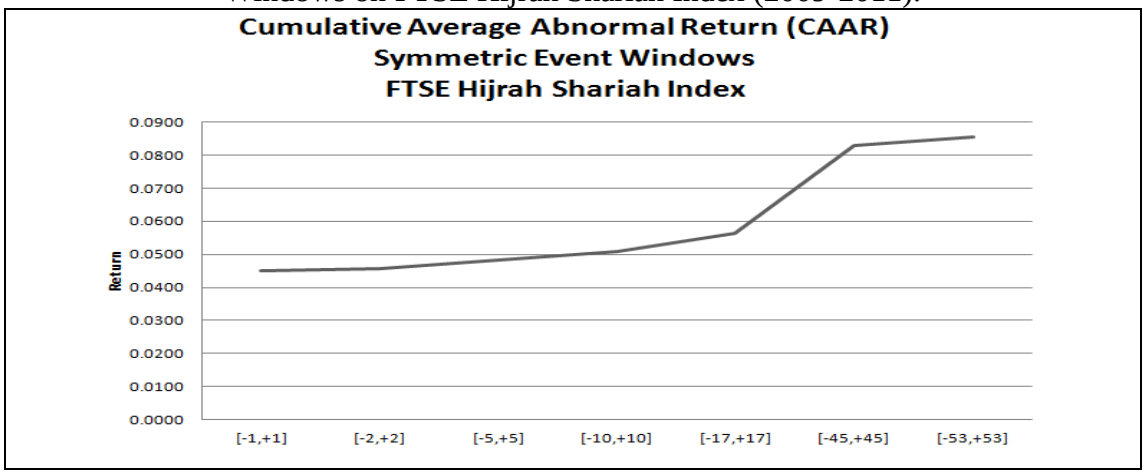


Figure 5: Cumulative Average Abnormal Return (CAAR) for Asymmetric Event Windows (Skewness to Positive) on FTSE Hijrah Shariah Index (2009-2011).

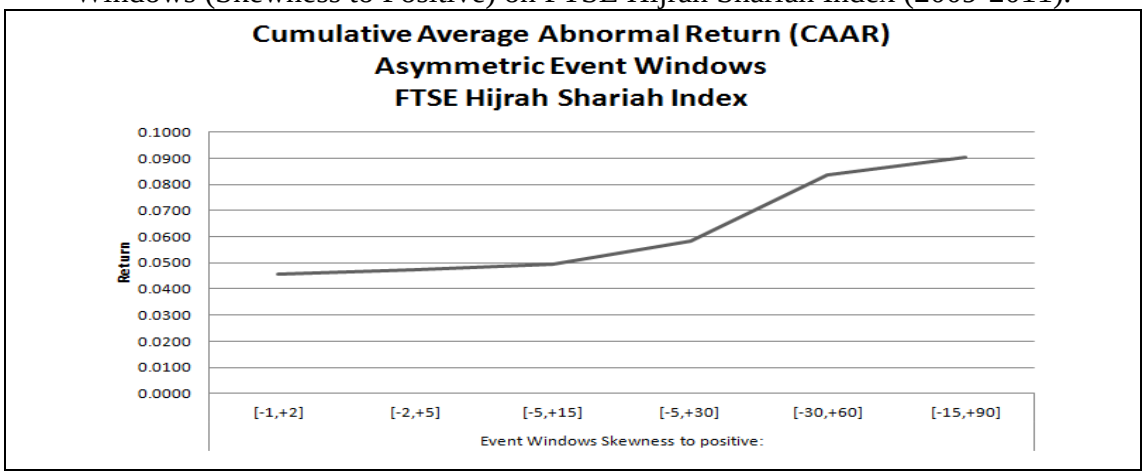
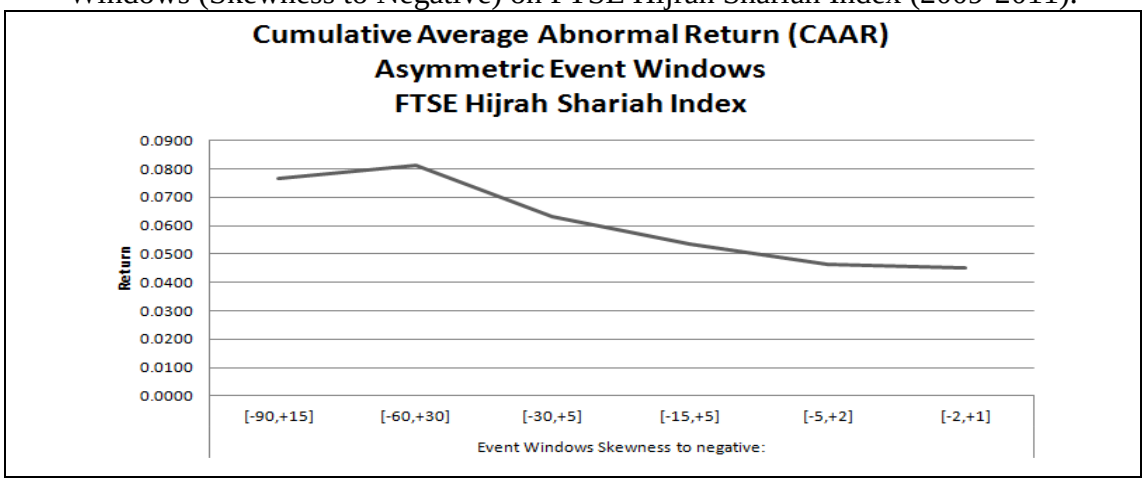


Figure 6: Cumulative Average Abnormal Return (CAAR) for Asymmetric Event Windows (Skewness to Negative) on FTSE Hijrah Shariah Index (2009-2011).



In short, financial markets in emerging economies are not expected to be as efficient as those in more advanced economies, so there could be a leakage of information when new sukuk are issued. As such, it is possible that abnormal returns are realized prior to the announcement date. In addition, small sample size and short duration of estimation windows for Dow Jones Shariah Index and FTSE Hijrah Shariah Index might also contribute to some of the insignificant findings. However, the increasing trend of $CAAR_t$ is a good early indication that recent sukuk announcement post-2008 financial crisis are perceived to be non-negative by investors. Therefore, there is a small non-negative wealth effect arising from sukuk issuance.

5. Conclusion

The paper investigates how market reacts to sukuk issuance after the recent 2008 financial crisis in Malaysia. The findings indicate that in general, there are positive and significant asymmetric market reactions towards sukuk announcement for both FTSE Hijrah Shariah Index and Dow Jones Islamic Shariah Index. The positive asymmetric market reactions can be interpreted in two ways. First, market can readily distinguish the news. Second, there are confidence effects that shareholders wealth will be increased through the issuance of sukuk. This is because, sukuk, being neither debt nor shares, are true to the calling of Islamic economics whereby the issue reflects the economic strength of the company and the real economic activities. However, future research might want to distinguish the instruments according to the issuance type and tests for asymmetric responses of the stock market to different types of sukuk issuance.

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INFLUENCES OF ISLAMIC PRACTICES ON SMALL FIRM PERFORMANCE: A STUDY IN NORTH SUMATERA, INDONESIA

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Abstract

Islam as *ad-din* (way of life) already outlined value systems established by al-Quran and al-*hadith* in every aspect of life. The underlying principle of the Islamic values is the well beings of human life and the '*alam* (environment). This study aims to investigate the impact of Islamic practices on small firm performance. Conceptually, practices translate knowledge, ability and experience into action for desired outcomes or performance. Three main theories namely the theory of human capital, organization and strategy are used as the underpinning theories in explaining performance. Eight independent variables delineated from the respective theory are chosen for developing a multivariate performance model. It includes networking, branding, financing, education, motivation, size, age and ownership as independent variables, while performance is conceptualized as sales growth serves as a dependent variable. The Government small firm policy on Islamic management practices is tested for its moderating effects. The study approach is evidence-based positivism and employs quantitative deductive hypotheses testing methods. The sample size (N) is 370 small firms' owner-managers randomly picked from four regions in the Province of North Sumatra, Indonesia. The measurement justifications are based on the Islamic values/perspectives or conventional values that are in compliance with the Islamic principles. The findings of this study might add knowledge to the small firm performance literature, probably help policy makers in their decision making regarding small firm sector, and possibly small firms' owner-managers who want to improve their performance.

1. INTRODUCTION

The small firm sector is an important component to economic development in all countries around the world. It makes contributions in improvement of income distribution, poverty reduction, employment creation, export growth, industry growth and rural economics development (Tambunan, 2009). For example, in Southeast Asia developing countries, the small firm's contributions are in terms of employment (generate 50-80% of total employment); production (contribute about 50% of sales/value added to GDP) (Narain, 2003). Moreover, the small firm industry is the highest in Asia Pacific

region with a contribution of 43.66% or US$2.53 billion to the GDP (World Bank, 2006) and Indonesia has an economic growth of 6.5% with a GDP per capita of $3,900 and a labor force of around 112 million in 2010, hence has a strong potential of economic development besides China and India (Thee, 2006). This suggests the crucial role of the small firm sector for economic growth and well-beings of the society that justifies continuous government support and encouragement to the sector's efficiency and effectiveness.

Islam is a religion with a comprehensive way of life (*ad-Din*) based on Al-Qur'an and *Sunnah* that rules everything, including commercial activities. It governed the business operational and managerial aspects aimed to achieve better performance and satisfaction as God commanded in which all the process of business must be observed strictly to the permissible (*halal*), abstaining from the prohibited (*haram*) and *Shariah* compliance (Rosly, 2006). The Islamic principles in business of honesty, justice, ethical and shariah compliance are believed to be the performance key success factors (Yousef, 2001). Most Muslims are aware of the benefits of Islamic concept and practices in their lives, but to what extent those practices influence their performance might not widely explained. Thus, this study expected to answer the question to what extent Islamic practices and behavior encapsulated in human capital theory, business strategy theory and organizational theory explain small firm performance?

The small firm generally refer to companies with a limited number of employees (Hong and Jeong, 2006) or a company whose headcount or turnover falls below a certain limit (Chu, 2004). Burns (2001) stated that small firms are not just scaled down versions of large ones but the manner in which small firms go about their business differs from larger organisations. Sandee et al. (2002) mentioned that small firm were implemented traditional way of organizing business; family orientation; poor management; and adopted inappropriate method of production. The Ministry of Cooperative and SMEs of Indonesia and the two government agencies such as Department of Industry (MoI) and Central Statistical Agency (BPS), defined a small firm as a firm (retail, service, manufacturing and agriculture) that employs fewer than 20 employees with total initial

assets of up to US$20,000, not including land and buildings, or with an annual value of sales of a maximum of US$100,000.

The optimal contribution of small firm through maximization output can be gained from better performance and growth. Despite the increased of total enterprises' units in Indonesia in 2006-2010 (9.79% growth), but the total output is fluctuated with low proportionate growth by 2.82% as depicted in Table 1.1. It assumed the small firms' performances have low efficiency and has negative growth.

Table 1.1 Total enterprises by size category in Indonesia, 2006 - 2010

Indicator	MSEs					Proportionate Growth 2006-2010 (%)
	2006	2007	2008	2009	2010	
Units	48,985,040	50,107,518	51,369895	52,723,470	53,781,101	9.79%
Share GDP(%)	42.46%	42.61%	42.24%	33.08%	43,66%	2.82%

Source: Ministry of Cooperative and Small and Medium Enterprises (2010)

The negative growth may derive from low quality of human capital such as skills and education of firms' owner-managers. Tambunan (2008) found out that 28.81% of labours in Indonesia are educated and skilled labour, and the rest of 71.9% are dominated by low skills labour. Moreover, other possibilities of firms' negative performance, it could be the entrepreneurs, strategy and characteristics of the firms specifically the absent of Islamic practices implementation in their performances, althought, it has positive development of such Islamic banking and finance growth of assets up to 19.71% annually with total financing of USD519 billion in 2011. Furthermore, the adoption of *halal* certificate as an authority for *halal* compliance product is still under researched. The process of certification is tedious and may take some time to be authorised besides high costs incurred. Does halal certification influence firm performance? This is also a problem faced by the owner-manger of small firms.

Having educated human resource team in an organisation has been associated with high performance. Small firms however, have very limited resources to employ graduates especially from high reputable universities who usually demand high pay. An alternative

option is to employ employees from Islamic education institutions who usually not so demanding in their pay, though their reputation as pious persons are high. Small firm owner-managers really wanted to know whether religious education impact firm performance. Observing all these problems faced by the small firm owner-managers, this study is trying to investigate whether Islamic practices in small firms' management influence performance.

In traditional measurement of performance, the financial ratio variables used as explanatory variables. These include return on investment, return on equity and return on sales (Browne et. al., 1997). Neely (1999) posited that traditional measurement has problems such as rarely integrated with each other or aligned with business process and it is less relevant due to rapid changing of business environment (Maskell, 2001). However, some researchers used non-financial variables as dependent variables of business performance. Hall (1995) posited that qualitative dependent variables can be use as small firms performance determinants such as growth variable and that is the best indicator of performance (Rodriguez and Fratesi, 2004).

This study can be viewed to serve as an information for the stakeholders to benchmark the development and ensure quality outcome to increase small firms' productivity. In addition, the Islamic practices could be seen as value added among the Muslim owner/manager in their performance. Lastly, it expected to provide significant contribution for future research of small firms' performance.

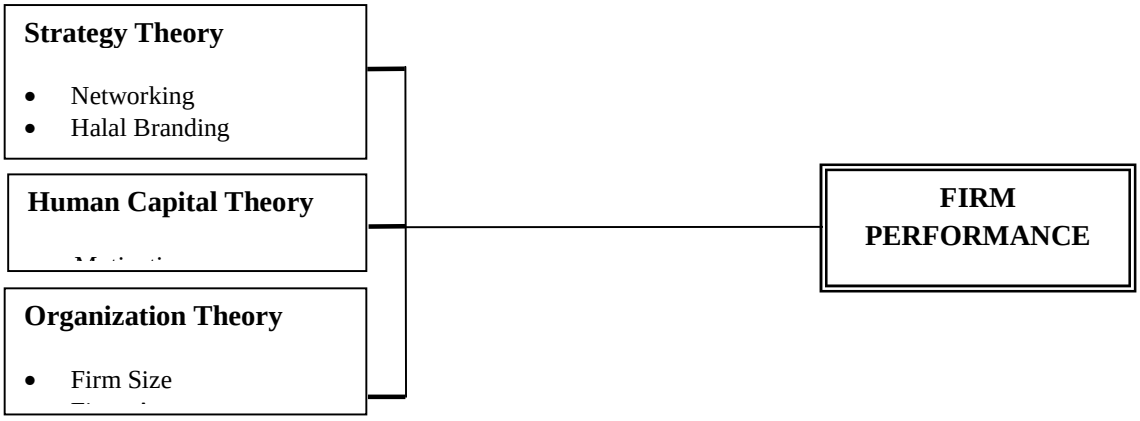
Conceptual Framework

Neely et al. (1999) posited that the role of performance measurement as a process of quantifying the efficiency and effectiveness of a company's actions. An organization has to achieve its desired goals with greater efficiency and effectiveness than its competitors to have better performance. Browne et al. (1997) asserted that a company must have a process of measurement that measures both the present performance and the performance after any changes have been made in order to have improvement in performance. Meanwhile, Storey (1994) proposed that factors influencing performance in small firms

derive from three components, (i) the owner-manager (ii) the firm (iii) the strategy employed by the firm. These include motivation, firm age and size, marketing and policy, human resource, competition, strategic and financial management, infrastructure and external relationships.

Based on the previous literature review on firm performance measurement which mostly derived from experience in other countries, the research propose by considering a conceptual framework of Storey's (1994). Thus, the study will be focus on whether or not that the Islamic practices in owner-manager characteristics and firms' strategies, the firm and business environment influence the small firm performance. Below is the proposed theoretical framework in this study:

Theoretical Framework of the Research



2. LITERATURE REVIEW AND HYPOTHESES

The Islamic and Protestant Value Systems in Organization

Clarke (1998) posited that values, beliefs, intentions and objectives that people bring to their work are regarded as the work ethics. Islam as a religion which prescribes an extensive set of principles and regulations shaping all the aspects of life, including business ethics such asunity, equilibrium, free will, responsibility and bounty/benevolence (Torlak, et al. 2008). Hanafi and Salam (1995) highlighted the importance of work ethics in Islam based on the Qur'an and Hadith. They specifically relate to six principles of Islamic ethics namely truthfulness, trust, sincerity, brotherhood,

knowledge and justice. Other Islamic business guidelines are; mode of transactions that adherence of contracts, accurate measurements and weights, interests and unlawful trade, fair recruitment practices and treatment of employees and protection of environment are crucial to apply in any business operations. Moreover, Islam regards working as *ibadah* (good deeds to God), encourages trading, productivity and puts strong emphasis on the equal distribution of wealth in society (Ocal, 2007).

Islam and Christianity are having different belief systems, work ethic values with comparable characteristics (Weber, 2004). Weber posited that Islam was such a salvaging religion that did not support the economic growth in the world, while Protestant ethic has influenced people to work hard, expand their business, involve in trading, create wealth and then invest their wealth in order to gain more wealth, in which this related to the capitalism approach. However, Naqvi (1981) argued that ethical values in Islam are not oriented to social economics system or welfare state but oriented to an economics system which based on Unity of God or the *tauhid* principle as the moral basis that will create a fair and distributable economic system. Thus, the aim of Islamic economics is to reach the overall good deeds of maslahah (welfare) for everyone including the non-Muslim.

Islamic Practices

In small firms' behavioural theory, the behaviour of the owner-manager (entrepreneurs) and the behaviour of the firs are regarded as synonymous (Hall, 1995). In this study, Islamic practices are conceptualised into two dimensions. Firstly, the practices of the Muslimpreneurs religiosity such as performing prayers, give *sodakah* (charity), fasting during *Ramadhan*, join the Muslim *jemaah* (networking) are contributively to the performance of the firm. Secondly, the practices of the firm that is *shaariah* compliance such as, Islamic finance, Halal production, paying *zakat,* Islamic values in the business management functions' are also contributively to the firms' performance. Thus the main hypothesis of the study is, "*Islamic practices are influencing the firms' performance.*

The Growth Models

Growth is a process of overcoming resource deficiencies resulting from the liabilities of newness and smallness (Shelton, 2005) or a differential outcome between (at least) two points in time or measures over a certain number of years or within the time periods of 1-, 3-, or 5- year periods (Penrose, 1959; Delmar, et al., 2003). The research of growth has been done by many researchers. Davidsson et al., (2006) came out with similar work and suggested two models of growth, there are: (i) stages and transitions; (ii) growth antecedents and determinants. Storey (2000) and Davidsson et al. (2006) assumed the stages models measure the growth process of life cycles or stage or transition throughout the life of an organization. The life cycle model refers to start-up, growth, maturity and decline stages. Mostly, it is focus on identifying problems that organization face during growth stage such as transition and managerial role problems (Davidsson et al., 2006). However, the limitation is not all the firms begin at the first stage and move to final stage, and eventually, the management roles do not shift at the same time in related stage. Storey (1994) asserted that an organization may have a management styles that is more or less advanced than its stage.

Models of growth antecedents and determinants refer to factors or determinants that affect the firm growth. However, Storey (2000) differentiates the models which based on personality or entrepreneurs' perception. The origin of personality-based models may explained in Davidsson's model whereby the determinants are ability, need, opportunity and entrepreneur's perception. Thus, this study is adopting the Storey's growth model.

Factors Influenced the Small Firm Performance

STRATEGY THEORY

Schermerhorn (2002) defined a strategy as a comprehensive actions plan that identifies long-term direction for an organization and guides resource utilization to accomplish goals with sustainable competitive advantage. Porter (1980) mentioned that a strategy is important for the firms to gain competitive advantages and able to outperform their competitors. Beaver (2002) asserted that a strategy is the action takes by an organisation to pursue its business objectives. Thus, a new venture success or failure depends almost

totally on the strategic initiatives taken by the firm (Roper 1997). Previous research discussed and investigated on the relationship between new venture strategies and firm performance such as quality, low cost and innovativeness (Tsai and Li 2007), new product development (Zott and Amit 2008) and market development and geographic scope (Hsu and Pereira 2008). This study emphasize to the Islamic marketing and financial strategies' implementation in an organization.

Marketing Strategy in Relation to Firm Performance

Marketing strategy refers to the best marketing practices used by firms to gain competitive advantage and achiving company goals (Brassington and Pettitt, 2003). Marketing practices in small firms are different with larger firms. Hill (2001) posited that the small firms are more flexible, closer to customers, more capable of adaptation and implementing creative change through exploitation of core competencies and small firms cannot follow formal marketing practices because of the limited resources and different ways of managers' minds (Gilmore et. al., 2001). A study by Indrati and Langenberg (2004) on small firms' performances in Indonesia found out that marketing practices are the main factor of firm performance and positively related to the business success in a significant way.

There are five categories of ethical principles in Islamic marketing practices (Hanafy and Salam (1988). These include (i) truthfulness; communication which relate to advertising or personal selling, must be done in a truthful manner, (ii) trust; a marketer must uphold the trust Allah SWT through proper management of resources for the betterment of society and environment, (iii) sincerity; to be sincere in fulfilling consumers' needs and ensuring consumer safety, (iv) brotherhood; having a sense of brotherhood in dealing with business partners and consumers and (v) justice; the justice could ensure all dealings are conducted with fairness to all parties. A study by Abdullah and Ahmad (2010) found that many businessmen do not observe the marketing practices as outlined in the Quran and Sunnah particularly in products' promotion such as giving full disclosure of information, use of exaggerations and vulgar languages and false promises in their attempt to sell the products. Thus, the Islamic marketing practices have superior influence

which based on the values that embedded in every element of practices (Arham, 2010). This study focuses on variables of Islamic networking and Halal strategies of small firms.

Islamic Networking

The networking strategy refers as an access to people and their resource of information and knowledge of its relational activities through informal and personal or formal and professional networking (Macpherson and Holt (2007). Burt (2005) added that a networking increased understanding of potential markets, new business locations, innovations, sources of capital and potential investors, and it is positively influence the performance of small firms. Networking is the most useful of marketing practices and as an important sign of growth in small firms (Brown et al., 2005; Gilmore et al., 2001). A study conducted by Delapierre et al. (1997) found that most successful firms in terms of growth belong to dense and convergent networks while the inadequate networking will lead to firm poor performance.

In Islamic perspective, networking relates in having good relationship among the human beings which is compulsory especially seeking for doing goodness. The role of Islamic networking is maintaining the relationship that encourage trust, reciprocity and shape the quality and quantity of the interactions towards providing the inputs and growth (Chapra, 1992) with an application of the Islamic value dimensions such as honesty of communication, appreciation of diversity of human race, justice and fairness (Rice and Al-Mossawi (2002) Thus, the proposed hypothesis is:

H1: A networking strategy with Islamic organizations is related to firm growth.

'Halal' Branding Strategy

The small firms need to encourage the branding experiences to their customers in order to explicitly communicate positive associations and increase customer confidentiality in goodness of products. The branding strategy emphasizes on creation and development of brands as a source of sustainable competitive advantage (Gilmore, 2003) and generates growth (Mowle and Merrilees, 2005). With an increasing competitive market, the small firms are motivated to build brand strategy to enhance sales. In Islamic perspective, the

concept of branding strategy associated with halal certification as a way to inform and reassure their target consumers on their products are shariah compliant (Wilson and Liu, 2011). The term halal is better known by consumers as a food that is permissible to be consumed. The small firms need to invest and align the standard set by local authorities to obtain halal products' certification. A study by Osman and Sahidan (2002) in Malaysia (N=891) indicated that halal logo did play a role in their purchase decision. He added that the halal concept is an absolute key to consumption and the products which carry halal logo have more meaningful and important than those carrying ISO or similar certification. Thus, the hypothesis is:

H2: A branding strategy with halal certified product is related to firm growth.

Financial Strategy in Relation to Firm Performance

Financial strategy refers to the practices that a firms adopts to pursue financial objective. With sufficient financial support, new ventures can more effectively utilize their existing resources to continuously improve, upgrade, and develop advanced products and processes. Cassar (2004) asserted that financial capital is an instrumental resource required by new venture and as a factor for growth. Levine (2004) posited that a firm with limited or no access to external capital may face serious constraint in its ability to pursue the firm's growth. For example, In Indonesia, a total of 75,63% of small firms' owners use their own money to finance their businesses and 2.35% borrow money from financial institutions (Tambunan, 2008).

In Islamic perspective, Shanmugam and Zahari, (2009) posited that Islamic finance aims of fulfilling the teachings of the Quran as opposed to earning maximum returns on financial assets. It is based on five main principles, which include the prohibition of interest (riba), excessive uncertainty (gharar), speculation (maysir), risk and return sharing, and the prohibition of investing in 'unethical' industries. However, the small firms in Malaysia does not consider the Islamic financing scheme as the most desirable capital source in operating their daily business transaction due to reason that it is less competitive as compared to their conventional counterparts (Norafifah and Sudin 2002). Meanwhile, in Indonesia, the development of Islamic finance showed positive

development by the high demand on its products and services with reached the total assets of USD713 billion, increased of 5,23% compare the previous quarter in 2011 (Bank of Indonesia, 2011).

The Islamic micro financing institution (IMFI) provide financing to the small firms to improve the firm performance by increasing their income, profit and assets (Widiyanto and Ismail, 2007). With the concept of profit/loss sharing, it avoid a burden to the borrowers and this shows by the low rate of non-performing loan (NPL) problem with less than 5% or the rate of repayment greater than 95% during years of 2002-2005 in Indoneesia. Moreover, Zaher and Hassan (2001) provide an overview of the returns by 37 Islamic equity funds for the period 1997–1999 and found that ethical investments offer a good return compared to conventional mutual funds. Given these arguments, thus the hypothesis is:

H3: The Islamic financing is related to firm growth.

ORGANIZATION THEORY

The organization factors refer to the characteristics of the firms in terms of age, size and ownership. These there factors are the most comprehensive set of small firms' organizational factors in many studies (Wong and Aspinwall, 2004) which influence significantly to the firms' performances and growth (Hunger and Wheelen, 2003).

Firm Size in Relation to Firm Performance

There are arguments from previous studies on the firm size and its relationship with the firm performance. Gibrat's (1931) Law of Proportionate Effect (LPE) point out that firm's growth is independent of its size or irrelevant to growth rates. Number studies found evidence which fully or partially support the LPE (Piergiovanni, et al. 2002; Audretsch et al., 2002). Goddard et al., (2006) argued that the firm growth is just happed, thus, past growth is not a reliable predictor of future firm growth and some empirical studies have rejected the LPE (Hall, 1987; Evans, 1987; Geroski and Gugler, 2004). Moreover, Jovanovic (1982) suggests that differences in firm size would reflect different positions along the critical growth path. The larger firm may enjoy the advantages of having bigger resources that may give the optimum combination for optimum production.

However, Liedholm (2002) argued that small firms grow more rapidly than large ones. Menwhile, Storey (1994) found that the firm size was a significant factor to small firm performance and it is the most widely studied factor for its contributions to growth. Thus, the hypothesis is:

H4: Firm size is related to the firm growth.

Firm Age in Relation to Firm Performance

Storey (1994) stated that young firms are more likely to achieve significant growth than older firms. Older and larger firms tend to exhibit lower growth rates due to having less of a growth imperative and their expansion is more likely to involve mergers and acquisitions (Davidsson et al., 2006). Jovanovic (1982) asserted that firms learn about their real efficiency over time which relates to the firm's age, thus, the small firms grow faster than large firms. An IDB study reveals that the major expansion of dynamic enterprises occurs during their third year of operation (Kantis et al., 2004). Thus, the firm age is an important factor in determining business growth of small firms and the hypothesis is:

H5: Firm age is related to the firm growth.

HUMAN CAPITAL THEORY

Rastogi (2000) posited that human capital is an important input for organizations and employees' continuous improvement mainly on knowledge, skills and abilities. The entrepreneurs' characteristic of human capital constitute a key determinant of business success and give positive impact on firm performance (Hoxha, 2009; Al-Ma'ani and Jaradat, 2010). In Islamic perspective, the human capital is the integration of physical and spiritual. The better person is posses the technical knowledge, skills and good values as taught in Islam religion (Trim, 2009). It aims to produce better workers that obliged and fearful not only to the employer but most importantly to the Al-Mighty.

Islamic Motivation

Motivation refers to a driving force which helps and causes to achieve goals. Griffin and Ebert (2007) defined a motivation is the set of forces that costs people to act in a certain

ways and as an amount of effort that employee invests in a given task (Buhler, 2003). Number of authors asserted that the motivation contribute significantly to firms performance (Benzing and Chu (2009). While, Muslim workers find the motivation factor as a very important aspect as stated in the religion taught compared to other religions (Ali, 2009). In his study on the perception of 147 employees towards the Islamic motivation concept from various organizations in Bangladesh, Ather et al., (2011) found out that the traditional motivation concept is a reflection partially of a total Islamic motivation concept. They insist to have mix expectations of materialistic world and the world hereafter because the permanents world hereafter is world of happiness. Muslim feels motivated to earn these materialistic gains for rendering the duty of a Muslim to Almighty Allah SWT as well as the duty of a Muslim towards fellow and all other creations of Allah SWT. Thus, the hypothesis is:

H6: The owner/manager with Islamic motivation is positively linked with growth potential.

3. METHODOLOGY

The quantitative deductive research approach is chosen in this study. The deductive approach allows the research to establish a hypotheses by using theory Creswell (2002). Trochim (2011) posited that a deductive research is based on the general idea to reach at the specific situation and it is linked with the positivism paradigm. Furthermore, this study is using the cross-sectional correlation survey design which requires using the statistical tests of correlation to describe and measure the degree of association/relationship between or among variables or sets of data (Creswell, 2002), in this case to reveal the Islamic practices factors influence small firm performance.

Population and Sampling Frame

The population chosen for the study is the owner-managers of 10,757 small firms registered in Ministry of Cooperative and SMEs and as the Chamber of Commerce Association members which located in the 4 (four) most strategic and potential regions. Refer to the table of determining random sample size by Sekaran (2003), the sample size

of 10,757 population is 370 respondents. However, in this pilot study stage, there are 30 (thirty) owner-managers drawn randomly from small firms in the regions.

Research Variables

The measurement of the variables is based on the conceptual and theoretical framework operationalized in the studies. The variables measures are as follows:

1. Islamic Motivation is measured by whether or not the firm has a program of religiosity to drive spiritual factors into business. It is measured as dummy variable (yes: 1; no: 0).
2. Halal Strategy is measured whether or not the firm obtained Halal products' certification. It is measured as dummy variable (yes: 1; no: 0).
3. Islamic Networking Strategy is measured whether or not the firm become an Islamic trading/commerce association. It is measured as dummy variable (yes: 1; no: 0).
4. Financial Strategy is measured whether or not the small firm purchased the Islamic financing. It is measured as dummy variable (yes: 1; no: 0).
5. Firm Age is measured by use the number of years a firm has been incorporated.
6. Firm Size is measured by the total number of employees employed by the firms.
7. Growth Sales. The growth rate of sales is calculated by the proportionate values of sales growth rate from the given period of five years from 2007 – 2011.

Result

Based on the 30 questionnaires received in this pilot study, there are 46.2% were male and 30.8 were female. The responses were largely males due to the fact that, majority of the owner-manager was predominance by male. Most of respondent of 96.7% were Muslim, 3.3% were Protestant and none for Catholic, Buddha or Hindu. This is due to the Muslim majority of population in the region. While, the education level of owner-managers who has secondary and higher education level have the same portion of 50%. Additionally, the majority of business' age of 59.0% were incorporated since 3-5 years ago and most of them by 55.0% were in the age of 22 – 40 years old, and majority of firms has range of 4-7 employees of 41%. The validity of instruments can be seen at the

Durbin-Watson value of 2.087 in Table 3.1 which indicated non-autocorrelation between variables.

Statistical Estimation

The main quantitative analysis method used in this research is the Multiple Regression analysis. The relationship between independent and dependent variables is modeled in the following equation:

$$\mathbf{Yi = a + bXi + e}$$

Where Y represents growth rate of sales (GrS) in i^{th} small firms, Xi represents six independent variables such as Islamic motivation (X1), Halal strategy (X2), Islamic networking strategy (X3), Islamic financing strategy (X4), firms' age (X5) and firms' size (X6), a is intercept, and e is error term. Table 3.1 summarises the regression results of the growth model generated by OLS techniques. The direction of the sign of each variable would be used as the hypothesis testing technique. From Table 3.2, it is depicted that adjusted R^2= .967 indicates that the variables in the model explained 97% of the variation of the dependent variable sales growth. The results also explained that all the predictive variables are positively associated with the firms' performance which has had significant *t-test*. The Growth Model is given below:

Y = -581.965X1 + 1307.850X2 + 2151.229X3 + 12208.569X4 + 1036.268X5 + 91.289X6 + e

Table 3.1 Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate	Durbin-Watson
1	.967[a]	.935	.918	570.514	2.087

Table 3.2 Multiple Regression analysis of Islamic Practices and Firm Performance (Sales Growth)

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.	95.0% Confidence Interval for B	
	B	Std. Error	Beta			Lower Bound	Upper Bound
(Constant)	-581.965	482.288		-1.207	.240	-1579.653	415.723
Islamic Motivation	1307.850	241.356	.326	5.419	.000	808.567	1807.134
Halal Strategy	2151.229	221.929	.528	9.693	.000	1692.133	2610.325
Islamic Networking Strategy	2208.569	285.014	.542	7.749	.050	1618.974	2798.165
Islamic Finance Strategy	1036.268	239.788	.242	4.322	.010	540.229	1532.308
Firm Age	527.441	50.931	.607	10.356	.050	422.082	632.800
Firm Size	91.289	33.025	.169	2.764	.011	22.972	159.606

a. Dependent Variable: Growth

Table 5. shows the estimation of factors contributing to the growth of SMEs. From this table, it can be found out that the variable Islamic Motivation and Halal strategy are have a positive impact on the growth rate of sales (coefficient of 1307.850, 2151.229, respectively) at a statistical significant level of 1 per cent (both have p value=0.000). Similarly, the variable Islamic Networking Strategy, Islamic Finance Strategy, Firm's Age, Firm's Size have a positive effect on the growth rate of sales (coefficient of 2208.569, 1036.268, 527.441, 91.289) at a statistical significant level of 5 per cent (p value=0.050, 0.010, 0.050, 0.11). These findings support all the hypotheses H1, H2, H3, H4, H5 and H6.

4. CONCLUSION

This study has investigated the relationship between 6 (six) independent variables (Islamic motivation, Halal strategy, Islamic networking strategy, Islamic financing strategy, firm size, firm age and one dependent variable (growth rate of sales). It concluded that all variables are positively related to the small firms growth. It is consistent with the previous research findings that factors of firm's age, firm's size and the 4 (four) Islamic practices have significantly affected the firm performance in small firms and as a useful tool to increase the sales growth. The highest contribution to the firm performance is Islamic networking strategy (β=2208.569) and followed closely by Halal strategy (β=2151.229) in small firms.

This study has implications for the small firms, stakeholders and researchers. For the small firms sector, owners/managers implementing the Islamic practices like 'halal' certification, networking and financing strategies is actually influencing the firms' growth. It would probably engaged to the high concern of customers toward the cleanliness and procedures in compliance to the shaariah compliance as in the Islamic principles, the importance of building the trust, reciprocity and quality interactions, and the vital of minimization of burden and increase their profit with the profit/sharing concept. These kind of strategy should be long termed and should be planned specifically. Secondly, it is needed to consider toward spiritual motivation of materialistic gains to seek happiness in the world of hereafter. Lastly, as shown by previous researches of positive relationship of firm's age and firms' size and the sales growth.

This study provides an additional empirical evidence that analysis of small firm growth could be based on a multidimensional framework. The Islamic practices at the firm's level suggest positive linked with the growth of the firm. Also interestingly found is that, older firms are inclined to Islamic practices as compared to the younger firms, suggesting that age does matter in good and ethical behavior. Further studies should be implemented with the support of more comprehensive and coherent theoretical background to reflect actual conditions on researching sample. This is a potentially important form of growth that should be considered in the design of future studies.

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PROFITABILITY AND EFFICIENCY DETERMINANTS: A PANEL DATA ANALYSIS OF ISLAMIC BANKS IN MALAYSIA

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Abstract

This paper attempts to investigate whether banks' efficiency in the Islamic banking industry in Malaysia is determined by a set of profitability variables. Using quarterly data for the period of 2007 to 2010 across seventeen Malaysian Islamic banks, this study examines how bank specifics, financial structure and macroeconomic variables affect the profitability and efficiency of Islamic banks. In order to find out the determinants of Islamic banks' profitability, the unbalanced panel data regression technique has been applied to analyse the cross-section and time series data. In addition to that, this study uses the Data Envelopment Analysis (DEA) Approach to estimate the technical efficiency as the dependent variable. Also, the multiple regression method is used to analyse the efficiency determinants of Malaysian Islamic banks. Tobit multiple regression which allows limited dependent variables is used to analyse the factors that influence banks' efficiency. Empirical results indicate that bank specifics, financial structure and macroeconomic determinants are able to explain significant part of profitability and efficiency of Islamic banks in Malaysia. However, some factors which are important for banks' profitability became unimportant for banks' efficiency and vice versa. The study reveals that domestic and foreign Islamic banks have different profitability and efficiency. Contrary to the efficiency of Islamic banks, the profitability of Islamic banks is negatively affected by the global financial crisis.

Keywords: Islamic banks, Banks profitability and efficiency, Malaysia, global financial crisis

1. INTRODUCTION

Malaysia has emerged as the first country to implement a dual banking system, where the Islamic banking system operates side-by-side with the conventional banking system. The

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industry structure of the banking institutions participating in the Islamic banking system has changed with the liberalization of the Islamic banking industry, which propels the entry of foreign Islamic banks into the Malaysian banking. Thus, Malaysian Islamic banks have been operating in a very competitive industry. Presently, there is a total of seventeen Islamic banking institutions, eleven domestic Islamic banks and six foreign Islamic banks (Bank Negara Malaysia, 2011). These Islamic banks constitute part of the Malaysian Islamic financial system which has grown very rapidly to enable Malaysia to become the centre for Islamic banking.

Studies of banks' profitability and efficiency are an important tool towards the improvement of bank performance, evaluation of bank operations and determination of management planning to help in increasing their chance to survive in competitive markets. Studies of banks' profitability and efficiency are important for the improvement of the economy since banks contribute to economic growth. The objective of this study is to investigate whether banks' efficiency in the Islamic banking industry in Malaysia is determined by a set of profitability variables. The work on identifying banks' profitability determinants has received much attention from academic researchers, but there has been little study about banks' efficiency determinants. To the best of researchers' knowledge, no study has been conducted to compare the determinants of profitability with determinants of efficiency to investigate whether banks' efficiency is determined by a set of profitability variables. In contrast to the previous studies which are conducted to find out the determinants of profitability and to identify determinants of efficiency, this study, however, is an attempt to identify the differences between profitability determinants and efficiency determinants of Islamic banks in Malaysia.

This paper is organized as follows: section 2 discusses the existing literature on bank profitability and efficiency, section 3 presents the data and explains the research methodology, section 4 presents the results and discussion, and section 5 presents the conclusion.

2. LITERATURE REVIEW

The banking literature explains the determinants of profitability and efficiency based on internal and external variables. Internal variables or bank specific factors are under the control of bank management, whereas external variables are affected by the macroeconomic environment. To measure the profitability of banks, the literature on bank profitability makes use of several ratios, such as return on assets, return on equity, return on deposits, Net interest margin and profit margin. The two most often used are the return on assets and the return on equity (Iqbal and Molyneux, 2005).

In the banking literature, two major methods for the estimation on bank efficiency are used: parametric and non-parametric approaches. The non-parametric methods do not presume any explicit functional form for the frontier and construct it from the observed input-output ratios using mathematical programming techniques. The main method frequently used in estimating bank efficiency is the Data Envelopment Analysis (Tahir et al. 2009).

Previous empirical studies related to the present study can be classified in two categories: studies that focus on the determinants of banks' profitability and studies that focus on the determinants of banks' efficiency. Many studies have been done to examine the profitability determinants of banks, but very few studies have attempted to look into the determinants of banks' efficiency.

Short (1979) and Bourke (1989) were among the first who examined the determinants of banks' profitability. Following them, a lot of studies have been done to examine the profitability determinants, for example, Bashir (2003), Naceur (2003), Sanusi and Ismail (2005), Wasiuzzaman and Tarmizi (2010), Dietrich and Wanzenrie (2010), Idris, et al (2011) and Khrawish et al. (2011). Most of these studies have come to the finding that bank specifics, financial structure and macroeconomic determinants are able to explain the changes in bank profitability.

Sanusi and Ismail (2005) examine the determinants of Islamic banks' profitability in Malaysia. Using fifteen samples of full-fledged Islamic banks and Islamic windows during the period (1995 - 2004), the study has found out that: firstly, high profitability tends to be associated with banks that hold a relatively high ratio of total loans over total assets, lower non-interest earnings and growth of total assets. Secondly, there is a positive relationship between bank profit and the financial structure variable. Thirdly, the GDP growth rate has no impact on bank profitability.

Wasiuzzaman and Tarmizi (2010) examine the impact of bank characteristics and macroeconomic determinants on the profitability of sixteen Islamic banks in Malaysia during the period of 2005- 2008. The study finds out that capital and asset quality have an inverse relationship with bank profitability while liquidity and operational efficiency have a positive influence. The macroeconomic variables, as in the Gross Domestic Product (GDP) and inflation have positive relationship with bank profitability.

Sufian and Habibullah (2010) examine the determinants of Indonesian banks' profitability during the period 1990–2005 using the least square method of the fixed effects model. The return on asset ratio is used as proxy for profitability. The findings indicate that income diversification and capitalization are positively related to bank profitability, while size and overhead costs exert negative impacts. The impact of economic growth and banking sector concentration are observed to be positive during the pre-crisis and crisis periods.

Idris, et al (2011) examine the determinants of profitability for Islamic banking institutions in Malaysia using the panel data analysis. The bank-specific determinants include capital adequacy, credit risk, liquidity, bank size and management of expenses. Return on assets is used as a profitability measure. Using quarterly data from nine Islamic banks for the period of 2007- 2009, this study suggests that the Bank Size is the most important factor in explaining the variation of profitability for Islamic banking.

Ali et al. (2011) examine the profitability indicators of public and private commercial banks of Pakistan during the period of 2006-2009.The findings suggest that the profitability seems to have been positively affected by size, operating efficiency and asset management and negatively by capital and credit risk in the case where profitability is measured by return on assets. The macroeconomic variables, GDP is found to have a positive effect on Return on Assets and Return on Equity, but the Inflation Rate is found to have a negative effect on Return on Assets only.

Khrawish et al. (2011) examine the factors that might affect the Jordanian Islamic banks' profitability during the period from 2005 to 2009. The analysis has revealed that there is a significant and negative relationship between the ROA and the bank size, total liabilities, Gross domestic product, Growth Rate and Inflation Rate. Also, the study has found that there is a significant and positive relationship between ROE and bank size, total income to total Asset of the Islamic Banks. Next, a significant and negative relationship between ROE and GDPGR and INF has also been found.

Smaoui and Bensalah (2011) examine how bank-specific characteristics and the macroeconomic environment affect the profitability of Islamic Banks in the Gulf Cooperation Council. The panel data of 44 Islamic Banks over the period 1995-2009 is used. The results find that capital strength is positively and significantly related to the profitability of Islamic Banks, but the impact of liquidity on bank profitability is insignificantly related. The results also show that overhead and efficiency are negatively and significantly related to profitability, whereas, the results of GDP growth, inflation and size have been found to be positively and significantly related to bank profitability.

Previous studies have also examined the determinants of efficiency. For example, Grigorian and Manole (2006) have looked at determinants of the efficiency of financial institutions in transition countries. The study has used Tobit regression to test the relationships of data envelopment analysis estimated efficiency scores with commercial bank-specific variables, macroeconomic variables and regulatory variables. These variables are equity capital ratios, market concentration, foreign ownership, old banks,

capital adequacy, GDP per capita, rate of inflation and size of the financial sector. The findings indicate that equity capital ratios, Market concentration, foreign ownership, capital adequacy and GDP per capita, are all positively related to the efficiency.

Zamil (2007) examines the efficiency of Islamic Commercial Banks and Conventional Commercial Banks in Malaysia from the year 2000 to 2004. Data Envelopment Analysis is used to examine the relative efficiency of the selected banks in intermediating inputs into outputs. The study examines the influence of the banks' specific characteristics like the bank size, profitability, market power, non-performing loans and bank capitalization on the efficiency. The study has found that bank size is significantly positively associated to Technical Efficiency and Non-Performing Loans is significantly positively associated to Scale Efficiency. On the other hand, market power is significantly negatively associated to Technical Efficiency and Scale Efficiency.

Seelanatha (2007) uses a non-parametric Data Envelopment Analysis (DEA) to measure the efficiency of banks in Sri Lanka during the period from 1989 to 2004. Microeconomic, macroeconomic and other factors affecting banks' efficiency are used. These factors are assets quality, capital strength, fixed assets to total assets, gross interest margin, liquidity, profitability, loans, bank size, stock market capitalization, GDP growth, inflation ratio, commercial banks, privately-owned banks, and old banks. The results show that technical efficiency has positive relationships with variables capital strength, profitability, loans, liquidity and stock market capitalization; and negative relationships with lines of businesses namely private banks, commercial banks and old banks.

3. METHODOLOGY

The data of bank-specific variables are collected from the quarterly balance sheet and income statement of seventeen Malaysian Islamic banks. Regarding the macroeconomics variables, the data is collected from Department of Statistics, Malaysia. This study uses

an unbalanced panel for the period of the first quarter of 2007 to the fourth quarter of 2010.

In order to examine the determinants of Islamic banks' profitability in Malaysia, the unbalanced panel data multiple regression technique has been applied to analyse the cross-section and time series data, therefore the panel estimation technique is utilized to analyse the internal determinants and the external determinants. Pooled Ordinary Least Squares (POLS), Fixed Effects Models (FEM), and Random Effects Models (REM) are types of panel analytic models. To identify the right estimator for the model, various tests have been performed.

Also, this study uses the Data Envelopment Analysis (DEA) Approach to estimate the technical efficiency as the dependent variable. The regression method is used to analyse the efficiency determinants of Malaysian Islamic banks. In cases with limited dependent variable (where the DEA index ranges between 0 and 1) the Tobit model is known to generate consistent estimates of regression coefficients (Grigorian and Manole 2006). Thus, Tobit multiple regression which allows limited dependent variables is used. An unbalanced panel data of the Tobit regression model is used to analyse the factors that influence bank efficiency.

3.1 Estimation Model

The regression models can be written as follows:

$$ROA_{it} = \alpha_{0} + \beta_1 CRTA + \beta_2 OHTA + \beta_3 LOTA + \beta_4 DTA - \beta_5 LATA + \beta_6 TE + \beta_7 INF + \beta_8 GDPGR + \beta_9 GDPPC + \beta_{10} LOGTA + \beta_{11} CONC + \beta_{12} AGE + \beta_{13} DDF + \beta_{14} GFC + \varepsilon_{it}$$

$$TE_{it} = \alpha_{0} + \beta_1 CRTA + \beta_2 OHTA + \beta_3 LOTA + \beta_4 DTA - \beta_5 LATA + \beta_6 INF + \beta_7 GDPGR + \beta_8 GDPPC + \beta_9 LOGTA + \beta_{10} CONC + \beta_{11} AGE + \beta_{12} DDF + \beta_{13} GFC + \varepsilon_{it}$$

Where:

ROE represents the Return on Assets as a dependent variable

TE represents the efficiency as a dependent variable

The Independent variables are:

CRTA = Capital and Reserves over Total Assets

OHTA = Overhead Expenditure over Total Assets

LOTA = Loans over Total Assets

DTA = Deposits over Total Assets

LATA = Liquid over Total Assets

TE = Technical Efficiency

INF = Annual Inflation Rate

GDPGR = Gross Domestic Product Growth Rate

GDPPC = Gross Domestic Product Per Capita

LOGTA = Bank Size

CONC = Concentration ratio

AGE = Bank Age

DDF = Different between Domestic and Foreign Banks

GFC = Global Financial Crisis

In the above model, α is a constant and ε is an error term.

3.2 Profitability and Efficiency Measure

3.2.1 Profitability Measure

Profitability is measured in terms of ratios. The advantage of using profitability ratios is that the inflation invariant is not affected by changes in price levels. There are several ratios used to measure the profitability of banks, the two most often used are the rate of return on assets and the rate of return on equity (Iqbal and Molyneux, 2005). This study uses the ROA as the dependent variable because it can be measured for Islamic banks and it is able to show the profit earned per unit of assets and reflect the management's ability to utilize the banks financial and real investment resources to generate profits. ROA is the proxy measure of bank’s profitability calculated as net income after tax is divided by total assets.

3.2.2 Efficiency Measure

The Data Envelopment Analysis (DEA) Approach is used to estimate technical efficiency for Malaysian Islamic banks during the period from $q_1$2007 to $q_4$2010 for each bank. DEA is a linear programming technique for examining the different efficiency of the decision-making units.

Following Taher et al. (2011), this study uses two inputs (Total Deposits, Overhead Expenses) and two outputs (Total Earning Assets, Total loans) to estimate the technical efficiency for Malaysian Islamic banks.

The efficiency of each bank is computed as follows:

$$\mathbf{TE} = \sum_{j=1}^{n} \mathbf{U}j \ \mathbf{Y}jk \ / \sum_{i=1}^{m} \mathbf{V}i \ \mathbf{X}ik$$

Where:

Y_{jk} is the amount of the *j*th output produced by the *k*th bank, X_{ik} is the amount of the *i*th input used by the *k*th bank, U_j is the output weight, V_i is the input weight.

X_{ik} , $Y_{jk} \geq 0$, $i = 1,\ldots, m$, $j = 1,\ldots, n$, $k = 1,\ldots, s$

U_j , $V_i \geq 0$, $i = 1,\ldots, m$, $j = 1,\ldots,n$

$$\sum_{j=1}^{n} \mathbf{U}j \ \mathbf{Y}jk \ / \sum_{i=1}^{m} \mathbf{V}i \ \mathbf{X}ik \leq 1$$

3.3 Determinants of Profitability and Efficiency

The determinants of profitability and efficiency are explained through internal and external determinants in the literature:

3.3.1 Internal determinants

Capital and reserves ratio (CRTA) is the difference between the value of a bank's assets and its liabilities. Bank capital to assets is the ratio of bank capital and reserves to total assets.

The overhead expenses ratio (OHTA) refers to an ongoing expense of operating a business. The overhead expense is usually used to group expenses that are necessary to the continued functioning of the business. The Overhead is obtained by dividing Personnel and overheads expenses by total assets.

Loans ratio (LOAT) is used to estimate the component of the income that is attributable to the management quality. It is computed by total loans over total assets. Loans of bank are expected to be the main source of income and are expected to have a positive impact on bank performance.

Deposits ratio (DTA) is total deposits from customers and deposits received from banks and other financial institutions (Non-Mudharabah Fund and Mudharabah Fund) as a percentage of total assets. Deposits of the banks are considered the main source of bank funding and hence, it has an impact on the profitability of the banks.

Liquidity ratio (LATA) is defined as to what extent the bank has funds available to meet cash demands. Cash, short term funds and deposits and placements with banks and financial institutions divided by total assets are used to measure the liquidity ratios.

Technical Efficiency (TE) refers to the ability of a bank to minimize input (or maximize output) use given a target output (or specific inputs). The efficiency ratio gives a measure of how effectively a bank is operating. Previous studies have confirmed that efficiency is one of the most important factors in explaining differences in profitability across the banks. Technical efficiency is measured by means of the Data Envelope Analysis (DEA) method.

3.3.2 External determinants

The macroeconomic variables and the financial structure variables which are used in the present study are elaborated as follows:

Macroeconomic Determinants

Inflation rate (INF) is defined as a sustained general rise in prices in an economy. As previous studies have reported, the inflation has positive impact on banks' profitability. Bashir (2003) reports that inflation may impact performance positively if a larger portion of Islamic banks' profits accrues from direct investment, shareholding and/or other trade activities (Murabahah). Inflation may have a negative effect on bank profitability if wages and other costs grow at a faster rate than the rate of inflation.

Gross domestic product growth rate (GDPGR) measures the national output of an economy. The GDP is expected to influence numerous factors related to the supply and demand for loans and deposits. As the GDP growth slows down, and, in particular, during recessions, credit quality deteriorates, and defaults increase, thus reducing bank returns. Gross domestic product growth rate is measured by the annual growth rate of real, and it is expected to be positive, relation with profitability.

The GDP per capita measures of the total output of a country takes the gross domestic product (GDP) and divides it by the number of people in the country. In other words, GDP per capita takes into account the average GDP per person in the economy.

Structural Determinants

Bank size (LOGTA) is considered an important determinant of its performance. Economic theory postulates that if an industry is subject to the economies of scale, large institutions will be more efficient and thus are able to produce services at a lower cost. As in most studies on banking, the natural logarithm of the bank's total assets is used as a measure of bank size to account for size-related economies.

Bank age (AGE) is the number of working years for each bank. Newly established banks are not particularly profitable in their first years of operation, as they place greater emphasis on increasing their market share, rather than on improving profitability (Athanasoglou et al, 2008). Nevertheless, according to the results of Dietrich and

Wanzenrie (2010) newer banks seem to be a little bit more profitable than older banks, implying that newer banks are able to pursue successfully new profit opportunities.
Concentration ratio (CONC) is measured by the proportion of the total assets for all Islamic banks divided by the total assets of the banking sector in Malaysia. Studies related to determinants of bank profitability are based on the structure-conduct-performance theory (SCP), which proposes that market concentration lowers the cost of collusion between firms and thus, results in higher profits. The idea that profits of firms are determined by the concentration level of the market was proposed by Bain (1951). Following him, a lot of studies have used the Structure-Conduct-Performance theory to explain the profitability of banks.

The difference between Domestic and Foreign Banks (DDF) as a dummy variable is included to investigate whether there is a difference between domestic and Foreign Islamic banks. A dummy variable (DDF) is to represent the type of banks, (1) for domestic Islamic banks and (0) for Foreign Islamic banks.

Global Financial Crisis (GFC) is another dummy variable included to examine the effect of the global financial crisis on the profitability and efficiency of domestic and foreign Islamic banks in Malaysia, (1) for the period of the crisis (q4 2008, q1 2009, q2 2009 and q3 2009) and (0) other periods.

4. RESULTS AND DISCUSSION

4.1 Descriptive Statistics of Variables

Table 1 reports the descriptive statistics of the variables used in the regression analyses.

The results of table 1 indicate that, on average, the Malaysian Islamic banks have a ROA of 0.17% over the entire period from $q_1$2007 to $q_4$2010. On average, the mean value of Technical Efficiency (TE) is 81.2% over the entire period, also there is a difference between the mean and median of TE which means that there is a difference in efficiency among the banks.

Table 1: Descriptive Statistics of Variables

Variables	Mean	Median	Std. Dev.	Skewness	Kurtosis	Obs
ROA	0.001707	0.001876	0.001999	-1.573363	4.039071	236
TE	0.812399	0.838336	0.167472	-0.827787	3.023207	236
CRTA	0.087952	0.079075	0.035694	0.937556	3.215483	236
OHTA	0.003785	0.003750	0.001497	0.292807	2.679337	236
LOTA	0.540883	0.562352	0.164480	-0.507790	2.614710	236
DTA	0.860544	0.867494	0.048727	-0.656494	2.821825	236
LATA	0.306671	0.279228	0.144072	0.887413	3.348544	236
INF	0.023525	0.018000	0.026489	0.673474	3.373873	236
GDPGR	0.038517	0.053000	0.046917	-0.824365	2.581568	236
GDPPC	0.025157	0.040000	0.046216	-0.830581	2.585306	236
LOGTA	9.048827	8.996098	0.817759	-0.373902	3.518467	236
CONC	0.132714	0.150200	0.034473	-0.746820	2.147186	236
AGE	4.873941	3.000000	5.987154	2.828595	10.12174	236
LOGAGE	1.176847	1.098612	0.828419	0.622980	3.867530	236

The values of skewness and kurtosis for the variables included in the table indicate that the data are normal distribution or very closer to a significantly normal distribution. To overcome the violation of the assumptions of the regression model, the variable bank age (AGE) is not closer to normal distribution, thus, the study resorts to Log Transformation for (LOGAGE).

4.2 Testing the Stationarity and Multicollinearity

Before analysing the regression model, it is important to test whether the variables in the model are stationary or non-stationary, as well as the fact that it is important to test whether or not the independent variables suffer from the multicollinearity problem.

To evaluate the stationarity condition of the variables in the model, the Levin, Lin & Chu; Augmented Dickey-Fuller-Fisher Chi-square and Phillips-Perron -Fisher Chi-square are carried out to test the unit roots. The tests are implemented on the level difference (with intercept and intercept & trend).

Table 2 shows the results of the Panel unit-root test for stationarity. The findings showed that all panel variables are integrated at 1% level of significance. The results prove that

all the variables are efficient and appropriate in measuring Islamic banks' profitability and efficiency in Malaysia over the study period and the results will be reliable.

Table 2: Displays the Panel Unit-Root Test

Variables	Levin, Lin & Chu; ADF-Fisher and PP-Fisher Chi-square tests for Unit-root tests (Results of tests on the level)					
	Levin, Lin & Chu		***ADF-Fisher Chi-square***		***PP-Fisher Chi-square***	
	Intercept	**Intercept & trend**	**Intercept**	**Intercept & trend**	**Intercept**	**Intercept & trend**
ROA	-13.4*	-12.2*	156.6*	127.7*	218.6*	213.3*
CRTA	-14.7*	-22.0*	152.2*	184.1*	187.9*	290.0*
OHTA	-10.4*	-11.6*	145.5*	118.8*	207.9*	201.3*
LOTA	-18.2*	-16.3*	206.2*	172.7*	284.2*	281.1*
DTA	-18.3*	-18.8*	209.2*	168.8*	229.2*	223.4*
LATA	-17.2*	-15.6*	191.7*	161.9*	209.0*	213.3*
TE	-15.1*	-16.9*	180.7*	168.3*	285.1*	257.6*
INF	-21.3*	-18.1*	260.4*	206.7*	300.4*	289.4*
GDPGR	-34.0*	-33.3*	399.0*	332.9*	313.7*	313.1*
GDPPC	-11.4*	-10.1*	90.3*	76.5*	94.0*	232.4*
LOGTA	-12.7*	-42.8*	155.2*	245.1*	184.8*	296.3*
CONC	-15.7*	-50.5*	199.0*	275.2*	222.1*	317.4*
LOGAGE	-13.5*	-33.2*	155.3*	253.5*	200.5*	328.5*

* denotes the rejection of the null hypothesis where a panel variable has a unit root at 1% level of significance (all panel variables are integrated at 1% level of significance).

Table 3 presents the correlation analysis for all independent variables. It indicates that the correlation between most of the variables is small, but there are some large value correlations (LATA and LOTA), (GDPGR and GFC), (LOTA and TE) and (DTA and CATA). The correlation among the explanatory variables is high, which might suggest that multicollinearity is present and that it might be serious. Given that the sample size is not large and because of the presence of the multicollinearity problem, it cannot include all variables in one analysis. Thus, the variables are divided into two equations based on the correlation matrix. Dividing the independent variables between the two equations is based on reducing the values of correlations. Hence, every two variables which have large values of correlations are separated.

Table 3: The Correlation Matrix Between the Independent Variables

Variables	CATA	OHTA	LOTA	DTA	LATA	TE	INF	GDPGR	GDPPC	LOGTA	CONC	LOG-AGE	GFC	DDF
CATA	1													
OHTA	0.47	1												
LOTA	0.05	0.02	1											
DTA	-0.72	-0.31	-0.15	1										
LATA	-0.01	-0.11	-0.84	0.13	1									
TE	-0.10	-0.18	0.74	-0.03	-0.68	1								
INF	-0.10	-0.05	-0.03	-0.01	0.07	-0.02	1							
GDPGR	-0.01	0.01	0.01	0.06	-0.01	0.01	0.20	1						
GDPPC	-0.02	-0.01	0.12	0.07	-0.15	0.09	0.14	0.51	1					
LOGTA	-0.55	-0.27	0.27	0.33	-0.30	0.47	-0.01	0.01	0.14	1				
CONC	-0.01	0.05	0.18	0.05	-0.22	0.12	-0.27	-0.18	0.40	0.19	1			
LOGAGE	-0.08	0.19	-0.24	0.26	0.03	-0.12	-0.11	0.07	0.18	0.39	0.21	1		
GFC	-0.00	0.00	0.01	-0.05	0.01	-0.01	-0.29	-0.90	-0.50	-0.01	0.22	-0.08	1	
DDF	-0.62	-0.46	0.12	0.51	-0.10	0.31	0.05	0.05	-0.02	0.59	-0.13	0.26	-0.06	1

The determinants of banks' profitability are as follows:

Equation (1): $ROA_{it} = \alpha_{0+} \beta_1 OHTA + \beta_2 LOTA + \beta_3 DTA + \beta_4 GDPGR + \beta_5 GDPPC + \beta_6 CONC + \beta_7 DDF + \varepsilon_{it}$

Equation (2): $ROA_{it} = \alpha_{0+} \beta_1 CRTA + \beta_2 LATA + \beta_3 TE + \beta_4 INF + \beta_5 LOGTA + \beta_6 LOGAGE + B_7 GFC + \varepsilon_{it}$

The determinants of banks' efficiency are given below:

Equation (1): $TE_{it} = \alpha_{0+} \beta_1 OHTA + \beta_2 LOTA + \beta_3 DTA + \beta_4 GDPGR + \beta_5 GDPPC + \beta_6 CONC + \beta_7 DDF + \varepsilon_{it}$

Equation (2): $TE_{it} = \alpha_{0+} \beta_1 CRTA + \beta_2 LATA + \beta_3 INF + \beta_4 LOGTA + \beta_5 LOGAGE + B_6 GFC + \varepsilon_{it}$

4.3 Testing the Determinants of Islamic Bank's Profitability in Malaysia

4.3.1 Testing by equation (1)

$$ROA_{it} = \alpha_{0+} \beta_1 OHTA + \beta_2 LOTA + \beta_3 DTA + \beta_4 GDPGR + \beta_5 GDPPC + \beta_6 CONC + \beta_7 DDF + \varepsilon_{it}$$

Table 4: Estimates Results of Pooled Ordinary Least Squares (POLS), Fixed Effects Model (FEM), and Random Effects Model (REM) - Dependent Variable (ROA)

Independent Variables	*POLS*	*FEM*	*REM*
C	-0.011987***	-0.011778***	-0.012863***
	(0.0041)	(0.0052)	(0.0010)
OHTA	0.240730***	0.402381***	0.317098***
	(0.0027)	(0.0001)	(0.0003)
LOTA	0.004052***	0.002690**	0.003658***
	(0.0000)	(0.0126)	(0.0000)
DTA	0.008492***	0.009446***	0.009641***
	(0.0016)	(0.0098)	(0.0016)
GDPGR	-0.001313	-0.001073	-0.001082
	(0.6616)	(0.6806)	(0.6774)
GDPPC	3.41E-07	5.38E-07	4.23E-07
	(0.6685)	(0.4397)	(0.5407)
CONC	0.003256	0.001223	0.000215
	(0.4083)	(0.7300)	(0.9510)
DDF	0.001818***	0.001766***	0.001737***
	(0.0000)	(0.0000)	(0.0001)
R^2	0.385071	0.570625	0.254123
F	20.39638***	12.86680***	11.09723***
	(0.0000)	(0.0000)	(0.0000)
DW	1.552864	2.151026	1.931185
N	236	236	236

* Numbers in brackets below the coefficient are the probability levels of significance. *, ** and *** indicate the significance levels of 10, 5, 1 percent respectively.

To identify either the pooled model or the panel random effect model is appropriate; The Breusch-Pagan Lagrange multiplier (LM) test is used.

Table 5: The Summary of the Breusch Pagan Lagrangian Multiplier Test (LM)

	Chi- chi-square(1)	**Prob>chi2**
Dependent variable: ROA	69.304	0.000

With the high chi-squared Statistics, we have rejected the null hypothesis in favour of the panel random effect model. Therefore, the Lagrange Multiplier test results favour the panel over the pooled OLS estimation model (the panel random effect regression model is appropriate).

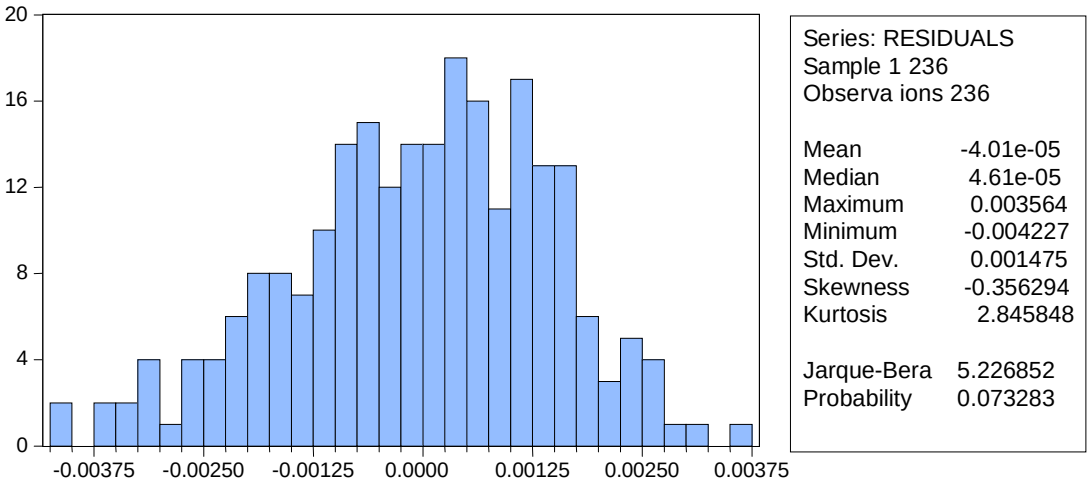
To determine the use of the fixed effect model or random effect model, the Hausman test is used by calculating the p-value (Prob>chi2). The following results are observed, with the panel that reports the Hausman test results being noted here in the following table:

Table 6: The Summary of Hausman Test

Test summary	Chi-Sq. Statistic	Prob>chi2
Cross-section random	10.133	0.119

The result of the Hausman test statistics in the table suggests that the Random Effects Model (REM) is the appropriate panel data estimator. One of the important assumptions of regression models is that the residuals are normally distributed. Jarque–Bera (JB) test of Normality can be used to test the residual normally.

Figure 1: Explains The Probability Distribution of the Residuals and the Results of the Jarque–Bera Test



As shown in Figure 1, the residuals seem to be symmetrically distributed. The application of the Jarque–Bera test shows that the JB statistics is about 5.22 and the probability of obtaining such a statistic under the normality assumption is about 0.073. Therefore, the hypothesis that the error terms are normally distributed is not rejected.

There are several heteroscedasticity diagnostic tests, with the White heteroskedasticity test being one of the most widely used. The white test is to be used in this study to detect the presence of heteroskedasticity.

Table 7: Displays White Heteroskedasticity

Test	F-statistic	Prob. F-statistic	Chi-Sq-Statistic	Prob>chi2
Heteroskedasticity test: White	5.498	0.000	113.721	0.000

Applying White's heteroscedasticity test, we find evidence of heteroscedasticity. The problem of heteroscedasticity is corrected automatically using the SUR procedure.

Table 8: Results of Random Effect Estimate for ROA as Dependent Variable

Independent Variables	***Equation (1)***
C	-0.012863***
	(0.0023)
OHTA	0.317098**
	(0.0118)
LOTA	0.003658***
	(0.0003)
DTA	0.009641***
	(0.0091)
GDPGR	-0.001082
	(0.5797)
GDPPC	4.23E-07
	(0.4061)
CONC	0.000215
	(0.9321)
DDF	0.001737***
	(0.0000)
R^2	0.254123
F	11.09723***
	(0.0000)
DW	1.93118
N	236

* Numbers in brackets below the coefficient are the probability levels of significance. *, ** and *** indicate the significance levels of 10, 5, 1 percent, respectively.

The estimation of the random effect model provides the Durbin-Watson (DW) test statistics in Table 8. Therefore, it can be seen that there is no evidence of serial correlation in the model. The first bank characteristic, which is the variable overhead to total assets (OHTA), has a positive and statistically significant impact on the return on assets (ROA). The result suggests that high profits earned by Islamic banks may be appropriated in terms of higher overhead (wages and salaries) which is in line with the Expense-Preference theory. This result is also consistent with the findings from some other related studies, i.e., Naceur (2003); Al Manaseer (2007); Bennaceur and Goaied (2008).

Loans to total assets (LOTA) have a positive effect on the bank's ROA and it is statistically highly significant as well. This result is consistent with what is expected, that Islamic banks play the intermediary role between the lenders and borrowers, which emphasizes that more deposits have been transformed into loans.

Deposits to total assets (DTA) have a positive and statistically significant impact on the return on assets. This result is in line with similar studies that have focused on banks' profitability such as Al-Jarrah and El-Rimawi (2010) and Javaid, et al (2011). The results of (LOTA) and (DTA) are in support of the view that, more deposits lead to their transformation into loans, thereby, making the profits higher.

For the impact of macroeconomic variables, the result reveals that Gross domestic product growth rate (GDPGR) has an insignificant impact on the return on assets. The support for the insignificant impact for the growth rate of gross domestic product in banks' profitability can be found in the following empirical studies: Sanusi and Ismail (2005); Al Manaseer (2007); Li. Yuqi (2008); Ramadan et al. (2011) and Sufian (2011).

The estimated result shows that Gross domestic product per capita (GDPPC) has an insignificant impact on the ROA. Al Manaseer (2007); Bennaceur and Goaied (2008) and Flamini et al. (2009) have found a similar result that the GDPPC has an insignificant impact on banks' profitability.

For the impact of the structural variables, the results indicate that the concentration ratio (CONC) has positive and an insignificant impact on the return on assets, which is not in line with the structure-conduct-performance theory. The result of the (CONC) variable indicates that the (CONC) variable is not important in determining banks' profitability. However, this finding is supported by the results of Al Manaseer (2007); Bennaceur and Goaied (2008); Flamini et al. (2009); Sufian (2010).

A dummy variable (DDF) has positive and highly statistically significant impact on the return on assets. This result suggests that domestic and foreign Islamic banks have different profitability, and the domestic banks are associated with high profits.

4.3.2 Testing by equation (2)

$$ROA_{it} = \alpha_{0+} \beta_1 CRTA + \beta_2 LATA + \beta_3 TE + \beta_4 INF + \beta_5 LOGTA + \beta_6 LOGAGE + B_7 GFC + \varepsilon_{it}$$

Table 9: Estimates Results of Pooled Ordinary Least Squares (POLS), Fixed Effects Model (FEM), and Random Effects Model (REM) - Dependent Variable (ROA)

Independent Variables	*POLS*	*FEM*	*REM*
C	-0.004179**	-0.012181**	-0.007740**
	(0.0337)	(0.0112)	(0.0119)
CRTA	-0.014827***	0.003421	-0.006036
	(0.0001)	(0.6536)	(0.2790)
LATA	0.000199	0.002981*	0.001443
	(0.8449)	(0.0938)	(0.3080)
TE	0.004467***	0.004366***	0.004352***
	(0.0000)	(0.0071)	(0.0014)
INF	-0.008537**	-0.006433	-0.008084**
	(0.0448)	(0.1173)	(0.0390)
LOGTA	0.000437**	0.001050*	0.000724**
	(0.0424)	(0.0535)	(0.0312)
LOGAGE	-0.000166	-0.000121	-0.000200
	(0.2922)	(0.7462)	(0.4026)
GFC	-0.000206	-0.000284	-0.000271
	(0.3989)	(0.2011)	(0.2154)
R^2	0.374582	0.546712	0.192369
F	19.50803***	11.11710***	7.758178***
	(0.0000)	(0.0000)	(0.0000)
DW	1.686008	2.178023	2.049559
N	236	236	236

* Numbers in brackets below the coefficient are the probability levels of significance. *, ** and *** indicate the significance levels of 10, 5, 1 percent, respectively.

The results of the Breusch-Pagan Lagrange multiplier (LM) test in the table below indicate that the Lagrange Multiplier test favours the panel over the pooled OLS estimation model (the panel random effect regression model is appropriate).

Table 10: The Summary of The Breusch Pagan Lagrangian Multiplier Test (LM)

	Chi- chi-square(1)	Prob>chi2
Dependent variable: ROA	46.114	0.000

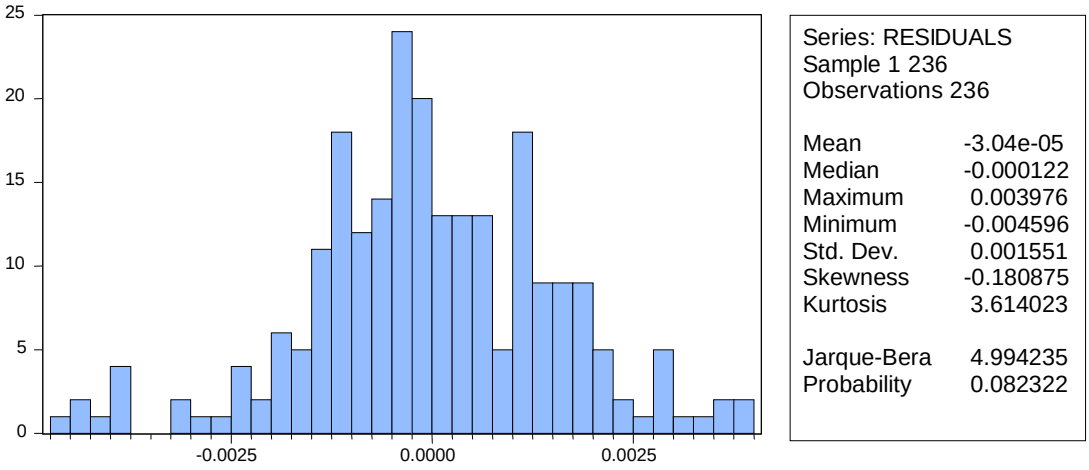
The result of the Hausman test statistics in the table below suggests that the Random Effects Model (REM) is the appropriate panel data estimator.

Table 11: The Summary of the Hausman Test

Test summary	Chi-Sq. Statistic	Chi-Sq. d.f.	Prob>chi2
Cross-section random	9.123	7	0.243

One of the important assumptions of the regression models is that the residuals are normally distributed.

Figure 2: Explains the Probability Distribution of the Residuals and the Results of the Jarque–Bera Test



The application of the Jarque–Bera test shows that the JB statistics is about 4.99 and the probability of obtaining such a statistics under the normality assumption is about 0.082.

Therefore, the error terms are normally distributed. The white test is to be used in this study to detect the presence of Heteroskedasticity.

Table 12: Displays White Heteroskedasticity

Test	F-statistic	Prob. F-statistic	Chi-Sq-Statistic	Prob>chi2
Heteroskedasticity test: White	3.929	0.000	94.226	0.000

The evidence of heteroscedasticity is found after the application of the White's heteroscedasticity test. The problem of heteroscedasticity is corrected using the White procedure automatically.

Table 13: Results of Random Effect Estimate for ROA as Dependent Variable

Independent Variables	*Equation (2)*
C	-0.007740* (0.0683)
CRTA	-0.006036 (0.2487)
LATA	0.001443 (0.4960)
TE	0.004352** (0.0480)
INF	-0.008084*** (0.0000)
LOGTA	0.000724* (0.0535)
LOGAGE	-0.000200 (0.1950)
GFC	-0.000271*** (0.0058)
R^2	0.192369
F	7.758178 (0.0000)
DW	2.049559
N	236

* Numbers in brackets below the coefficient are the probability levels of significance. *, ** and *** indicate the significance levels of 10, 5, 1 percent, respectively.

The estimation of the random effect model provides the Durbin-Watson (DW) test statistics in Table 13.This result indicates that there is no evidence of the present serial correlation in the model.

Capital and reserves to total assets (CRTA) has an insignificant impact on the ROA. This result is consistent with similar other studies; Sanusi and Ismail (2005) assert that the ratio of total equity capital to total assets of Malaysian Islamic banks during the period of 1995-2004 has negative and an insignificant impact on return on assets. Said and Tumin (2011) also suggest that the capital to total assets is not significant in influencing the return on assets in Malaysian banks.

Liquidity to total assets (LATA) has an insignificant impact on ROA, which is consistent with the findings of some other related studies. Idris, et al (2011) examine the determinants of profitability for nine Islamic Banks in Malaysia for the period of 2007-2009. The result reveals that Liquidity to total assets is insignificant in determining profitability (ROA).

For the impact of the Technical Efficiency variable (TE), the result indicates that the TE has the expected positive and significant impact on the return on assets. This gives support to the Efficient-structure theory. The result suggests that high profits of Islamic banks are consistent with higher Efficiency.

The macroeconomic variable inflation rate (INF) has negative and statistically significant impact on return on assets. As Bashir (2003) has pointed out that, in the case of Islamic banks, this may be due to the fact that the inflation may have a negative effect on bank profitability if wages and other costs grow faster than the rate of inflation. Thus, this may suggest that during the period of study, Islamic banks could not accurately predict the levels of inflation and the costs of banks had a faster increase than banks' revenues. However, this finding is supported by the results of Khrawish et al. (2011) and Ali et al. (2011).

Bank size (LOGTA) has a positive and statistically significant impact on the ROA. This indicates that large size provides Islamic banks with the opportunity to have greater ability to diversify and utilize the economies of scale. Many empirical studies find similar results such as those found in Athanasoglou et al. (2008); Al Manaseer (2007).

Bank age (LOGAGE) has an insignificant impact on ROA. This result is supported by Dietrich and Wanzenrie (2010) who analyse the profitability of commercial banks in Switzerland. The result has found that newer banks seem to be slightly more profitable than older banks.

The global financial crisis (GFC) has a negative and statistically significant impact on return on assets. This result means that Islamic banks in Malaysia are affected by the global financial crisis in terms of profitability. This result is consistent with study of Sufian and Habibullah (2010) which have found that the Asian financial crisis exerts a negative and significant impact on the profitability of Indonesian banks.

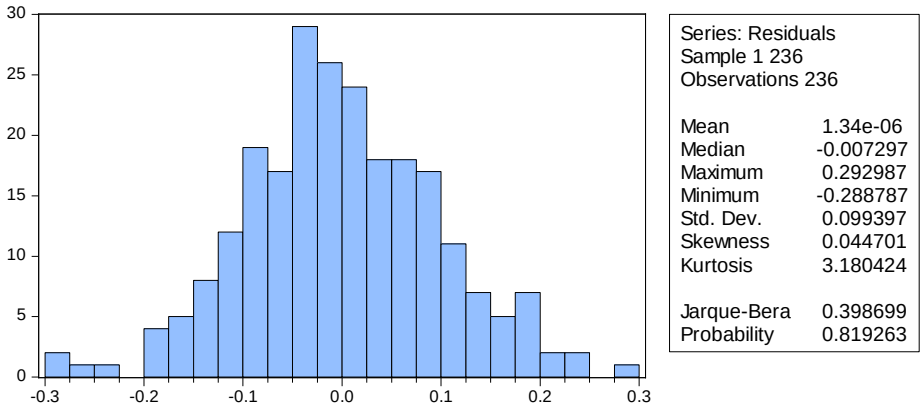
4.4 Testing the Determinants of Islamic Banks' Efficiency in Malaysia

4.4.1 Testing by equation (1)

$$TE_{it} = \alpha_{0+} \beta_1 OHTA + \beta_2 LOTA + \beta_3 DTA + \beta_4 GDPGR + \beta_5 GDPPC + \beta_6 CONC + \beta_7 DDF + \varepsilon_{it}$$

The violation of the normality assumption in limited dependent variable models may be quite severe (Gujarati, 2003). Also, Greene (2003) points out that the non-normality of the residual is important violation that can face the usage of the Tobit regression. Thus, the Jarque–Bera (JB) Test of Normality is used to test the normality of the residual.

Figure 3: Explains the Probability Distribution of the Residuals and the Results of the Jarque–Bera Test



The application of the Jarque–Bera test shows that the JB statistics is about 0.398 and the probability of obtaining such a statistics under the normality assumption is about 0.819. Therefore, the error terms are normally distributed.

The heteroscedasticity is an important violation that can face the usage of the Tobit regression (Brooks, 2008) and (Greene, 2003). Table 14 displays the Results of White Heteroskedasticity test**,** where evidence of heteroscedasticity can be found.

Table 14: Displays White Heteroskedasticity Test

Test	F-statistic	Prob. F-statistic	Chi-Sq-Statistic	Prob>chi2
Heteroskedasticity test: White	6.992	0.000	127.884	0.000

To overcome the problem of heteroscedasticity, the Huber/white procedure is automatically used.

Table 15: Tobit Regression Results for TE as Dependent Variable

Independent Variables	*Equation (1)*
C	0.557865* (0.0508)
OHTA	-1.823509*** (0.0036)
LOTA	0.734361*** (0.0000)
DTA	0.265080* (0.0918)
GDPGR	-0.045221 (0.7992)
GDPPC	1.93E-05 (0.6961)
CONC	0.173593 (0.4967)
DDF	0.064206*** (0.0022)
R^2	0.638016
Log likelihood	210.4691
N	236

* Numbers in brackets below the coefficient are the probability levels of significance. *, ** and *** indicate the significance levels of 10, 5, 1 percent, respectively.

Table 15 presents the Tobit regression result. The relative value of the estimated Tobit R^2 indicates that the model is able to explain the influence of the variables on TE. In addition, the estimated log likelihood value confirms the model's ability to explain efficiency.

The overhead to total assets (OHTA) has a negative and statistically significant impact on (TE), which gives support to the efficient structure theory. The result suggests that the high efficiency of banks is consistent with lower OHTA. Therefore, the Overhead variable is important in determining the efficiency of Islamic banks in Malaysia.

Loans to total assets (LOTA) have positive effect on banks' Technical Efficiency and it is statistically highly significant. The result suggests that the high efficiency of Islamic banks is consistent with high LOTA.

Deposits to total assets (DTA) next, have positive effect on banks' Technical Efficiency and it is statistically significant. This result supports the view that more deposits lead to higher level of Efficiency. The findings of this study that DTA is positively associated with banks' profitability and efficiency reveal that Islamic banks' Deposits are important in determining both profitability and efficiency.

For the impact of Gross domestic product growth rate (GDPGR) the result above reveals that GDPGR has an insignificant impact on TE. The insignificant impact for the GDPGR on banks' Technical Efficiency indicates that Islamic banks have not benefited from economic growth.

The macroeconomic variable Gross domestic product per capita (GDPPC) has an insignificant impact on banks' Technical Efficiency. Therefore, the macroeconomic variable GDPPC is not important in determining the efficiency of Islamic banks in Malaysia during the period of study.

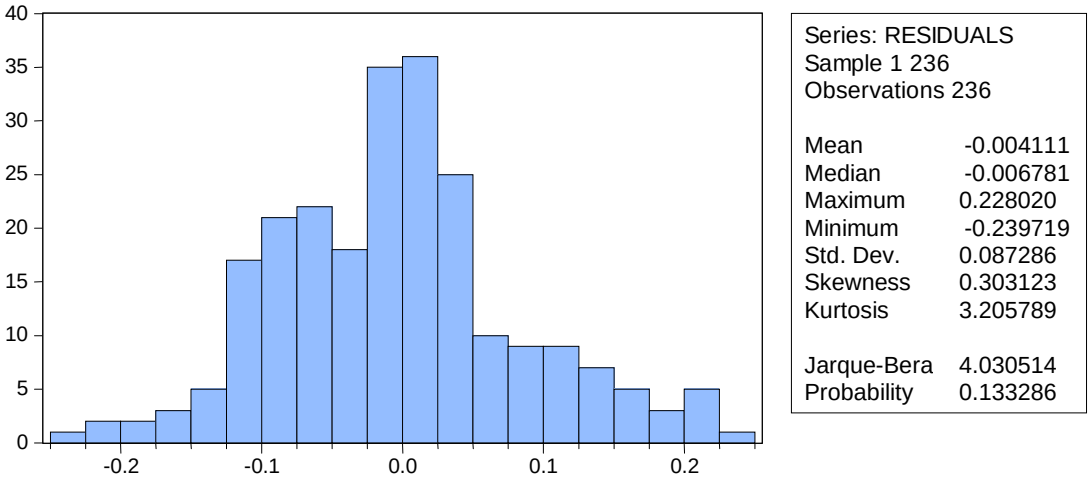
The structural variable concentration ratio (CONC) has an insignificant impact on banks' Technical Efficiency. This does not give support for the structure-conduct-performance theory. This result indicates that the concentration ratio is not important in determining banks' efficiency.

The different efficiency between domestic and Foreign Islamic banks as a dummy variable (DDF) has a positive and significant impact on banks' technical efficiency. This result reveals that domestic and foreign Islamic banks have different levels of efficiency.

4.4.2 Testing by equation (2)

$$TE_{it} = \alpha_0 + \beta_1 CRTA + \beta_2 LATA + \beta_3 INF + \beta_4 LOGTA + \beta_5 LOGAGE + B_6 GFC + \varepsilon_{it}$$

Figure 4: Explains the Probability Distribution of the Residuals and the Results of the Jarque–Bera Test



The Jarque–Bera test shows that the JB statistics is about 4.03 and the probability of obtaining such a statistics under the normality assumption is about 0.133. Thus, the residuals are normally distributed.

Table 16: Displays The White Heteroskedasticity Test

Test	F-statistic	Prob. F-statistic	Chi-Sq-Statistic	Prob>chi2
Heteroskedasticity test: White	2.086	0.0024	48.638	0.0046

Applying White's heteroscedasticity test, evidence of heteroscedasticity can be found. To overcome the problem of heteroscedasticity the Huber/white procedure is automatically used.

Table 17: Tobit Regression Results for TE as Dependent Variable

Independent Variables	*Equation (2)*
C	0.116184 (0.2725)
CRTA	0.585862*** (0.0005)
LATA	-0.638069*** (0.0000)
INF	-0.043847 (0.8682)
LOGTA	0.100337*** (0.0000)
LOGAGE	-0.055797*** (0.0000)
GFC	-0.009245 (0.5404)
R^2	0.630050
Log likelihood	207.3842
N	236

* Numbers in brackets below the coefficient are the probability levels of significance. *, ** and *** indicate the significance levels of 10, 5, 1 percent, respectively.

Table 17 presents the Tobit regression result. The estimated Tobit R^2 indicates that the model is able to explain the influence of the variables on TE. In addition, the estimated log likelihood value confirms that the model is able to explain TE.

Capital and reserves (CRTA) has a positive and significant impact on banks' technical efficiency. The result suggests that the high efficiency of banks is consistent with high CRTA. This result indicates that the CRTA variable is important in determining the efficiency of Islamic banks.

The liquidity ratio (LATA) has a negative and statistically significant impact on banks' technical efficiency. This result suggests that banks with more liquidity are lower in efficiency, automatically indicating that banks with more liquidity lead to low funds available for lending, thereby, low level of efficiency. This indicates that liquidity is a significant factor that contributes towards the efficiency of Islamic banks in Malaysia.

The macroeconomic variable inflation rate (INF) has an insignificant impact on banks' technical efficiency. The insignificant impact of the INF variable implies that the inflation rate variable was not important in determining banks' efficiency.

Bank size (LOGTA) has a highly significant positive impact on banks' technical efficiency, which means large banks tend to be associated with high efficiency. This result is in line with the market power theory.

Bank age (LOGAGE) has a negative and highly significant impact on banks' technical efficiency. This result means that old banks are less efficient than the new banks.

The global financial crisis (GFC) has a negative and an insignificant impact on banks' technical efficiency. This result means that the efficiency of Islamic banks in Malaysia is not affected by the global financial crisis.

5. CONCLUSION

In light of the liberalization of the Islamic banking industry, and the major challenges faced by the Malaysian Islamic banking sector, studying and analysing the determinants of profitability and efficiency of Malaysian Islamic banks become a great importance. In this context, this study has sought to examine whether banks' efficiency in the Islamic banking industry in Malaysia is determined by a set of profitability variables. In order to achieve that, various methods and various tests have been performed. The study findings indicate that, overhead expenses ratio, loans ratio, deposits ratio and bank's size have

significant effect in determining banks' profitability and banks' efficiency. Meanwhile, the gross domestic product growth rate, Gross domestic product per capita and concentration ratio are not able to explain the variability of profitability and efficiency of Islamic banks. Other findings of the study reveal that some profitability determinants of banks are different from the efficiency determinants of these banks, whereby some factors that are important for banks' profitability become unimportant for banks' efficiency and vice versa. The capital and reserves, liquidity ratio and banks' age have a significant effect in determining banks' efficiency, whereas these factors do not have any significant effect in determining banks' profitability. Otherwise, the inflation rate has a significant effect in determining banks' profitability, whereas it has no significant effect in determining banks' efficiency.

The study also reveals that domestic and foreign Islamic banks have different profitability and efficiency. The findings of this study indicate that the profitability of Islamic banks is negatively affected by the global financial crisis, but the efficiency of Islamic banks is undeterred. The results of the study suggest that, policy makers in Islamic banks should focus more on bank specifics (Internal determinants) to increase the profitability and efficiency of Islamic banks, while they should formulate appropriate policies to enable the Islamic banks to benefit from economic growth. For future studies, it is recommended to have a wider scope that, this study is confined to Islamic banks of Malaysia. It might be interesting to carry out the same research over traditional and Islamic banks in Malaysia. Another possible extension could include more variables such as Zakat, exchange rates as well as the quality of the offered services.

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THE INDONESIA EXPERIENCE STUDY IN ISLAMIC MICROFINANCE

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R. Bambang Budhijana[2]

Abstract

The Sharia microfinance information are obtained from the rural Islamic microfinance Chairmen's' Statement, Operating Review, or the Special Events Highlights in the annual reports, daily news, magazines. Data used came from various paper compilations, questioner to finance experts, Indonesian business newspapers and magazines. The questioner (not in the form of paper) is processed directly through computer input device and cover information regarding to the issues. Data is used in the research covers 2000-2010. Data and information is analyzed by Analytical Network Process (ANP) software. The study presents simulation analysis that comes from several related issues in the Sharia microfinance services and economic development model namely: ethics, exchange contract, profit sharing, investment ownership and economic development.

Findings of this study show that coefficient of ethics, exchange contract, profit sharing, investment ownership and poverty alleviation are respectively 0.18603; 0.11671; 0.07691; 0.16667 and 0.16667. From the model and its circular causation analysis can be concluded that coefficient of ethics, exchange contract, profit sharing, investment ownership and poverty alleviation are interconnectedness and have complementarities effects. The effects have reduced the scarce of fund and improved the productivity of small and medium scales entrepreneur. The conclusion is also indicated the roles of poverty eradication and the existences of investment ownership accumulation in the Indonesia Sharia microfinance.

Keyword: Sharia Microfinance, Investment Formation, Poverty Alleviation.

1. INTRODUCTION

Bank Muamalat Indonesia (BMI) as the first Islamic commercial bank established in 1991. As of 1998 (Act No. 10), Bank Indonesia officially recognized, as part of the new Banking Act, the existence of a dual banking system, conventional and sharia-

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based.

After the New banking Act (No. 10, 1998) was regulated, many conventional banks are interested to operate the special branches which are based on the Sharia law, named by Islamic windows or Islamic banking unit.

The mainstreaming of Islamic banking was backed by Act No. 23 of 1999 concerning Bank Indonesia, which authorizes the central bank to conduct its task also according to sharia principles. Beyond this, the law does not specify any substantively different provisions for Islamic banking. In 1999 Bank Indonesia established a team for sharia banking. At national and institutional levels, Islamic finance is supervised by sharia supervisory boards (SSB).

Eight years after Muamalat Bank (1999), the second Sharia commercial bank was established, namely Bank Sharia Mandiri (BSM). After BSM establishment, Bank of Indonesia as the Central Bank continued to provide vision and mission for promoting and accelerating the development of sharia banking in Indonesia:

"*A sound sharia banking system that is competitive, efficient and compliant with prudential practices, and capable of supporting real economic sector through the implementation of share based financing and trades with real underlying transactions in the spirit of brotherhood and good deeds to promote well-being for all society.*"

In 2000-2008, there are many Islamic banking units, for example Bank IFI Sharia branch (1999), Bank Jabar Sharia branch (2000), Bank BNI 46 Sharia (2000), Bank Bukopin Sharia branch (2001), BRI Sharia (2001), Bank Danamon Sharia (2002), and BII Sharia (2003).

The newest banking act regulated is Islamic banking act, No. 21, 2008 about Sharia banking is hoped that this Islamic banking act will support Islamic banking development to include Sharia People's Credit Bank as Sharia Rural Banks (SRB).
May 2009, there are five Islamic commercial banks namely Bank Bukopin Sharia, BRI Sharia, Mega Sharia, HSBC Sharia and BCA Sharia and 1134 Sharia rural banks

(SRB) in Indonesia. The Sharia rural banks are Islamic microfinance institutions named Baitul Mal wat-Tamwil (BMT). BMT is an Islamic micro-finance institution, established by individual or group initiatives to help micro-entrepreneurs as a strategy for eradicating rural poverty and accelerating rural economic development, especially in villages or traditional markets, operationally based on Sharia principles and cooperation. From the statistics of rural poverty in Indonesia is 45,9 million. The poverty is a crucial problem faced by Indonesian society. Based on these realities, it is very important to provide many financing scheme to make poor people leave their poverty by their effort themselves. The possible finance institutions that provide this scheme are BMT. In this case, as Sharia microfinance, BMT is expected to be alternative solution and has role to eradicate and alleviate poverty from the society.

Therefore, this research focuses on analysis to the role of Baitul Mal Wattamwil (BMT) as an Islamic Micro Finance Institution in Indonesia in their services, investment ownership and poverty alleviation in Indonesia. The objectives of the study are going to explain factors related to issues on Sharia microfinance Services and its contribution to rural economic development.

2. LITERATURE REVIEW

Poverty is one of the most fundamental problems in today's society. Despite of the disputes around factors that contribute to poverty, it is undeniable that poverty can lead to other social problems. Hunger, death, and criminals are among some of the problems associated with poverty. The problems of poverty are so pervaded that the United Nations has listed poverty eradication as one of the goals in the Millennium Development Goals. Poverty does not only prevent people from having healthy nutritious food, but poverty also contributes to the low quality of life. Below picture illustrates social problems associated with poverty

Microfinance is assured as one of the tools that can decrease as well as eradicate poverty. Microfinance might assist people in providing cash that can be utilized to change their life. The function of the cash provided by microfinance institutions vary from short term benefit as well as long term benefit. Short term benefit is when the cash used for consumption i.e. basic primer needs, while long term benefit occurs when the cash is utilized as a capital in order to initiate business thus help the people to improve

their life.

Numbers of research have been conducted in order to measure the success of microfinance. The stories of *Grameen Bank* in Bangladesh, *Bank Rakyat Indonesia (Indonesian People Bank)* in Indonesia, *Self-Help Group* in India show the extent to which microfinance can eliminate poverty. Obaidullah (2008) has also done research that attempts to identify the glory of microfinance. Another research that aims to investigate the impact of microfinance in eradicating poverty has been conducted by Chowdhury (1996). Chowdhury (1996) studied the extent to which microfinance can improve the nutritional status of people from economically underprivileged group. Another research conducted by Hulme and Mosley (1996) focus on the impact of microfinance to the income of the borrowers. Their research yields that microfinance does have a positive impact to the income of the borrowers 30% more compare to that of those who do not take credits from microfinance. Other similar research has also shown the impact of microfinance in erasing the poverty (Pitt & Khandaker, 1996; Halder, 1998; Zohir, 2000; Hakim, 2000; Latif, 2000; Chowdhury & Bhuiya, 2004).

Ismawan (2009) microfinance plays a vital role in supporting the economically active poor with capital as called as micro enterprises. Micro enterprises are not merely run by the poor. In many cases, the microenterprises run by wealth people in Indonesia, since its market is very large. According to Indonesian Law No. 20 Tahun 2008 microenterprises is a business entity which has asset maximum of 50 million rupiahs excluding land and building with maximum turnover of 300 million rupiahs per year. The type of business that mainly run by the microenterprises are:

a. Primary and secondary activities: agriculture, plantation, animal husbandry, fisheries (all is implemented in limited scale and subsistent), small craftsmen, tailors, snacks producers, etc.
b. Tertiary activities: transportation (in varied kinds), renting activities of houses, land, production tools, etc.
c. Distribution activities: small traders in markets, peddlers, retail distributors and agent, and the like.
d. Other service activities: street singer, shoes polisher, haircutter, mechanics, garbage laborer and street photographer

Tati and Kurniawan (2009), the number of microenterprises is about 98 % of total of

Indonesian Business Players. It means that these microenterprises are dominant player in the economic activities in Indonesia. Table 1 below show how the number of enterprises in Indonesia with their financing patters. It is obvious that the microenterprises represent almost 50,7 million of Indonesian people. The main sources of their funding are from government support scheme such as Community Empowerment Program (PNPM), Small and Microenterprises Program. Even though this microenterprises group represent majority of business player in Indonesia, however, they still lack of capabilities. They are lacking of capital access, lack of financial skills, and lack of law and regulatory framework. This shortcomings, later on will be explained as one of the factor contributing the decline of microfinance performance.

Table 1: Enterprises in Indonesia and Its Financing Patterns

Type of Enterprises	Number & Percentage	Assets Criteria	Financing Patterns
Large Companies	4,370 (0,01%)	> 50 billion rupiah	Capital Market, Banks, etc
Medium Enterprises	39,660 (0,08 %)	200 million – 50 billions rupiah	Banks, SME Credit Programs
mall Enterprises	520,220 (1,01%)	50 – 200 million rupiah	Banks, SME Credit Programs, Community Empowerment Program (PNPM),etc
Micro Enterprises	50,70 million (98,90%)	< 50 million rupiah	Micro Enterprises Program, Own Source, Money Lenders, People Effort Credit (KUR), etc

Source: Tati & Kurniawan (2009)

According to Rujito (2003), Obaidullah (2008) and SMERU (2009) the NGOs type of microfinance institution dominated by member-based cooperatives while the Self-Help Groups (SHGs) are completely informal organizations. Hundred of thousands of informal SHGs with savings and credit activities exist in Indonesia. Many are spontaneous groupings based on traditional forms of association. Many other SHGs have been founded by government and community organizations in connection with government programs. For instance, there was a Pola Hubungan Bank dan Kelompok Swadaya Masyarakat (PHBK), a program of linking Banks with Self Help Groups. However, the existence of this linkage is not longer continued.

Rudjito (2003) explained the successful of Bank Rakyat Indonesia using their microfinance programme such as BKD (Bank Kredit Desa/Village Credit Bank), P4K (Program Peningkatan Pendapatan Petani dan Nelayan Kecil/Fishery and Farmers Income Generating Project), and BRI Unit. Using cultural approach, BKD has built more than 4,500 microfinance institutions and served more than 700 thousands of people, only in Rural Area of Java and Madura Islands. The P4K has served the people by lending credit by more than 683 billion rupiahs to more 170 thousands group of people in the rural area, with non performing loan only 6,78 % on 2002. The BRI Unit which started since 1984 has achieved more than 25 millions of people in saving and serves more than 4 million of people in credit services.

Different with Rudjito, SMERU, A Research Institute Indonesia, specifically did specific research on microfinance in the 2005, and found significant contribution of microfinance to the poverty alleviation. The research was named as Sulawesi Agriculture Area Development Project (SAADP) and funded by the World Bank. The project is an economic-commercial project whose aim is to reduce poverty in Central Sulawesi and Southeast Sulawesi. The result of the research reveals that SAADP had a positive impact on increases in all types of agricultural perspectives among farming respondents. The greatest effect was on knowledge about land management and the use of fertilizer. The program had also a positive impact on changes in farming practices.

Indonesia implements a dual financial system that allows both conventional (mainstream) and Islamic financial system to coexist. In general Islamic microfinance in Indonesia is divided into two categories: banking sectors and non banking sectors. Banking sectors can be categorized as Islamic Banks and Islamic Rural Banks (BPRS) (Effendi, 2009).

According to Seibel and Agung (2005) Islamic finance in Indonesia has evolved since 1991, even though in the existence of Islamic finance informally has existed in Islamic boarding school in Indonesia since 1980’s in the form of Islamic Cooperatives of Islamic School (Koperasi Pondok Pesantren/Kopontren), yet its management are limited to members of the school only and thus its effect cannot be completely felt by the local people in general. Seibel and Agung also divide Islamic microfinance into Islamic

commercial banks, commercial banking units, rural banks, and financial cooperatives. Indonesia also has one of the most differentiated micro- and rural finance sectors among developing countries, comprising both formal and non-formal financial institutions. Obaidullah (2008) elaborates the characteristics of Islamic financial institutions in Indonesia by explaining the relationship between various Islamic microfinance institutions in Indonesia and what the roles of Central Bank, Supporting Organizations, to linkage of Islamic Banking between banking sectors and non banking sectors as suggested by Bank Muamalat Indonesia (BMI) as BMI Microenterprises Development Program.

Table 2: Islamic Microfinance Conditions in Indonesia

Type of Microfinance Institutions	Conditions
Islamic Rural Banks (BPRS)	• Regulated Islamic and conventional rural banks have evolved over almost the same time period, 13 and 15 years, respectively • Islamic rural banks have remained small. The volume of their services is negligible, compared to conventional rural banks, accounting for only 4% in number, 1.5% in assets as well as outreach, and 1.2% of deposits • Islamic rural banks growth in numbers has stagnated in recent years; and their growth in assets has remained far behind that of conventional rural banks • Lack of popular demand for Islamic banking services, absentee ownership, lack of young dynamic management, lack of mastery of overly complex Islamic banking practices, and emphasis on the informal sector and the poor to the neglect of more profitable market segments are among the many reasons for their retarded development
Islamic Cooperatives (BMT,Kopontren, etc)	• The whole cooperative sector has historically suffered from a complete lack of regulation and supervision, paralleled by excessive government interference and subsidies which have distorted rural financial markets and undermined self-help • The majority of Islamic cooperatives are reportedly dormant or technically bankrupt • Outreach and volume of services of Islamic cooperatives are negligible compared to conventional cooperatives, which are also in a state of acute but undiagnosed ill-health • The savings of depositors are at great risk; cooperatives should not be authorized to accept savings of non-members • No remedy is in sight

Source: Seibel & Agung (2005)

On Table 2, from institutional level, Islamic finance in Indonesia is extremely varied, hence they also distinct in term of their performances. As stated by Seibel (2005), the performance of Sharia micro finance is low compared to the performance of Islamic Rural Bank (BPRS) which is considered to be stagnant, despite of its fast development.

3. METHODOLOGY AND DATA COLLECTION

The methodology will be starting from the Tawhidi epistemology process is derived from divine unity of knowledge as verses on Qur'an {An Nahl (16):48-50 and Ar Ruum (30): 11)} and Hadits Rasulullah SAW. From the both as source of knowledge, the knowledge {θ} will be transmitted to mankind. The knowledge will be transmitted from person to person, person to majelis and majelis to majelis as called as shuratul process. At this stage the process have to pass through consensus, agreement or other workable process which cover interaction, integration and evolution as the best learning process in Islamic economic and finance (Choudhury, 1986; 1998; 1999 and 2004)

This study is expected to give information relating issues influence the Islamic microfinance in rural economic. The issues are namely: Tawhidi (T), Services (S) and Economic Development (E). They reflect to system and agency interaction among the pair ness that have pervasively complementary. They are expected to omit the scarce fund resource in rural and peasant society. In this regard, they are closed relational each other to improve Sharia Microfinance (SM). Since the SM exists, then, the Social Well-being (SW) function can be formulated as:

Simulate the SM

in general SWon $SM(\theta) = f\{ T, S, E, [(\theta)]\}$ or

in specific SWon $SM(\theta) = f\{[(\Omega,S)], (Et, EC, PS), (I\ O, ED)[(\theta)]\}$

is subject to the following circular causation (CC):

$[(\Omega,S)], = f\{(Et, EC, PS), (IO, ED)[(\theta)]\}$

$Et = f\{[(\Omega,S)]\ (EC, PS), (IO, ED)[(\theta)]\}$

$EC = f\{[(\Omega,S)], (Et, PS), (IO, ED)[(\theta)]\}$

$PS = f\{[(\Omega,S)], (Et, EC), (IO, ED)[(\theta)]\}$

$IO = f\{[(\Omega,S)], (Et, EC, PS), (ED)[(\theta)]\}$

$ED = f\{[(\Omega,S)], (Et, EC, PS), (IO)[(\theta)]\}$

$[(\theta)] = f\{[(\Omega,S)], (Et, EC, PS), (IO, ED)\}$

Where:

$[(\Omega,S)]$= Al Quran and Hadits

Et= Ethic,

EC= Exchange Contract,

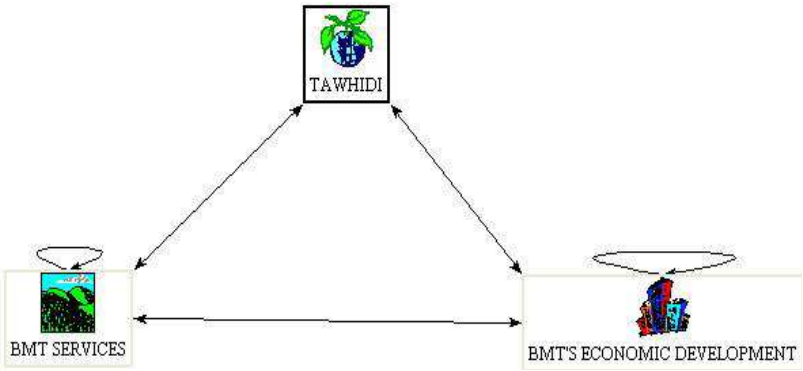
PS= Profit Sharing,

IO= Investment Ownership,

ED= Economic Development

Among those relating issues, Islamic Microfinance model can be graphed on figure 1 below.

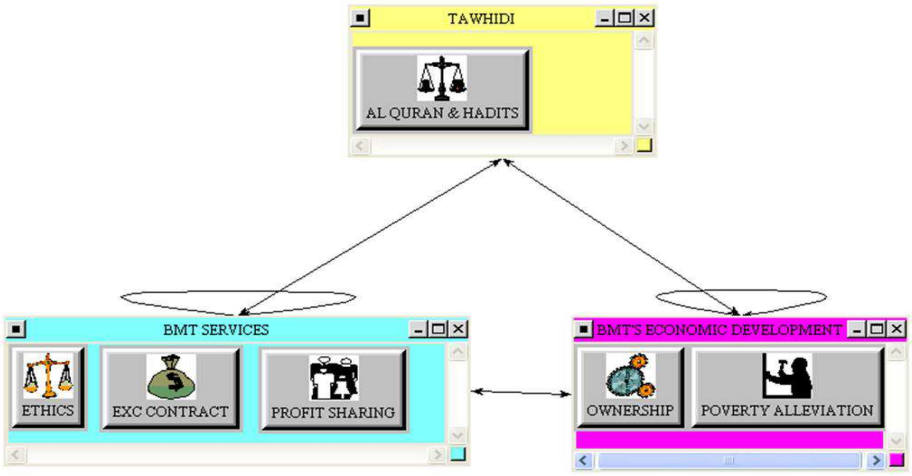
Figure 1: Relational issues on Baitul Mal wa Tanwil/ BMT microfinance model



The complete model shows the interconnected relating issues. Believe in Allah and Rasullulaah will keep interconnectedness whenever Sharia microfinance provides good services and contribute roles to rural economic development. The Sharia microfinance services cover ethics, Exchange Contract, Profit Sharing, Investment Ownership, and Economic Development. This complete model includes the Circular Causation model to measure the power interconnectedness among the issues. The CC in the model can be graphed on figure 2.

Consequently computation of predictive Simulation on Social Well-Being function can be expected to be occurred since all possible pair-ness {Az Zukhruf (43): 12 Yassin(36): 33-36} in this circular causation (CC) come into existence. The SEE learning process is openness and based on the principle of pervasive complementarities over unifying the world-systems.

Figure 2: Circular Causation is Applied in the Model.



The Sharia microfinance information obtained by carefully examining, for example, the Bank Chairmen's' Statement, Operating Review, or the Special Events Highlights in the annual reports, daily news, magazines. Data used will be obtained from various paper compilations, questioner to finance experts, Indonesian business newspapers and magazines. The observed data is expected to come from Sharia Banking, other Islamic product industries and wrap in form of questioner to expert (in deep interview). The questioner (not in the form of paper) is processed directly through computer input device and cover information regarding to the issues. Data is used in the research covers 2000-2010. Data and information is analyzed by Analytical Network Process as called the ANP software.

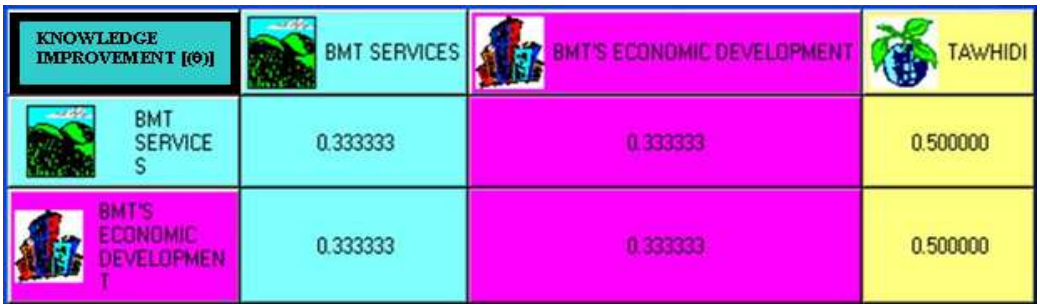
4. RESULT AND FINDINGS

Knowledge Improvement

Sharia microfinance Services and economic development has been instituted for many years. The institution interaction involved is usually called as polity interaction. (Myrdhal, 1957; North, 1991; Steven, 1993; Choudhury, 1993 dan 2003) This interconnectedness (among the polity interaction) would be cohesively benefiting each other and fertilized by ethic and moral growing. According to Sharia compliance, ethic and moral is borne by *iman* (believing) to Al Quran and Hadits (as Fundamental Direction). Time to time, the truth will appear and come into economic power as learning process. Knowledge improvement will be perceived value in rural

society ranged quantitatively from 0.3333-0.5000. This improvement presented on Table 3 below.

Table 3: Knowledge Improvement Appears on the Model



Simulation Model Analysis

The result of simulation model as a whole appears on Table 4. The table presents simulation coefficient that comes from several related issues in the Sharia microfinance services and economic development model.

Table 4: Simulation Result of Sharia Microfinance

Simulation Coefficient	Ethics	Exchange Contract	Profit Sharing	Ownership	Poverty-Alleviation
AlQuran and Hadith	0.33333	0.33333	0.33333	0.33333	0.33333
Ethics	0.18603	0.23078	0.18808	0.24764	0.24904
Exchange Contract	0.02326	0.11671	0.02854	0.02346	0.02484
Profit Sharing	0.12404	0.02565	0.07691	0.06223	0.05945
Ownership	0.05556	0.08333	0.05556	0.16667	0.16667
Poverty-Alleviation	0.27778	0.25001	0.27778	0.16667	0.16667

Ethical Services

Work ethics are closely related to job satisfaction (Yousef, 2001; Koh and Boo, 2001; Viswesvaran and Deshpande, 1996; Vitell and Davis, 1990). Understanding the relationship between work ethics and job satisfaction is essential in determining methods on intervention and strategies for mitigating factors that reduce satisfaction towards the work conditions (Yousef, 2000). Robbins (2005) described job

satisfaction as a collection of feelings that individual holds towards his or her job. This means that an employee who has a high level of job satisfaction will hold positive feeling towards job and vice versa. Typically, job satisfaction is a person's evaluation of the overall quality of his or her present job. The evaluation measures may include either an effective orientation towards one's job or job position or an attitude one holds about the job (Spector, 1997).

From Table 4, this research shows that work ethic is related to Sharia microfinance commitment. Quantitative result shows that ethic is tightly connected to tawhidi with scores of 33.3 percent. This is the highest score; if it is compared to other issues on Sharia microfinance services and economic development. It can be meant that ethic obey to Al Quran and Hadits as sharia compliance requirement. Sharia microfinance must have a sincere implementation of the Sharia commitment in its relations to various situational characteristics, attitudes and behaviors of employees. Moreover, according to Obaidullah (2008), the Sharia microfinance commitment is not only psychological but also the spiritual state that attaches to every employee to this institution. Furthermore, the study can be imagined that work values have correlation with moral commitment to the ummah and society. The employees serve intrinsic work values relate more closely to sharia (honest, sincere, transparency, no interest, no speculation, improve creativity and high dedication to work) commitment than extrinsic work values (good clothes costume, comfort, clean and neat office).

Profit Sharing and Contract of Exchange

From Table 4, it shows that exchange contract has been more preferable than profit sharing with coefficient 0.117 and 0.077 respectively. Mostly profit sharing are musyarokah and mudarobah. Musyarokah means equity participation, investment and management from all partners; profits are shared according to a pre-agreed ratio, losses according to equity contributions. Mudarobah is a profit-sharing partnership to which one contributes the capital and the other entrepreneurship; or the rural sharia microfinance provides the capital and the customer manages the project. Profit is shared according to a pre-agreed ratio.

Contract of Exchange consist of Murobahah, istisna, bai al salam, ijaroh (muntahia bi tamlik). Murabahah means a sales contract between a rural bank/ BMT and its

customers, mostly for trade financing. The rural Sharia microfinance purchases goods ordered by the customer; the customer pays the original price plus a profit margin agreed upon by the two parties or payment by installments within a specified period. Istisna is a sales contract between rural Sharia microfinance and customer where the customer specifies goods to be made or shipped, which the bank then sells to the customer according to a pre-agreed arrangement. Prices and installment schedules are mutually agreed upon in advance. Bai al Salam is purchase with deferred delivery: A sales contract where the price is paid in advance by the rural Sharia microfinance and the goods are delivered later by the customer to a designee. Ijarah Muntahia Bittamlik is Lease and hire purchase: A contract under which the bank leases equipment to a customer for a rental fee; at the end of the lease period, the customer will buy the equipment at an agreed price minus the rental fees already paid.

Investment Ownership

From Table 4, Sharia microfinance performance shows the investment ownership quantitatively equal to 0.16667. It means that investment ownership is growing at 16,67 percent. The fact is sufficient to prove the existence of Sharia microfinance contribution to capital accumulation in the rural economy. From Table 5, the Ministry of Cooperatives (2010) shows that Sharia microfinance has grown little bid higher than predicted on this paper at 18.58 percent for micro and small enterprises. followed by middle enterprises (23.05%) and big enterprises (58.37%).

The growth for micro and small enterprises was only 4.98% lower than medium enterprises. Therefore, the Indonesian government must support the development and growth of SMEs (Small and Medium Enterprises).

Table 5: Investment Formation Ownership Performance (2000-2008)

Type	Investment (Rp billions)	Market (%)	Investment per Unit (Rp million)	Growth
Micro and small	58,884	18.58	1.5	4.98
Medium	73,191	23.05	1,290.6	6.12
Big	185,043	58.37	91,424.2	4.64
Total	317,118	100.00	7.9	5.56

Source: www.depkop.go.id

Poverty Alleviation

A common feature of successful microfinance experiments is group-based financing and mutual guarantee within the group. This is a highly desirable feature of Islamic societies. Mutual cooperation and solidarity is a norm central to Islamic ethics. The second verse of Surah Al Maida in the holy Quran says:

"Assist one another in the doing of good and righteousness. Assist not one another in sin and transgression, but keep your duty to Allah" (5:2)

The following hadith by the Prophet (SAW) reinforces this principle of cooperation and mutual assistance.

"Believers are to other believers like parts of a structure that tighten and reinforce each other." (Al-Bukhari and Muslim)

The Islamic approach to poverty alleviation needless to say, must also be free from *riba, gharar, jahl* and *darar*. Prohibition of *riba*[3], *gharar*[4], *jahl*[5], *darar*[6] and other constraining norms in Islamic finance does not constitute an obstacle in building sound microfinance products. On the contrary, the need for Sharia compliance has led to considerable research into product development. While the conventional system provides for simple interest-based deposits, donations and loans, the Islamic financial system comprises an array of instruments for mobilization of funds, financing and for risk management.

According to Obaidullah (2008); Ismawan and Budiantoro (2005) Islamic microfinance institutions in Indonesia may be placed in three categories- the microfinance divisions of Islamic banks, the Islamic rural banks (BPRS) a subcategory of the rural banks (BPR); and the Islamic financial cooperatives that are not part of the formal financial sector. They are generally referred to as Baitul Maal wal Tamwil (BMT).

[3] Riba: Interest Rates, Growth, Addition
[4] Gharar: Danger, Risk and Uncertainty
[5] Jahl: Ignorance, Lack of Knowledge. In contract, it refer to lack of information with respect to the subject of the contract or the terms and condition of the contract
[6] Darar: Guarantee, Security

Islamic microfinance institutions (IsMFIs) in Indonesia have displayed their sustainability and robustness in the face of grave financial crises even when the mainstream banks had to depend on governmental assistance to tide over serious financial problems. It should be noted that Indonesian BMTs at the grassroots largely fall outside the financial regulatory mechanism since they operate as member-based cooperative organizations (similar to a musharakah structure) without governmental assistance or intervention. These organizations have been found to be less vulnerable to systemic risks that arise due to interdependence, as each BMT is an independently operating entity. As such, the system poses a serious challenge to the regulator – how to strike a balance between the need to strengthen the linkage between formal financial system and the BMTs while retaining the benefits of flexibility and independence.

Table 6: Poverty in Indonesia 1998-2007

	1998	1999	2000	2001	2002	2003	2004	2005	**2006**	**2007**
BPS*										
Number in Millions	49,5	47,9	38,7	37,9	38,4	37,3	36,1	35,1	**39,3**	**37,2**
Percentage	24,2	19,1	18,4	18,2	17,4	17,4	16,7	16	**17,8**	**16,6**
USD1-PPP/cap/day**										
Number in Millions	n.a	24,9	20,9	19,7	15,5	14,5	16,5	13,6	**19,5**	**15,5**
Percentage	n.a	12	9,9	9,2	7,2	6,6	7,4	6	**8,5**	**6,7**
USD2-PPP/cap/day***										
Number in Millions	n.a	135	125,3	125,2	115,6	110	109,1	102,1	**113,8**	**105,3**
Percentage	n.a	65,1	59,5	58,7	53,5	50,1	49	45,2	**49,6**	**45,2**

Source:Badan Pusat Statistik Indonesia (Indonesia's Institution for Statistical Center) and The World Bank from various period.

Note:

Poverty Line is converted to the real value, considering that the purchasing power of USD 1 will different from one country and another

* Poverty Line of BPS : Rp 166,697 /capita/month (USD 17,54 in real value using Rp 9500 /USD)

** Poverty Line of USD 1 of WB : Rp. 121,352/capita/month (USD 12,77 in real value using Rp. 9500/USD)

*** Poverty Line of USD 2 of WB : Rp. 242,704/capita/month (USD 25,54 in real value using Rp. 9500/USD)

Indonesia is the fourth highest population in the world after China, India, and the United States of America. With around 245 millions of people, Indonesia is still facing difficulties in the poverty alleviation. Table 6 shows the data of poverty in Indonesia from 1998 to 2007.

Table 6 obviously shows that according to Indonesia government standard of poverty lines, around 16,6 % or 37,2 million of Indonesia people are living under poverty line with USD 17,52 as their monthly income. If the standard used is that of the World Bank, then the monthly income real value becomes USD 12,77, with approximately 6,7 % or 15,5 millions people are living under poverty lines. But if we increase the daily standard to USD 2 per person, then half of Indonesian population (45,2 %) or 105,3 millions live are living under poverty lines.

Microfinance institutions in Indonesia have also given significant impact in combating the poverty. The approach of microfinance institution in Indonesia involves a diversity of regulated financial institutions. According to Obaidullah (2008) the NGOs type of microfinance institution dominated by member-based cooperatives while The Self-Help Groups (SHGs) are completely informal organizations. Hundred of thousands of informal SHGs with savings and credit activities exist in Indonesia. Many are spontaneous groupings based on traditional forms of association. Many other SHGs have been founded by government and community organizations in connection with government programs.

Numbers of research have also been conducted with regard to the impact of microfinance in eliminating the poverty in Indonesia. Among these researches are done by Rudjito (2003) and SMERU (2005). Rudjito (2003) explained the successful of Bank Rakyat Indonesia using their microfinance programme such as BKD (Bank Kredit Desa/Village Credit Bank), P4K (Program Peningkatan Pendapatan Petani dan Nelayan Kecil/Fishery and Farmers Income Generating Project), and BRI Unit. Using cultural approach, BKD (Bank Kredit Desa) has built more than 4,500 microfinance institutions and served more than 700 thousands of people, only in Rural Area of Java and Madura Islands. The P4K has served the people by lending credit by more than 683 billion rupiahs to more 170 thousands group of people in the rural area, with non performing loan only 6,78 % on 2002. The BRI Unit which started since 1984 has achieved more than 25 millions of people in saving and serves more than 4 million of people in credit services. According to MOA (2008) P4K is Indonesia's success story that

had reduced poverty 20-25 percent in rural economy and formerly funded by IsDB through International Fund for Agricultural Development (IFAD).

Ismawan (2009) defined Microfinance as Micro Enterprise Finance. The role of microfinance in the society, particularly in Indonesia is not only giving the poor and poorest people with money to help them fulfilling their primary needs, but also how to enhance their livehood to becoming better by making them economically active. To reach this objective, the potential economic activity run by this group should also be supported by microfinance. In this case, microfinance plays a vital role in supporting the economically active poor with capital.

Timberg (2006) stated that as Islamic financial institutions were relatively small. It is quite difficult to have big ones without strong commitments from government and effective strategy. According to him, Islamic banking should be mainstreamed by improving the interaction between Islamic institutions and the rest of the financial system, subject to the constraints of Sharia. The financial system and its regulation should be adjusted as necessary to accommodate the other two thrusts.

However, the potency of SMEs is very big. Based on Danamon Simpan Pinjam's research in November 2003 there was only 36% from 94% that were willing to borrow loans from banks (Rica, 2005).

In 2006, Ministry of Cooperatives and SMEs delivered Rp 76 billions for 860 Islamic micro financing projects. So far, the return has been high compared to the conventional system. Previously, 476 established Islamic micro financing institutions borrowed Rp 58 billions (Media Indonesia, 3 May 2006). In addition, some Islamic banks have strong commitment not to deliver their loans to big enterprises (Ashari & Saptana, 2005).

Circular Causation Analysis

This study uses ANP software to determine Circular Causation in the form of Correlation Matrix Coefficient. The matrix appears on Table 7 below.

Table 7: Circular Causation on Correlation Matrix Coefficient

Circular Causation	Exchange Contract	Profit Sharing	Ownership	Poverty Alleviation	AlQuran and Hadith
Ethics	0.28571	0.27778	0.24764	0.24904	0.35735
Exchange Contract	0.00000	0.05556	0.02346	0.02484	0.03340
Profit Sharing	0.04762	0.0000	0.06223	0.05945	0.10925
Ownership	0.08333	0.05556	0.00000	0.33333	0.04999
Poverty Alleviation	0.23001	0.27778	0.33333	0.00000	0.45000
AlQuran and Hadith	0.33333	0.33333	0.33333	0.33333	0.00000

Circular Causation-1 on Poverty Alleviation interconnectedness to Islamic Microfinance in term of Contract exchange, profit sharing, and ownership. The quantitative growing rates from this study are 0.23001; 0.27778 and 0.33333. The highest possibility comes from profit sharing, then followed by contract of exchange. The growing rates show the ability of Sharia microfinance to eradicate poverty. According to Obaidullah (2008); SMERU (2005); Rudjito (2003) numbers of research have been conducted with regard to the impact of microfinance in eliminating the poverty in Indonesia.

Circular Causation-2 on Investment Ownership has interrelatedness with the Islamic Microfinance in term of contract exchange, profit sharing, and poverty alleviation. The quantitative respective growth rates are 0.08333; 0.05556; and 0.33333. Since the growth rates of contract exchange greater than profit sharing, imply that Murabahah scheme will be more preferable compare to mudhorah and musyarokah scheme in rural economy. The Sharia microfinance is not only giving the poor and poorest people with money to help them fulfilling their primary needs, but also how to enhance their live hood to becoming better by making them economically active and reducing the poverty. They will become productive and have more income to accumulate their investment. In P4K experience, the investment accumulation generate from revolving fund. Their return will be provided for the next assistance fund to their neighbor.

Circular Causation-3 on Profit Sharing shows its interaction to Islamic Microfinance in term of Contract exchange, ownership, and Poverty Alleviation. The quantitative respective scores from this study are 0.04762; 0.06223; and 0.05945. Entrepreneurs who success run musyarokah and mudhorobah Scheme will do exchange contract (Murabahah scheme) with their credibility and society trust to them. The entrepreneurs grow through learning process by 0.04762. They will improve their capacity, technology used and capability in business management. This improvement will push the performance and productivity of Sharia microfinance institutions to be developed. Sharia microfinance institutions are usually dominated by member-based cooperatives and Self-Help Groups (SHGs). They will increase their productivity through savings and credit activities. The accumulation of their investment ownership grows by 0.06223. In line with this, the poverty alleviation has growth rate of 0.05945. The rural society is easy to get job and improve their productivity. They expand their business opportunity. As a whole, these interrelated issues will reflect the complementarities effect to rural economic improvement.

Circular Causation-4 on Contract of Exchange will generate simulation to all issues relating to Islamic Microfinance in term of Profit Sharing, ownership, and Poverty Alleviation. The quantitative respective scores from this study are 0.05556; 0.02346; and 0.02484. Entrepreneurs who success run Murabahah Scheme (Contract of exchange) will have wider opportunity to do profit sharing (Musyarokah and Mudhorobah). The entrepreneurs are growing by 0.05556 in line with credibility and trust to their business. It can be meant that the rate of capital ownership will increase by 0.02346. On the other hand, the poverty rate will decrease by 0.02484. From Saefulah (2010) stated that by increasing in investment ownership per unit was Rp 1.5 million per year for small enterprises, Rp 1.29 billion for medium enterprises, and 91.42 billions for large enterprises. This indicates particularly micro and small enterprises have no more limitation (scarce) for capital support which can cause limited development, poverty and lower productivity.

Circular Causation-5 on Ethic will be a trigger point to generate simulation to all issues relating to Islamic Microfinance in term of Exchange Contract, Profit Sharing, ownership, and Poverty Alleviation. The quantitative respective scores from this study are 0.28571; 0.27778; 0.24764; and 0.24904. Al Quran and Hadits will make

people and society to be conscious. What they have done, watched by God. From Table 4 Ethic has high interaction to Al Quran and Hadits with score of 0.35735.

5. CONCLUSION

The study presents simulation analysis that comes from several related issues in the Sharia microfinance services and economic development model namely: ethics, exchange contract, profit sharing, investment ownership and economic development. Findings of this study show that coefficient of ethics, exchange contract, profit sharing, investment ownership and poverty alleviation are respectively 0.18603; 0.11671; 0.07691; 0.16667 and 0.16667. Knowledge improvement is perceived value in rural society ranged quantitatively from 0.3333-0.5000.

From Sharia microfinance model and its circular causation analysis can be concluded that coefficient of ethics, exchange contract, profit sharing, investment ownership and poverty alleviation are interconnectedness and have complementarities effects. The effects have reduced the scarce of fund and improved the productivity of small and medium scales entrepreneur. The conclusion is also indicated the roles of poverty eradication and the existences of investment ownership accumulation in the Indonesia Sharia microfinance.

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ANALYSIS ON METHOD OF FINANCING FOR ISLAMIC PERSONAL FINANCING

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Abstract

In catering the needs of customer for Islamic personal financing, banks and finance company in Malaysia provides financing to ease their customers. Two methods of financing used by the banks in providing Islamic personal financing are Sum of Digit (SOD) and Constant Rate of Return (CRR). Findings from the analysis stated one of the methods will benefit the bank and another method will benefit the customer. The present study on Islamic personal financing investigates on customer's intention, religious obligation and pricing. This study will contribute towards a better understanding of the customer's expectation and knowledge on Islamic financing products despite promotion and strategies used by banks to attract customers in taking their financing.

Keywords: Islamic Personal Financing, Islamic Banks, Malaysia

1. Introduction

The Malaysian Islamic Banking industry had been growing remarkably since the emergence of Bank Islam Malaysia Berhad as the pioneer Islamic Bank in the 1980's. Since then, there were no turning back and more local and international players came in to coloured the Islamic banking scenario. With the growing number of banks, the industry had shown promising performance of acceptance on their products my muslims and non-muslims customers as the difference between conventional and Islamic system was the transaction done with accordance of the Islam rules and principles. In capturing the customer's needs, various products being develop by the Islamic bank. One of the current booming products in Islamic Banks was Islamic personal financing. Islamic personal financing provides financial assistance to customer who needs financing to purchase goods or other financial needs.

With the high demand from the customers, Islamic banks had produced products suits their customer's needs. Previous studies had found out that factors contribute to the

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acceptance of Islamic Banking Products are attitude and social influence (Taib et al,. 2008) and the recent study includes unique to the customer such as promotion attract the customers in accepting the product (Amin et al,. 2011). Customers who values their religious obligation on top of pricing in selecting their Islamic banking products shows customers were more knowledgeable and knew what they actually need in transacting (Haron et al,. 1994).

2. Literature review

2.1 Islamic financing and debt

The general principle in Islam says that one only buy when you actually have money, agreeing to a fixed price before purchase and avoid interest. According to Surah al-Baqarah, Allah declares War to those who deal with interest. Also narrated in Bukhari and Muslim that Someone said to him, “How often you seek refuge from heavy debt!” He said, “When a man gets into debt, he speak and tells lies, and he makes a promise and breaks it.” The main lesson learned that Islam discouraged debt as much as possible, and that debt was something serious and direct effect on one's imaan.

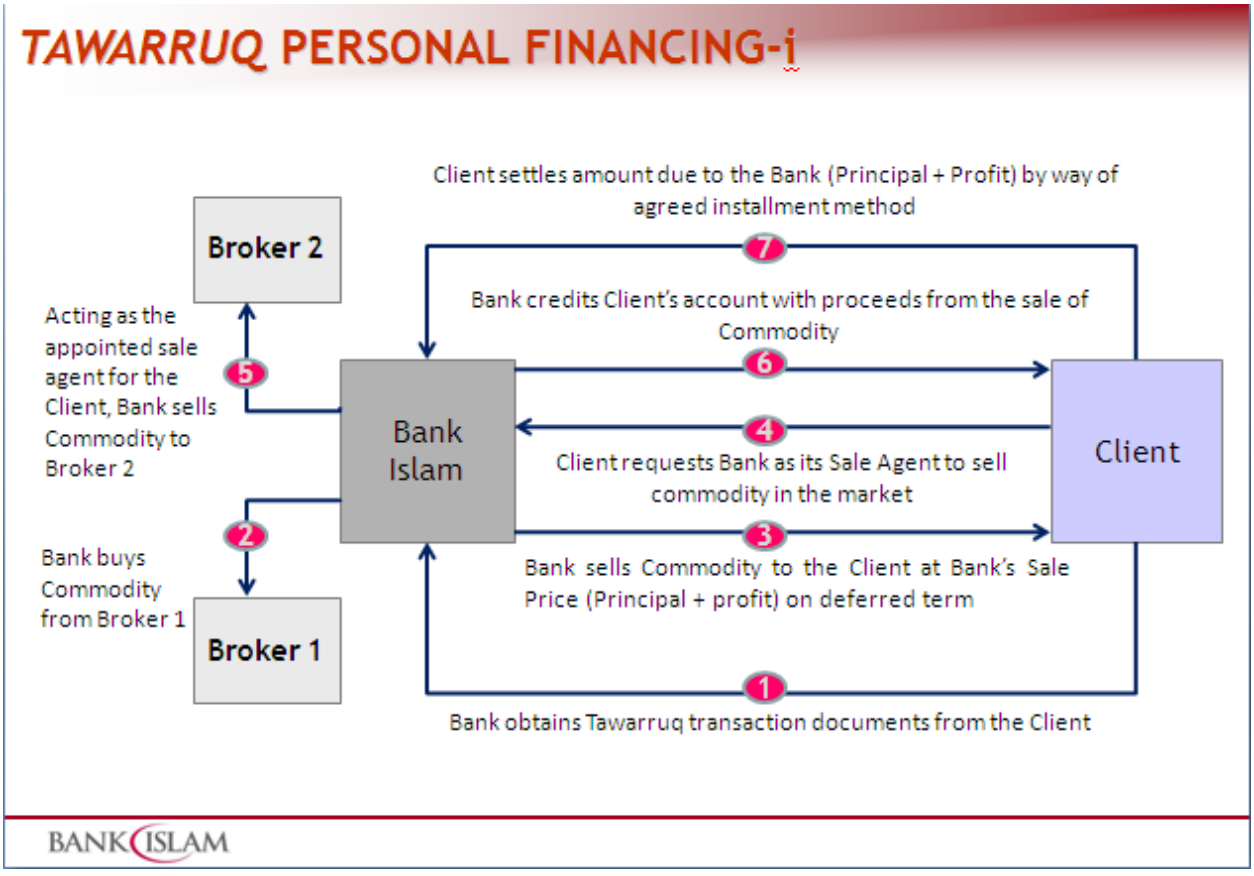
But now, financing is a way of life. In satisfying human needs, Islamic financing is much needed to grow one’s wealth (Khir et al 2008). In general, Islam does not encourage one to carry debts, but if Muslims were in debt for good reason, they are urged to deal with debtors by extending their repayment duration or convert the loan to charity which in most cases will not happen. Some banks provide payment holidays where the customer can skip to pay their financing in November and December. This was due to school reopens and parents require more money for their children. This helps the customers to relieve customer’s pockets.

2.2 How does Islamic personal financing work?

Islamic personal financing is normally qardhul hassan. Qardhul hassan refers to a beneficial loan or benevolent fund. It is a kind of gratuitous loan given to those in need for a fixed period without requiring the payment of interest for profit (Khir et al., 2008). There are two advantages with this method. First, qardhul hassan financing is conducted on a goodwill basis. The debtor is only required to repay the amount borrowed. Second, it is more consistent with Shariah Islamiyyah. This practice is not

suitable for financing in Islamic banks in Malaysia. This is due to much reason such as indirect charges in bank such as employee salary, office rental and other cost related to the bank.

Bank Islam Malaysia Berhad had introduced *Tawarruq* concepts which comprise bai Murabahah and Wakalah contract used to structure both deposit and financing product. It was widely used by the middle eastern bankers as it is the most acceptable approach in 'creating cash'. Bank Islam Malaysia Berhad is the only bank who introduces unsecured and secured financinf which was based on fixed and floating rate. In 28 July 2005 Bank Negara Malaysia had approved the *Tawarruq*-based product a.k.a "Commodity *Murabahah"*. Currently, some banks in Malaysia uses Bai Bithamal Ajil as the contract for personal financing.



Source : Bank Islam Malaysia Berhad (http://www.bankislam.com.my/en/Documents/Consumer/PDS-PersonalFinancing-Sales.pdf)

3. Fixed vs Floating Rate

Currently, most Islamic banks in Malaysia uses Sum of Digit (SOD) or known as Fixed rate in providing customers personal financing. The only Islamic bank who provides floating rate or Constant Rate of Return (CRR) are Banks Islam Malaysia Berhad (BIMB) Maybank, AgroBank and Bank Muamalat Malaysia Berhad (BMMB). How should customer choose in this matter? Banks who uses CRR method actually provide customer lesser monthly payment with the same tenure compared to SOD method which gives the Islamic Banks more advantage and profit.

Tenure (Years)	Bank AI	Bank BS	Bank R	Bank P	MBS	Bank C	Bank AB	Bank K	Bank MM
1	3.25	3.95	3.25	N/A	N/A	4.38	N/A	N/A	4.99
2	3.25	3.95	3.25	3.40	N/A	4.38	N/A	4.99	4.99
3	3.25	3.95	3.25	3.40	N/A	4.38	N/A	4.99	5.50
4	4.50	3.95	3.98	4.99	N/A	4.38	N/A	4.99	5.50
5	4.50	3.95	3.98	4.99	4.30	4.38	4.45	4.99	5.50
6 - 7	4.50	3.95	3.98	4.99	4.30	4.38	4.45	4.99	5.50
8 - 10	4.50	3.95	3.98	4.99	4.30	4.38	4.45	4.99	5.50
11 - 15	5.50	3.95	3.98	4.99	4.30	4.38	4.45	4.99	5.50
16 - 20	N/A	3.95	3.98	5.20	4.30	4.38	4.45	4.99	5.90
21 - 25	N/A	N/A	N/A	N/A	5.50	N/A	N/A	N/A	N/A

Best Fixed Rate for Islamic Financing

Tenure (Years)	Bank A	Bank AB	Bank M	Bank MM
1 - 2	BFR – 2.10	BFR + 1.60	N/A	BFR + 2.00
3	BFR – 2.10	BFR + 1.60	BFR + 1.80	BFR + 2.00
4 - 10	BFR – 0.60	BFR + 1.60	BFR + 1.80	BFR + 2.00
11 - 15	BFR + 0.25	BFR + 1.60	BFR + 1.80	BFR + 2.25
16 - 20	N/A	BFR + 1.60	BFR + 1.80	N/A

Best Floating Rate for Islamic Financing

Tenure	Floating	Fixed	Rate	Monthly Savings	Total Savings
1	4,268.93	4,302.08	3.25%	33.15	397.80
2	2,182.39	2,218.75	3.25%	36.36	872.64
3	1,487.35	1.524.30	3.25%	36.95	1,330.20
4	1,174.25	1,229.16	4.50%	54.91	2,635.68
5	966.64	1,020.83	4.50%	54.19	3,251.40
6	828.64	881.94	4.50%	53.30	3,837.60
7	730.43	782.73	4.50%	52.30	4,393.20
8	657.07	708.33	4.50%	51.26	4,920.96
9	600.29	650.46	4.50%	50.17	5,418.36
10	555.10	604.16	4.50%	49.06	5,887.20
11	540.28	607.95	5.50%	67.67	8,932.44
12	510.20	576.38	5.50%	66.18	9,529.92
13	484.98	549.67	5.50%	64.69	10,091.64
14	463.58	526.78	5.50%	63.20	10,617.60
15	445.23	506.94	5.50%	61.71	11,107.80

Comparison between Fixed and Floating Rate and the Savings for Customer

4. Conclusion

To develop competitive advantage for Islamic banks through innovating new product is hard, but to compare and analyse the product to find its competitive advantage which will gives the customers an added point and new information is priceless. From the above findings and calculation, customer will save more if they subscribe floating rate on both; monthly payment and redemption figure. The results of the above calculation will have managerial implications for Islamic bank and prospective

researchers. As the findings imply, the Islamic banks need to work on improving their product in servicing for their existing customers and getting more new customer. The limitation for this study was only looking at the rates and not the bank as overall.

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SHARIAH AND FIAT MONEY: THEORETICAL AND PRACTICAL RELATIONSHIPS BETWEEN *RIBA*, *GHARAR* AND *MAYSIR*

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Abstract

The present study analyses the nature of contemporary moneys and their use in economic transactions in accordance with the Shari'ah legal principles of *riba*, *gharar and maysir*. The analysis of fiat money and Shari'ah is conducted in five parts. First, an introduction summarizes the ambit of the present study. The second part elaborates upon the Shariah prohibitions against *riba*, *gharar* and *maysir*, as well as outlining the theoretical relationship between *riba*, *gharar* and *maysir*. The third part elaborates upon the nature, value and functions of traditional and contemporary moneys. The fourth part considers the effects of the use of contemporary moneys in local and international economic transactions in relation to issued associated with the local and international value of contemporary moneys and presents the relationship between *riba*, *gharar* and *maysir* that emerges as a result of the use of contemporary moneys in economic transactions. Finally, three principal conclusions are reached. Firstly, while the theoretical relationships between *riba*, *gharar* and *maysir* are premised upon *riba* serving as the foundation for the prohibition against *gharar*, which in turn serves as the basis for the analysis of *maysir*; in practice *gharar* serves as the basis for both *riba* and *maysir* in relation to economic transactions involving contemporary moneys as a countervalue, while extrinsic issues associated with *maysir* continually influence *gharar*. Secondly, contemporary moneys are most comparable to token moneys that were utilized in early Islamic societies. Thirdly, despite the existence of *riba*, *gharar* and *maysir* resulting from the nature, value and function of contemporary moneys, the economic transactions cannot be deemed impermissible under *Shariah* law due to the principle of *maslahah ul-siasa*.

Keywords: Shari'ah Legal Principles, R*iba*, *Gharar*, *Maysir*

1. INTRODUCTION

Within Islamic societies, the issue of risk in commercial exchanges is governed by *Shariah* law, which is established in accordance with principles and rules derived from the Qur'an; *sunnah*, or traditions of the Prophet Muhammad (SAW) contained

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within the text of *ahadith* compiled by Islamic scholars; *qiyas*, or analogies premised upon guiding principles contained within the Qur'an and *sunnah*; and *ijma*, or consensus amongst scholars.[3] Under *Shariah* law, issues concerning economic transactions are considered in light of principles and prohibitions arising thin the framework of *fiqh muamalat*, a body of rules specifically addressing commercial transactions and one of the four principal branches of *Shariah* law. While the various provisions of *fiqh muamalat* are generally applied in an effort to determine whether the manner in which commercial transactions are conducted are compliant with *Shariah* guidelines and frameworks, the guidance can also be applied to determine whether the items exchanged during a transaction are compliant with Islamic tradition and regulatory norms. One of the most prevalent items utilized in present day commercial transactions are contemporary moneys.

The present work considers the effects of the use of contemporary moneys in economic transactions, or exchanges involving the use of money as a countervalue for goods, services or commodities. Money, the principal contemporary financial instrument, is examined in light of the relevant *Shariah* guidelines rooted in the prohibitions against *riba*, *gharar* and *maysir*. The primary objective of the analysis is to examine the theoretical relationship between *riba*, *gharar* and *maysir* and draw distinctions between the theoretical relationship between the three elements and the practical relationship that has emerged pursuant to the use of contemporary moneys in economic transactions.

The examination of the practical and theoretical relationships between *riba*, *gharar* and *maysir* is conducted in four principal stages. Firstly, *riba*, *gharar* and *maysir* are explained as individual concepts and in terms of their broader relationship to one another from a theoretical perspective, followed by an explanation of the theoretical basis and the parameters of the *Shariah* analysis of contemporary moneys. Secondly, money is considered in light of the distinctions between traditional and Islamic monetary standards; and contemporary moneys. Thirdly, the effects of the use of contemporary moneys in contemporary economic exchanges and the by-products of

[3] Kamali, Mohammad Hashim. (2009) *Principles of Islamic Jurisprudence*. 2nd ed. Subang Jaya: Ilmiah Publishers, pp. 1-44.

such exchanges are considered in light of *riba*, *gharar* and *maysir*, followed by an explanation of the resulting model between the three *Shariah* components in practice. Lastly, the paper concludes with a summary of the findings regarding the distinctions between the theoretical relationships between *riba*, *gharar* and *maysir* and resulting practical relationships between the three *Shariah* components arising due to the use of contemporary moneys in economic transactions.

2. SHARIAH LAW AND ECONOMIC TRANSACTIONS: DEFINITION, INTERACTION AND APPLICATION

The objective of *Shariah* law, in relation to *fiqh muamalat*, is to promote social justice within financial and economic transactions within Islamic societies. The rules and guidelines established by *Shariah* are necessary to establish an Islamic moral economy, which, from its foundations, must be free from *riba*, *gharar* and *maysir*.[4] The three prohibitions, however, must be understood in regards to their individual meanings and the theoretical relationship between the three *Shariah* standards. Furthermore, the theoretical premises for the investigation of economic transactions involving contemporary moneys, in light of the principles related to prohibitions against *riba*, *gharar* and *maysir* within the corpus of *Shariah* law, and the parameters of the current *Shariah* analysis of contemporary moneys must be examined.

Economic and financial practices involving *riba* are condemned in the texts of both the Qur'an[5] and *ahadith*,[6] although there is little explanation of the precise meaning of the term within the aforementioned texts.[7] Three categories of *riba* have been depicted by scholars: *riba al-jahiliyya*, *riba al-nasi'ah* and *riba al-fadl*. *Riba al-jahiliyya* refers to pre-Islamic practices, whereby creditors charged interest to debtors

[4] Karim, Shafiel A. (2010). *The Islamic Moral Economy: A Study of Islamic Money and Financial Instruments*. Boca Raton: Brown Walker Press, p. 4; and Hitti, Lord Edwin E. (2007) *Basic Mechanics of Islamic Capitalism*. Hong Kong: ARABCCI Services LTD., p. 46.

[5] Al Qur'an, verses 2:275-81, 3:130-32, 4:161, 30:39.

[6] Siddiqi, Abdul Hamid. (1987) *Imam Muslim's Sahih Muslim: Vol.III*. New Delhi: Kitab Bhavan, #9:623; and Khan, Muhammad Muhsin. (1984). *The Translation of the Meanings of Sahih Al-Bukhari: Vol. 3*. New Delhi: Kitab Bhavan, #34:25-7.

[7] Vogel, Frank E. and Samuel L. Hayes. (1998). *Islamic Law and Finance: Religion, Risk and Return*. The Hague: Kluwer Law International, p. 72.

for delayed repayments of loans.[8] Prohibitions against *riba al-nasi'ah* are premised upon rules relating to spot exchanges,[9] the preferred type of transactions in accordance with *Shariah* sources, and includes three categories of permissible transactions involving the completion of a transaction at a future date: *istisna*, whereby a good must be manufactured and both delivery of the good and payment occur at a future date; *salam*, where money is exchanged for goods to be received at a future date;[10] and *nasi'ah*, whereby goods are provided and payment is deferred until a future date.[11] The final category, *riba al-fadl*, prohibits transactions involving unequal measures, where a payment includes an unjustified increase to the countervalue of the principal subjects of the transaction.[12] Although *riba* is often defined contemporarily described as 'interest', *riba* applies to a much broader category of offenses involving the unjustified increase, addition or growth of benefits arising from a transaction.[13] Effectively, *riba* occurs in a transaction where one party is obliged to pay an amount that reflects an excess of the nominal principal,[14] where the excess takes the form of goods or services involved in the transaction or the monetary unit(s) employed as a countervalue.

Unlike *riba*, prohibitions against *gharar* do not appear within the verses of the Qur'an,[15] but are only found in *ahadith*.[16] Although the prohibitions against gharar are

[8] *Ibid*., pp. 72-73.

[9] Uberoi, Priya and Ali Rod Khadem. (2011). 'Islamic Derivatives: Past Present and Future', in *Islamic Capital Markets: Products and Strategies*. Eds. M. Kabir Hassan and Michael Mahlknecht. West Sussex: John Wiley & Sons, Ltd, p. 152.

[10] *Ibid*., p.148.

[11] Vogel and Hayes, *op. cit.*, p.76.

[12] Uberoi and Khadem, *op. cit*., p. 152.

[13] Chapra, Muhammad Umar. (2008). 'The Nature of Riba and Its Treatment in the *Qur'an*, *Hadith* and *Fiqh'*, in *An Introduction to Islamic Economics and Finance*. Eds. Sheikh Gazali Sheikh Abod, Syed Omar Syed Agil and Aidit Hj. Ghazali. Kuala Lumpur: CERT Publications Sdn. Bhd., pp. 47-49.

[14] Toutounchian, Iraj. (2009) *Islamic Money and Banking: Integrating Money in Capital Theory*. Singapore: John Wiley & sons (Asia) Pte. Ltd., pp.151-153.

[15] Al-Saati, Abdul Rahim. (2003). 'The Permissible Gharar (Risk) in Classical Islamic Jurisprudence'. 16(2) *Journal of King Abdulaziz University: Islamic Economics*, p. 7.

[16] Siddiqi, *op.cit*., #3608-13, 3615, 3654-55, 3661-3713; and Khan, *op. cit*., #342-46, 353-61, 373, 389, 396-403.

not explicitly explained or defined within *ahadith*,[17] contemporary definitions and explanations generally focus upon risk and uncertainty arising in relation to transactions,[18] irrespective of whether the arising uncertainty or deception was unintentional or intentional on the party of one or both parties to the transaction.[19] While *Shariah* sources recognise the inherent risks associated with market activities, as markets are inherently volatile and the value of goods and services change in relation to supply and demand forces within the marketplace. The ambit of prohibitions against *gharar* focus upon elements of risk which result from the transaction or exchange that do not arise in relation to market conditions. Essentially, *Shariah* principles concerning *gharar* mandate that the terms must be certain, defined and unambiguous, effectively prohibiting two specific types of transactions: the sale of items not yet in existence; and exchanges or contracts with significant uncertainty concerning duration or costs,[20] although disagreement exists as to what level of uncertainty may exist in a transaction before it is invalid under *Shariah*.[21] In the analysis of the prohibition of *gharar*, Al-Dhareer establishes four universal conditions for a transaction to be invalidated: the *gharar* must be major; the contract effected must be a commutative financial contract; *gharar* must affect the principal components of the contract, such as price and object of sale; and there is no need met by *gharar* that cannot be met otherwise.[22]

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[17] Vogel and Hayes, *op. cit*., p. 64.

[18] Abdul-Rahman, Yahia. (2010). *The Art of Islamic Banking and Finance: Tools and Techniques for Community-Based Banking*. Hoboken: John Wiley & Sons, pp. 43-44; Zahraa, Mahdi and Shafaai M. Mahmor. (20020 'The Validity of Contracts When the Goods Are Not Yet in Existence in the Islamic Law of Sale of Goods'. 17(2) *Arab Law Quarterly*, p. 384; Vogel and Hayes, *op. cit*., p. 64; and Farook, Sayd and Rafi-Uddin Shikoh. (2011). 'Integration of Social Responsibility in Financial Communities' in *Islamic Capital Markets: Products and Strategies*. eds. M. Kabir Hassan and Michael Mahlknecht. West Sussex: John Wiley & Sons, Ltd., pp. 74-75.

[19] El-Gamal, Mahmoud A. (2006) *Islamic Finance: Law, Economic and Practice*. Cambridge: Cambridge University Press, pp. 59-60.

[20] Hamoudi, Haider Ala. (2008). 'The Muezzin's Call and the Dow Jones Bell: On the Necessity of Realism in the Study of Islamic Law'. 56(2) *American Society of Comparative Law*, p. 441.

[21] Vogel and Hayes, *op. cit*., p. 64; and Al-Saati, *op. cit*., p. 9; El-Gamal, *op. cit*., pp.32-33.

[22] Al-Dhareer, Siddiq Mohammad Al-Ameen. (1997). 'Al-Gharar in Contracts and Its Effects on Contemporary Transactions', in *Eminent Scholars' Lecture Series No. 16*, Jeddah: Islamic Research and Training Institute/Islamic Development Bank, pp. 44-51.

The Qur'an explicitly prohibits transactions amounting to *maysir*,[23] which has been most often understood in the context of games of chance enjoyed by the pre-Islamic Arabic populations.[24] Although verses in the Qur'an suggest that the prohibition arose due to the potential for such activities to provoke enmity and distract people from their religious duties and obligations,[25] the existence of *maysir* is viewed as effectively nullifying or voiding contracts.[26] As a result, while disagreement exists as to whether *lahw* (maysir of play) constitutes a prohibited form of *maysir*, as no property is at stake in the game,[27] no contention exists in relation to whether *qimar* (maysir of gambling) is prohibited.[28] Although some contention exists among scholars regarding whether speculation constitutes *maysir*,[29] speculation is generally seen as constituting *maysir*,[30] if not constitutive of *prima facie* evidence of both *gharar* and *maysir*.[31] Contemporarily, the prohibition is applied to all business activities that contain any element constituting unjustified enrichment arising purely from chance.[32]

The theoretical relationship between *riba*, *gharar* and *maysir* arises from the inherent premises of each of the *Shariah* prohibitions. According to contemporary scholars, *riba*, specifically *riba al-fadl*, serves as a foundation for the analysis of gharar, as prohibitions against both riba al-fadl and gharar seek to ensure just and fair

[23] Al Qur'an, verses 2:219 and 5:90-91.

[24] Rozenthal, Franz. (1975) *Gambling in Islam*. Leiden: E. J. Brill, pp. 67-112.

[25] Vogel and Hayes, *op. cit*., pp. 64, 90-91.

[26] Visser, Hans. (2009). *Islamic Finance: Principles and Practice*. Cheltenham: Edward Elgar Publishing Limited, p. 46.

[27] Stilt, Kristen. (2011). *Islamic Law in Action: Authority, Discretion, and Everyday Experiences in Mamluk Egypt*. Oxford: Oxford University Press, p. 90.

[28] *Ibid*., p. 90; Vogel and Hayes, *op. cit*., p. 87; and Lewis, Mervyn K. (2010). 'The Evolution of Takaful Products', in *Islamic Capital Market: Products and Strategies*. eds. M. Kabir Hassan and Michael Malknecht. West Sussex: John Wiley & Sons, Ltd., p. 166.

[29] Uberoi and Khadem, *op. cit*., pp.156-157.

[30] Visser, *op. cit*.,p. 45.

[31] Uberoi and Khadem, *op. cit*., pp.155-156.

[32] Lewis, *op. cit*., p.186.

transactions, free from uncertainty.[33] In a similar fashion, *gharar* serves as a foundation for the prohibition against *maysir*, but can be distinguished on the basis that *maysir* applies to excessive risk and speculation, while *gharar* encompasses a broader range of potential offenses.[34] In essence, *gharar*, which is a prohibition arising purely from *Sunnah* reported in *ahadith*, serves as a bridge between the concepts of *riba* and *maysir*, which appear in both *ahadith* and verses of the Qur'an. Therefore, *riba al-fadl* serves as a theoretical basis for the examination of *gharar*, which in turn serves as a basis for the prohibition against *maysir*. Conversely, an act involving *maysir* will necessarily contain elements of *gharar* and result in transactions which incur *riba al-fadl*.

The examination of the effects of the use of contemporary moneys is supported by secular economic theory. Schumpeter argues that contemporary transactions involving money lack any important theoretical distinction with transactions based upon barter, or the direct exchange of goods or commodities for other goods or commodities without a medium of exchange.[35] While in contemporary transactions, the position of the buyer (party with money) and the seller (party with goods or services) would appear to be absolute, Schumpeter's appraisal of contemporary transactions therefore depicts a relative position of the buyer and the seller. The buyer can either possess money; or goods or services, while the seller can possess goods or services; or money, respectively. As such, an individual can be said to be buying 1,000 monetary units for a good or service, in the same manner the opposite party can be said to be buying a good or service for 1,000 monetary units.

The examination of the effects of the use of contemporary moneys in economic transactions in light of *Shariah* prohibitions against *riba*, *gharar* and *maysir* is

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[33] Chapra, *op. cit*., p. 54.

[34] Vogel, Frank. (2010). 'Islamic Finance: Personal and Enterprise Banking', in *Islamic Banking and Finance in the European Union: A Challenge*, eds. M. Fahim Khan and Mario Porzio. Cheltenham: Edward Elgar Publishing Limited, p. 48; and Simonsen, Jørgen Bæk. (2003). 'Sharia and Sunna in the Qur'an and in the Writings of Sayyid Qut', in *Scriptural Politics: The Bible and the Koran as Political Models in the Middle East and Africa*. ed. Niels Kastfelt. London: C. Hurst & Co. (Publishers) Ltd., p.75.

[35] Schumpeter, Joseph A. (1994) *History of Economic Analysis*. London: Routledge, p.561.

supported by existing Islamic studies of the aforementioned principles. The following hadith depicts *ribawi*, or particular items susceptible to *riba* related offenses:[36]

> Gold is to be paid for by gold, silver by silver, wheat by wheat, barley by barley, dates by dates, salt by salt, like for like and equal for equal, payment being made hand to hand. If these classes differ, then sell as you wish if payment is made hand to hand.[37]

The mention of gold and silver, interpreted by scholars as referring to commodity moneys, has allowed for the expansion of the categories of *ribawi* to include contemporary moneys.[38] Likewise, the analyses of economic transactions in light of *gharar* have concluded that expressly forbidden transactions include those that involve a lack of sufficient knowledge in relation to the type of price or subject matter; the characteristics of the price or subject matter; and the quantum of the price or the quantity of the subject matter.[39] *Maysir,* on the other hand, can be most correctly understood as an extreme instance of *gharar*,[40] arising due to the ignorance of the gambler regarding the outcome[41] or a potential result in transactions if issues pertaining to *gharar* are not restricted.[42] Therefore, *maysir* is inherently considered in a fashion similar to that of *gharar* in respect of the application of *Shariah* to economic transactions involving contemporary moneys. As such, the analysis of the effects of the use of contemporary moneys on transactions is supported by *Shariah* law.

In order to analyze the effects of the use of contemporary moneys in economic transactions in light of the three aforementioned groups of *Shariah* prohibitions, two

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[36] Uberoi and Khadem, *op. cit*., p. 151.

[37] Siddiqi, *op. cit*., at 9:624:3853

[38] Uberoi and Khadem, *op. cit*., p. 152; and Chapra, *op. cit*., p. 51.

[39] Zahraa and Mahmor, *op. cit*., p. 387.

[40] Iqbal, Jacquir. (2009). *Islamic Financial Management*. New Delhi: Global Vision Publishing House, p. 144.

[41] Hitti, *op. cit*., pp. 246-247.

[42] Vogel and Hayes, *op. cit*., p. 92.

assumptions are made. First, being that the focus of the analysis concerns the effects of the use of contemporary fiat moneys in economic transactions, the assumption is made that all other aspects of the exchanges are considered to be *Shariah* compliant. As a result, issues relating to *riba al-jahiliyya* and *riba al-nasi'ah* are not considered, as the two categories are principally concerned with the intentional addition of benefit or cost for one party to a transaction; and the terms and conditions associated with payment in transactions involving deferred completion. The second assumption made is that the market value of goods and services, or the value of goods and services in relation to other goods and services in the market, remains constant.

The role of *Shariah* normative standards in promoting social justice within financial and economic transactions is an important feature in the Islamic Moral Economy and the three categories of prohibitions share a common purpose and attribute relating to the empirical elements of such transactions. While El-Gamal notes that cost-benefit analyses are requisite in meaningful examinations of *gharar*,[43] the case can be made that such analyses are also necessary for meaningful analyses of actions that potentially amount to *riba* and *maysir*. Each of the three principles requires that a cost and benefit be established and evaluated in an effort to ensure fairness, justice and equity in transactions. As mentioned above, costs and benefits, in an empirical sense, relate to a quantitative assessment of the value of an item in order to negotiate and determine an appropriate countervalue, which can contemporarily consist of goods, services or currency. In most instances, if the benefit received is less than or greater than the countervalue, the empirical results of the transaction present a *prima facie* case for the analysis of the effects of the use of contemporary moneys on economic transactions in light of *Shariah* prohibitions against *riba*, *gharar* and *maysir*.

3. TRADITIONAL MONEYS AND CONTEMPORARY MONEYS: NATURE, VALUE AND FUNCTION

Moneys have been utilized in economic transactions as countervalues accepted for the exchange of goods, services and commodities for over 2,000 years. While *Shariah* law provides a firm basis for the examination of contemporary moneys, such moneys differ from the moneys depicted in *Shariah* sources. Traditional moneys in both

[43] El-Gamal, *op. cit.*, p. 33.

Islamic and non-Islamic societies differ considerably from contemporary moneys in three distinct fashions: the nature of the moneys; the manner in which the moneys attain value; and the functions performed by the moneys. The aforementioned distinctions shed light on the principal issue to be considered in relation to the use of contemporary moneys in contemporary transactions.

Traditionally, two types of moneys were utilized for the purposes of economic transactions within Islamic societies. Commodity moneys, which were simply specific commodities utilized as a unit of exchange[44] against which the value of all other goods were measured,[45] typically consisted of precious metals by the dawn of Islamic civilization. Gold, silver and copper were a virtually universal monetary standard due to their durability, portability, divisibility, quality, opportunity cost and stability of value,[46] as well as factors relating to their utility, ornamental beauty, relative scarcity, geographic distribution, and high market demand.[47] Within Islamic societies, the use of gold and silver as commodity moneys in economic transactions was demonstrated by the use of the *dinar* and *dirham* coinage, respectively. *Fals*, which were coins minted from copper, were also utilized as commodity money and utilized to provide smaller denominations of coins to be utilized for change and in smaller transactions.[48] However, at various points in Islamic history, *fals* and *maghshush* were used as token moneys, or moneys that represented a value greater than the actual value of the material utilized in the token,[49] whose value was established by the government or issuing authority.[50] The distinction between the use of the *dinar* and *dirham*; and *fals* and *maghshush* within Islamic societies was that the former were utilized for large

[44] von Mises, Ludwig. (2009). *The Theory of Money and Credit,*.Trans. J. E. Batson. Auburn: Ludwig von Mises Institute, p. 62.

[45] Menger, Carl. (2009). *On the Origins of Money*. Auburn: Ludwig von Mises Institute, pp. 35-43.

[46] Eachern, William. (2008). *Economics: A Contemporary Introduction*. Mason: South-Western College Publishing, p. 618.

[47] Menger, *op. cit.*, pp. 45-50.

[48] Abdul Azim Islahi. (1988). *Economic Concepts of Ibn Taimiyah*. Leicester: The Islamic Foundation, p. 42.

[49] Mukherjee, Sampat. (2002). *Modern Economic Theory*. New Delhi: New Age International, p. 768.

[50] Siegfried, Nikolaus. (2001). 'Concepts of Paper Money in Islamic Legal Thought'. 16 *Arab Law Quarterly*, pp. 320-321,326.

domestic transactions and international trade, while the latter were intended for use only in small domestic transactions, such as the purchase of foodstuffs, and were established as a means to provide smaller denominations for providing change for purchases made with gold and silver.[51]

Contemporary moneys, on the other hand, universally consist of fiat money, following the departure from commodity-based moneys, or moneys valued according to an underlying commodity, in the twentieth century. The gradual withdrawal from commodity-based money began with use of commodity-backed moneys or moneys whose value was obtained in relation to a specific measure of a commodity. Commodity-backed moneys have included notes issued by grain warehouses in ancient Egypt[52] and by merchants and banks in Europe.[53] Towards the end of the nineteenth century, however, banks and governments began to recognize the advantages of monetary systems which were not linked to an underlying commodity.[54] Governments, who had gained control over the regulation and supply of money following the introduction of coinage in most instances,[55] rapidly began adopting fiat monetary systems following World War II. Initially, par values were established for emerging fiat moneys in relation to the US Dollar, which had remained commodity-backed money, under the Bretton Woods Agreement. Following the withdrawal of the US from the gold standard in 1971, fiat money had become the universal standard.[56] Essentially, fiat money is the polar opposite of commodity based money, completely separated from any objective and empirical market values

[51] Noonan, Thomas S. (1974). 'Medieval Islamic Copper Coins From Europe and Surounding Regions: The Use of *Fals* in Early Islamic Trade with Eastern Europe'. 94(4) *Journal of the American Oriental Society, pp. 449-451*.

[52] Green, Stephen. (2009). *Good Value: Reflections on Money, Morality and an Uncertain World*. London: Penguin Books, p.71.

[53] Furnham, Adrian and Michael Argyle. (1998). *The Psychology of Money*. London: Routledge, p.15.

[54] Moore, Basil. (2003). 'Endogenous Money', in *The Elgar Companion to Post Keynesian Economics*. ed. J. E. King. Cheltenham: Edward Elgar Publishing Ltd., p. 118.

[55] Cesarano, Filippo. (2008). 'The New Monetary Economics and the Theory of Money', in *Money and Monetary Systems: Selected Essays of Filippo Cesarano*. Cheltenham: Edward Elgar Publishing Limited, p. 47.

[56] Bagus, Phillip. (2010). *The Tragedy of the Euro*. Auburn: Ludwig von Mises Institute, pp. 12-18.

associated with commodities and allowing for a virtually limitless supply of money from the government or central bank.[57]

As a result of the fact that fiat money is not linked to the value of a unit of commodity in the same manner as traditional moneys, the manner in which contemporary money attains value for the purposes of domestic and international exchanges differs as well. In the context of domestic economic transactions, contemporary monetary standards attain their respective local values from a variety of factors. Initially, fiat money gained its value from the trust and confidence of the public that the money would be accepted, which was later reinforced by the introduction of legal tender laws by national governments that required persons within the jurisdiction of the governing authority to accept the national monetary standard as payment for goods and services rendered.[58] Contemporarily, fiat money acquires its value from a 'value convention', which is based upon local and national practices relating to exchanges and premised upon the cultures, customs and traditions of the collective. The 'value convention' remains intact as long as the banks and government institutions are able to maintain credibility, credence, reputation, confidence, social recognition and 'brand-name value' of the currency in the eyes of the public.[59]

While traditional moneys utilized in international economic transactions were valued in relation to the specific measure of the commodity either present in, or represented by, the money utilized in the transaction, the same cannot be said in the case of contemporary moneys. Contemporary monetary standards attain their respective international values in a similar fashion to the moneys attain local value, albeit with a considerable increase in the number of factors that affect the value of the units of different monetary standards. Contemporarily, the values of local moneys are valued in relation to the supply and demand for specific currencies in international markets, which, in turn, is affected by numerous economic, political and psychological

[57] Moore, *op. cit*., pp. 118-121.

[58] Mihm, Stephen. (2009). *A Nation of Counterfeiters: Capitalists, Con Men and the Making of the United States*. Cambridge: First Harvard University Press, pp.11-12.

[59] Bonus, Holger. (2001). 'On Exchange and Deceit', in *Expanding the Economic Concept of Exchange: Deceit, Self-Deception and Illusions*. ed. Caroline Gerschlager. Dordrecht: Kluwer Academic Publishers, pp. 86-97.

factors.[60] Economic factors include interest rates and foreign investment in the country in question; balance of payments, which applies to trade flows between two countries; domestic stock exchange activity; and the demand for the exports of the country in question. Political factors include government policy and central bank intervention affecting currency value; and political stability.[61] Finally, psychological factors affecting currency exchange rates include the perceived credibility of statements concerning intervention and inflation rates of the government and central bank,[62] as well as expectations concerning the future value of the local money or future trade performance, which can result in the strengthening or weakening of the currency exchange rate of a given country, referred to as a 'shadow exchange rate'.[63] As a result of the numerous factors that influence currency exchange rates, the rate of exchange between two local moneys changes from minute to minute and hour to hour,[64] which occurs due to unforeseeable and unpredictable fluctuations arising from the multitude of economic and non-economic factors that affect exchange rates.[65]

The distinctions regarding the natures of the moneys used and the manners in which they attained their respective values have an important bearing on the functions performed by the two distinct monetary systems. Generally speaking, commodity moneys perform three functions: a medium of exchange; a unit of account; and a store of value.[66] Contemporary moneys, which are universally fiat-based moneys, are simply currencies, where the store of value function has been dominated by its

[60] Macesich, George. (1996). *Integration and Stabilization: A Monetary View*. Westport: Praeger Publishers, pp.46-47.

[61] Whittington, O. Ray and Patrick R. Delaney. (2012). *Wiley CPA Exam Review 2012: Business Environment and Concepts*. Hoboken: John Wiley & Sons Inc., p. 136.

[62] Gonçalves, Fernando M. (2008). *Accumulating Foreign Reserves Under Floating Exchange Rates*. Washington D.C.: International Monetary Fund, pp. 17-18.

[63] Becker, Torbjörn, Gaston Gelos and Anthony J. Richards. (2000). *Devaluation Expectations and the Stock Market: The Case of Mexico in 1994/95*. Washington D.C.: International Monetary Fund, p. 7.

[64] Burton, Maureen and Bruce Brown. (2009). *The Financial System and the Economy: Principles of Money and Banking*. 5th ed. Armonk: M. E. Sharpe, p. 436.

[65] Ajami, Riad A., Karen Cool, G. Jason Goddard and Dara Khambata. (2006). *International Business: Theory and Practice*. 2nd ed. Armonk: M. E. Sharpe, p. 123.

[66] Greco, Thomas H. (2009). *The End of Money and the Future of Civilization*. White River Junction: Chelsea Green, p.90.

function as a medium of exchange, and, without an objective value premised upon an underlying commodity, the actual 'value' of the money consists of a hope or expectation that the money will retain some type of purchasing power tomorrow.[67]

Contemporary moneys are unlike traditional moneys in a variety of fashions. Firstly, unlike commodity moneys, contemporary moneys do not attain their value from an underlying commodity, but from sentiment and esteem. In the case of *fals* and *maghshush*, which were used as forms of token moneys, it is important that such monies were utilized for small local purchases and were not utilised for the purposes of large domestic exchanges or international exchanges generally, whereas contemporary moneys are utilized for all types of economic transactions. Furthermore, contemporary moneys lack a store of value function that was inherent in traditional moneys. Issues concerning the value of monetary units are the underlying elements behind each of the distinctions between traditional moneys and contemporary moneys. Value, which is often discerned in relation to the price, cost and benefit of an item in an exchange, is the focal point of the present analysis of contemporary money.

4. THE VALUE OF CONTEMPORARY MONEY AND ECONOMIC TRANSACTION: AN ANALYSIS OF THE ISSUES ASSOCIATED WITH LOCAL AND INTERNATIONAL ECONOMIC EXCHANGES

The *Shariah* analysis of the value of contemporary moneys is conducted in four principal stages. First, issues concerning value arising from the use of contemporary moneys in local economic transactions, or exchanges involving parties based within a jurisdiction utilizing a common monetary standard, are considered in the context of spot exchanges and deferred payments occurring during periods of relative monetary system stability and monetary system instability. Second, issues concerning value arising from the use of contemporary moneys in international economic transactions, whereby the parties to an exchange are based in differing jurisdictions in relation to their respective local monetary standards, are considered in light of spot exchanges and forward contracts occurring during periods of relative monetary system stability

[67] Shubik, Martin. (1999). *The Theory of Money and Financial Institutions*. Vol. 1. Cambridge: Massachusetts Institute of Technology, pp. 281-282.

and monetary system instability, as well as the consideration of further issues concerning the incongruent valuation of local moneys in the international market. Finally, *riba al-fadl*, *gharar* and *maysir* are examined in light of the relationship that emerges as a result of the use of contemporary moneys in economic transactions.

Local Economic Transactions

The use of contemporary moneys in local economic transactions presents a unique set of issues, particularly in relation to the manner in which the local money attains and maintains value. The analysis of the value of local money and the resulting effects upon local economic transactions is conducted in five stages. First, the concepts of inflation and deflation are presented and the relationship of the concepts to the value of local moneys is surveyed. Second, the relationship between inflation, deflation and spot exchanges is examined. Third, the effects of inflation on local economic transactions involving deferred payments during periods of relative monetary system stability are examined. Fourth, the effects of inflation on local economic transactions involving deferred payments are considered in the context of periods of monetary system instability. Finally, the issues are considered in light of *Shariah* normative standards concerning *riba al-fadl* and *gharar*.

While deflation, or the increase of the value of an individual unit of local money, was common prior to 1945, governments and central banks contemporarily endeavor to ensure that inflation, or the decrease of value of an individual unit of local money, occurs perpetually, albeit at a managed and stable rate.[68] Inflation results in greater amounts of money being required to conclude an exchange. Inflation can be caused by cost-push inflation, whereby increases in wages and raw materials result in an increase in prices; demand-pull inflation, whereby an economy grows too quickly and demand begins to outstrip supply causing an increase in prices; monetary supply fluctuation, whereby the government or central bank expand the existing pool of money in circulation; tax rates, such as sales tax and other indirect taxes; and

[68] Burdekin, Richard Charles Keighley and Pierre L. Siklos. (2004). 'Fears of Deflation and the Role of Monetary Policy: Some Lessons and an Overview', in *Deflation: Current and Historical Perspectives*. eds. Richard Charles Keighley Burdekin and Pierre L.Siklos. Cambridge: Cambridge University Press, pp. 10-12.

expectations, whereby the fear of an economic downturn and the attempt of the general public to protect their individual living standards results in inflation.[69] Inflation, ever present within contemporary monetary systems, can be relatively low and stable. In certain instances, however, inflation can increase dramatically and unpredictably over a short period of time, leading to a dramatic decrease in the value of the local money. While such instances of hyperinflation are argued to occur solely following revolution, civil war and collapse of a government,[70] the simple fact is that the existence of inflation causes varying degrees of uncertainty regarding the value of the currency utilised in economic transactions.[71]

Although the value of local money changes constantly, due to inflation and deflation, the measurement of the rate of inflation is often considered in relation to price indices, such as the consumer price index (CPI), which measures the change in the number of units required to purchase an item equivalent to an item from the previous month or year. The CPI depicts the value of local money in relation to the actual purchasing power or value of an individual unit of local money for purposes of transactions within its domestic market. As a result of the manner in which the value of local moneys is measured, in terms of the change in price or perceived value of an individual unit of local money against a particular good or service, the value of the local money for purposes of domestic spot exchanges, reflected by the price, actually serves as the basis of inflationary measurements. Essentially, inflation represents an increase of value of goods and services against units of local money, whereas deflation represents an increase of value of money against goods and services. Because of this intrinsic relationship, inflation and deflation rates do not have an effect on domestic spot exchanges *per se*, rather inflation and deflation rates are affected by domestic spot exchanges.

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[69] Welch, Patrick J. and Gary F. Welch. (2010). *Economics: Theory and Practice*. Hoboken: John Wiley & Sons, Inc., pp. 165-166.

[70] Lipsey, Richard G. and K. Alec Chrystal. (2007). *Economics*. 11th ed., Oxford: Oxford University Press, p. 552.

[71] Wannacott, Paul and Ronald Wannacott. (1990). *Economics*. New York: John Wiley & Sons, pp. 268-269.

The same cannot be said for local transactions involving deferred payments, irrespective of whether the economic transaction occurs during a period of relative monetary system stability or monetary system instability. A monetary system is said to be stable or normal when inflation rates are between 2% and 4% per annum.[72] In the case of the United States economy between 1991 and 2008, representing a relatively stable currency system, the annual rate of inflation ranged from 1.6 percent to 4.2 percent.[73] Despite the fact that such monetary systems are denoted as 'stable' or 'normal', the continuous inflationary pressure demonstratively affects the value of local money over a period of time. Table 1, below, demonstrates the resulting effects of inflation on the value of the Malaysian Ringgit during 2011, based upon CPI data, in relation to the base value of the Malaysian Ringgit in December of 2010.

Table 1 demonstrates that as a result of the constant inflationary pressures, the local value of the Malaysian Ringgit consistently decreases in relation to the base value established in December of 2010. Furthermore, the decrease of local value of the Malaysian Ringgit results in corresponding losses of value in remuneration in the event deferred payments are employed in a local economic transaction. While the resulting loss of value in remuneration is relatively minor over a short period of time and for small sums of future payment, the relative losses become significantly greater as the amount of the payment and the period of time for which payment is deferred increases. Finally, the table demonstrates that even during a period of monetary system stability, the rate of inflation and effects upon the value of the local money are far from consistent, varying from month to month.

[72] Casterline, Sean D. and Robert G. Yetman, Jr. (2010). *Investor's Passport to Hedge Fund Profits: Unique Investment Strategies for Today's Global Capital Markets*. Hoboken: John Wiley & Sons, Inc., p. 83.

[73] Burton and Brown, *op. cit.*, p. 106.

Table 1. The Effects of Inflation on the Value of the Malaysian Ringgit (RM) During a Period of Monetary System Stability, with an Annual Inflation Rate of 3.0%

	Inflation Rate (Monthly)	Cumulative Effect On Value of RM In Relation to Base	Cumulative Loss of Value on RM100 In Relation to Base	Cumulative Loss of Value on RM 1,000,000 In Relation to Base
December 2010	N/A	1.00000	N/A	N/A
January 2011	0.59288%	0.99411	RM0.59	RM5,894.00
February 2011	0.49115%	0.98925	RM1.08	RM10,752.70
March 2011	0.09775%	0.98828	RM1.17	RM11,718.80
April 2011	0.19531%	0.98635	RM1.36	RM13,645.30
May 2011	0.29239%	0.98348	RM1.65	RM16,520.90
June 2011	0.29154%	0.98062	RM1.94	RM19,379.90
July 2011	0.19379%	0.97872	RM2.13	RM21,276.60
August 2011	0.19342%	0.97683	RM2.32	RM23,166.10
September 2011	0.19305%	0.97495	RM2.50	RM25,048.20
October 2011	0.19267%	0.97308	RM2.69	RM26,923.10
November 2011	0.09615%	0.97142	RM2.86	RM28,579.00
December 2011	0.09606%	0.97121	RM2.88	RM28,790.80

Source of Inflation Data: Bank Negara Malaysia

During periods of monetary system instability, however, inflation can rise sharply and have deleterious effects within an economy. In Indonesia in 1998, for example, following the Asian Financial Crisis of 1997, the average monthly inflation rate was 4.96 percent, reaching as high as 12.67 percent in February of 1998 and resulting in an annual inflation rate of 78% for 1998.[74] In certain circumstances, hyperinflation has occurred and resulted in the value of the currency plummeting to almost nothing. The effects of hyperinflation have been felt in Germany following World War I, with the monthly inflation rate reaching as high as 332 percent; in Serbia in 1993, where the annual inflation rate reached 302 million percent;[75] and in Zimbabwe in 2008,

[74] Ramakrishnan, Uma and Athanasios Vamvakidis. (2002). IMF Working Paper: Forecasting Inflation in Indonesia. Washington D.C.: International Monetary Fund, p.7.

[75] Lipsey and Chrystal, *op. cit.*, p. 552.

where the inflation rate in July of 2008 was estimated at over 231 million percent and 516 quintillion percent in November of 2008.[76] While the cumulative losses associated with the Malaysian Ringgit during a twelve month period of relative monetary system stability result in cumulative losses of value with a mere 3.0% annual inflation rate, the inflation rates during monetary system instability are significantly higher over a mere one month period, resulting in considerably larger relative losses of value of the local moneys from a base period prior to the episode of crisis. As a result, any economic transaction employing a method of deferred payments that extended into a period of monetary system instability would be exposed to a considerable higher degree of loss of relative value in relation to the payment received.

The *Shariah* analysis of the effects of the resulting fluctuation of value of contemporary local moneys when such moneys are utilized in local economic exchanges focuses upon the prohibitions against *gharar* and *riba al-fadl*. In relation to gharar, four principal observations are made. First, in the case of local economic transactions involving spot exchanges, there is relatively little uncertainty that arises in relation to the value of the local money utilized in the transaction, as the measure of the change in value of the local money is most aptly demonstrated by the price of goods and service available within the local market, as the price is representative of the value of the local money in relation to the value of goods and services available in the market at the time of the transaction. In the case of deferred payments, however, uncertainty exists and increases with the amount of local money deferred and the length of the period for which payment is deferred. While the argument can be made that short-term deferred payments and deferred payments involving small amounts of local money incur relatively minor levels of uncertainty and are therefore within the limits prescribed by *Shariah* law, the same case cannot be made in relation to larger sums of money and lengthier periods of deferred payments. Thirdly, the uncertainty of the future value of local money is reflected in inflation rates during periods of relative monetary system stability and monetary system instability. Even during periods of relative monetary system stability, inflation rates are far from consistent from month

[76] Wiggin, Addison and Samantha Buker. (2012). *The Little Book of the Shrinking Dollar: What You Can Do To Protect Your Money Now*. Hoboken: John Wiley & Sons.

to month, while inflation rates during monetary system instability are simply exacerbated demonstrations of fluctuations that occur during periods of monetary system stability. Finally, local economic transaction employing deferred payments which extend into periods of monetary system instability result in highly uncertain outcomes regarding the actual value of the local money received at a future point in relation to the goods and services involved in the economic transaction at an earlier point in time. While spot exchanges arguable do not incur *gharar* as a result of the use of contemporary local moneys in local economic exchanges, any local economic transaction employing deferred payments and involving a large sum of money would be considered as incurring *gharar*, particularly in light of the constant, yet inconsistent, decrease of the value of local money over a period of time and the fact that periods of monetary system instability, although not common, are often as unforeseeable and unpredictable as the rate at which local moneys lose value from month to month.

The analysis of local economic transactions in light of the *Shariah* prohibition against *riba al-fadl*, however, leads to a conclusion in relation to the aforementioned issues considered in relation to *gharar*. As noted above, prohibitions against *riba al-fadl* are more absolute, lacking the ambiguity associated with the determination of the level of significance of uncertainty in a transaction. As a result, even a minor inconsistency arising from the value of the local money at the time of agreement for a local economic transaction employing deferred payments constitutes a violation of the prohibition. Such a violation can be empirically measured in regards to the relative value of the local money at the time of the agreement and the relative value of the local money at the future time of payment. As contemporary moneys lose value over time, due to the nature of the fiat money itself rather than supply and demand forces within the local goods and services market, any transaction employing deferred payment and utilizing contemporary local moneys will inevitably incur some degree of *riba al-fadl*.

International Economic Transactions

Issues relating to international economic transaction are considered in a similar fashion to the issues considered in relation to local economic transactions. First,

international economic transactions involving spot exchanges are surveyed in light of the effects of international currency exchange value fluctuations during periods of elative monetary system stability. Second, international economic transactions involving forwards contract are surveyed in light of the effects of international currency exchange value fluctuations during periods of elative monetary system stability. Third, international economic transactions are considered in general terms in relation to the fluctuation of currency exchange values. Fourth, issues concerning the incongruent valuation of contemporary moneys, in terms of local value and international value, are considered. Finally, the issues are analyzed in light of the *Shariah* prohibitions against *riba al-fadl* and *maysir*.

International economic transactions involving spot exchanges are not altogether dissimilar from local economic transactions, but can be distinguished in relation to the length of time allowed for the completion of the transaction. While local economic transactions are immediate transactions, therefore completed at the time of agreement, international economic exchanges involving spot exchanges can be concluded over a two day period from the conclusion of the agreement.[77] The extension of the conclusion of a spot exchange by 48 hours would bear little consequence on a local economic transaction completed during a period of relative monetary system stability, since inflationary pressures are relatively minor over short periods. The same, however, cannot be said in the case of international economic transactions involving spot exchanges during similar periods of monetary system stability. As noted above, international currency exchange values change from minute to minute, irrespective of the stability of the monetary systems involved in the completion of an international economic transaction. Table 2 demonstrates the effects of the actual currency exchange rate fluctuations on a hypothetical international economic transaction, involving a countervalue amounting to USD 500,000, due to the fluctuation of the international valuation of the national monetary standards of the US and Malaysia.

[77] Quirk, Peter J., Graham Hacche, Viktor Schoofs and Lothar Weniger. (1988). *Policies for Developing Forward Foreign Exchange Markets*. Washington D.C.: International Monetary Fund, p. 1.

Table 2. Effects of Exchange Rate Fluctuation on a Countervalue Amounting to USD 500,000 Stemming From an International Spot Exchange Over a 48-Hour Period

	Exchange Rate	Effect on Amount Received From Terms of Transaction	Increase/Decrease In The Sum Received As Payment
5 September 2012, 13:00 UTC	3.11965	RM1,559,825.00	N/A
6 September 2012, 01:00 UTC	3.11576	RM1,557,880.00	-RM1,945.00
6 September 2012, 13:00 UTC	3.11624	RM1,558,120.00	-RM1,705.00
7 September 2012, 01:00 UTC	3.10985	RM1,554,925.00	-RM4,900.00
7 September 2012, 11:00 UTC	3.10760	RM1,553,800.00	-RM6,025.00
7 September 2012, 13:00 UTC	3.10023	RM1,550,115.00	-RM9,710.00
High			
5 September 2012, 21:45 UTC	3.12112	RM1,560,560.00	RM735.00
Low			
7 September 2012, 13.00 UTC	3.10023	RM1,550,115.00	-RM9,710.00

Source for Exchange Rate Data: XE.com

As demonstrated in Table 2, currency exchange values fluctuate considerably, even during a 48-hour period. While a spot exchange involving a USD 500,000 countervalue would yield an equivalent of RM 1,559,825.00 at the time of the agreement, the amount of remuneration received in relation to the base value of the offer at the time of the agreement would result in varying degrees of loss or additional profit depending upon the time at which the principal was paid and the transaction concluded. In the scenario, the Malaysian party to the transaction could potential receive RM9,710.00 less than expected if payment were to be received on 7 September 2012, thereby suffering a loss, or pay RM9,710.00 less than expected on 7 September 2012, thereby benefitting from the exchange rate fluctuation.

In the case of international economic transactions involving forwards contracts, which allow for the deferment of payment in international transactions, the situation becomes exacerbated. International economic transactions involving deferred payments typically utilize forward contracts or futures contracts, establishing a date of

maturity, or payment, after 1, 2, 3, 6 or 12 months.[78] Table 3 examines the actual fluctuation of international currency exchange rates between the US Dollar and the Malaysian Ringgit over a twelve month period in regards to a hypothetical international economic transaction involving a countervalue of USD 500,000. Table 3 demonstrates that despite the relative monetary system stability of the US and Malaysia during 2011, the resulting fluctuations of value have a considerable impact on the remuneration that would be received/disbursed. For example, a forward contract concluded on 2 January 2011 could have resulted in the Malaysian party paying/receiving RM 38,250.00 less when the contract matured six months later, thereby incurring a benefit/loss as a result of the effects of the fluctuation of international currency exchange rates. Conversely, if the same forward contract matured after twelve months, a Malaysian party would pay/receive RM 42,250.00 more due to currency exchange rate fluctuations, thereby incurring a loss/benefit.

[78] Quirk, *et. al*., *op. cit*., pp. 7-8.

Table 3. The Effects of Exchange Rate Fluctuation on a Nominal Principal Amounting to USD 500,000 Stemming From an International Economic Transaction Involving a Forward Contract

	Exchange Rate	Effect on Amount Received From Terms of Transaction	Increase/Decrease In The Sum Received As Payment
2 January 2011	3.08450	RM1,542,250.00	N/A
2 February 2011	3.06250	RM1,531,250.00	*-RM11,000.00*
2 March 2011	3.03700	RM1,518,500.00	*-RM23,750.00*
2 April 2011	3.02800	RM1,514,000.00	*-RM28,250.00*
2 May 2011	2.96100	RM1,480,500.00	*-RM61,750.00*
2 June 2011	3.00800	RM1,504,000.00	*-RM38,250.00*
2 July 2011	3.00800	RM1,504,000.00	*-RM38,250.00*
2 August 2011	2.93700	RM1,468,500.00	*-RM73,750.00*
2 September 2011	2.99050	RM1,495,250.00	*-RM47,000.00*
2 October 2011	3.19000	RM1,595,000.00	RM52,750.00
2 November 2011	3.12040	RM1,560,200.00	RM17,950.00
2 December 2011	3.14693	RM1,573,465.00	RM31,215.00
2 January 2012	3.16900	RM1,584,500.00	RM42,250.00

Source of Exchange Rate Data: XE.com

In the case of international economic transactions involving spot exchanges or forwards contracts during periods of monetary system instability, the volatility of the international value of the unstable monetary standard is exacerbated, as demonstrated in the case of the Indonesian Rupiyah during the Asian Financial Crisis of 1997 and the Zimbabwean Dollar in 2008. Prior to the Asian Financial Crisis, the exchange value of the Indonesian Rupiyah (IDR) to the USD fluctuated between IDR 2,300.00 and IDR 2,500.00 between January 1997 and July 1997, further decreasing in value to almost IDR 6,000.00 to the USD by December 1997. Following the Asian Financial Crisis, the IDR exchange value decreased from IDR 10,000 to the USD, on 20 January, to IDR 12,800 to the USD, on 22 January 1998, only to decrease in value further to IDR 14,800 to the USD 1.00 by 23 January 1998. In the case of the Zimbabwean Dollar (ZWD), the exchange rate dropped from ZWD 30,000.90 to the USD, on 9 May 2008, to ZWD 160,000,000 to the USD, on 11 May 2008. The

increased volatility of monetary systems during such crises makes any attempt to gauge the future international value of the monetary standard impossible. As noted above, such instances, albeit rare, are unforeseeable and the resulting decline in value of the monetary units affected is unpredictable.

A further issue exists in relation to the values of contemporary moneys, particularly in regards to the manner in which they attain their value in local and international markets. As noted above, the local value of a local is affected by a different set of variables than the international value of the same local money. Additionally, the manner in which their respective value is measured differs, as local value is determined in light of processes within local markets and international value is determined by processes within international markets, as noted above. In the past, commodity-based moneys attained their value in accordance with the market value of the underlying commodities and their exchange ratio could therefore be determined in relation to the respective values of their underlying commodities. For example, if the local value of the money of Country A was 1/35 of an ounce of gold, as was the case with the US Dollar prior to 1971, and the local value of the money of Country B was 1/70 an ounce of gold, the exchange rate of Country A against Country B would be 1:2. This, however, is not the case with contemporary moneys.

Table 4 compares the local values of the Indonesian Rupiyah (IDR) and the US Dollar, adjusted for the respective inflation figures of the two countries for the periods examined; and the actual international exchange rate between the two local moneys during a period of relative monetary system stability. The relative change in the local value of the IDR against the local value of the USD reflects the strengthening/weakening of the local value of the IDR, while the relative change in the international value of the IDR against the USD is measured based upon the international currency exchange rate for the same period. Additionally, the table demonstrates the distinctions between the anticipated international value of the IDR against the USD in relation to changes in the local value of the IDR and USD due to inflation/deflation during the respective months; and the actual reported exchange rate for the last day of the months.

Table 4. Comparison of the Change in Value of the IDR Against the USD based upon Local Value, Adjusted for Inflation, and the Change in International Value of the IDR Against the USD based upon Currency Exchange Rates (CER), During a Period of Relative Monetary System Stability

	Inflation Rate for Month Indonesia	Inflation Rate for Month US	Relative Change In Local Value of IDR Per USD (Inflation)	Theoretical Result in Relation to Currency Exchange Rate	Actual Reported Exchange Rate Last Day of Month	Relative Change in Value of IDR Per USD (CER Based)
December 2010	-----	-----	--------	-------	8873.11	-------
January 2011	0.89%	0.48%	*-0.40639%*	8909.32	8920.61	*-0.53248%*
February 2011	0.13%	0.49%	0.35953%	8877.40	8833.92	0.98133%
March 2011	*-0.32%*	0.98%	1.30417%	8763.11	8665.51	1.94345%
April 2011	*-0.31%*	0.64%	0.95295%	8680.39	8503.40	1.90641%
May 2011	0.12%	0.47%	0.34958%	8598.45	8467.40	0.42516%
June 2011	0.55%	*-0.11%*	*-0.65639%*	8655.27	8610.00	*-1.65622%*
July 2011	0.67%	0.09%	*-0.57614%*	8705.42	8488.96	1.42585%
August 2011	0.93%	0.28%	*-0.63411%*	8760.98	8481.76	0.08488%
September 2011	0.27%	0.15%	*-0.11968%*	8771.47	8904.72	*-4.74985%*
October 2011	*-0.12%*	*-0.21%*	*-0.09011%*	8779.39	8795.07	1.24672%
November 2011	0.34%	*-0.08%*	*-0.41858%*	8816.29	9132.42	*-3.69399%*
December 2011	0.57%	*-0.25%*	*-0.81536%*	8888.76	8968.61	1.82648%

Source of inflation data for United States: United State Bureau of Labor Statistics, United States Department of Labor. Source of inflation data for Indonesia: Badan Pusat Statistik. Source of currency exchange rate data: GoCurrency.com.

Table 4 demonstrates that the increase/decrease in strength of the local value of the IDR against the local value of the USD in 2011 did not correspond with the increase/decrease in strength of the international value of the IDR against the USD. The argument can be made that since inflation measurements occur monthly and currency exchange values are monitored from minute to minute, that discrepancies would inevitably occur due to the more frequent monitoring of the volatility of the value of the IDR and the USD in relation to the international value of the two monetary standards. However, Table 4 demonstrates that relatively minor decreases in

the local value of the IDR against the local value of the USD were accompanied by significant decreases in the international value of the IDR against the USD in September and November, while significant decreases of the local value of the IDR against the local value of the USD were accompanied by fairly significant increases in the international value of the IDR against the USD in July and December. While the frequency of monitoring will inevitably account for some measure of discrepancy between the local values and international values of the IDR against the USD, the use of such an argument to explain the variances in July, September, November and December would be dubious at best. Table 4 demonstrates the inherent complexities of attempting to determine the value of local moneys during times of monetary system stability.

The resulting discrepancies between the local value of contemporary moneys and the international values of contemporary moneys become more extreme in situations of monetary system instability. Table 5 compares the local values of the IDR and the USD, adjusted for the respective inflation figures of the two countries for the periods examined; and the actual international exchange rate between the two local moneys during a twelve month period of monetary system instability following the 1997 Asian Financial Crisis. The relative change in the local value of the IDR against the local value of the USD reflects the strengthening/weakening of the local value of the IDR, while the relative change in the international value of the IDR against the USD is measured based upon the international currency exchange rate for the same period. Additionally, the table demonstrates the distinctions between the anticipated international value of the IDR against the USD in relation to changes in the local value of the IDR and USD due to inflation/deflation during the respective months; and the actual reported exchange rate for the last day of the months.

Table 5. Comparison of the Change in Value of the IDR Against the USD based upon Local Value, Adjusted for Inflation, and the Change in International Value of the IDR Against the USD based upon Currency Exchange Rates (CER), During a Period of Monetary System Instability

	Inflation Rate for Month Indonesia	Inflation Rate for Month US	Relative Monthly Inflation Rate of IDR in Relation to USD	Theoretical Result in Relation to Currency Exchange Rate	Actual Reported Exchange Rate Last Day of Month	Relative Change in Value of IDR Per USD (CER Based)
September 1997	-----	-----	--------	-------	3260	-------
October 1997	1.09%	0.25%	*-0.83095%*	3287.32	3,615.00	*-9.82020%*
November 1997	1.39%	*-0.06%*	*-1.43013%*	3335.01	3,650.00	*-0.95891%*
December 1997	0.79%	*-0.12%*	*-0.90287%*	3365.40	5,447.50	*-32.99679%*
January 1998	1.72%	0.19%	*-1.50413%*	3416.79	9,800.00	*-44.41327%*
February 1998	7.17%	0.19%	*-6.51302%*	3654.83	8,850.00	10.73446%
March 1998	12.67%	0.19%	*-11.07660%*	4110.09	8,520.00	3.87323%
April 1998	5.27%	0.18%	*-4.83519%*	4318.91	8,050.00	5.83850%
May 1998	4.70%	0.18%	*-4.31710%*	4513.78	11,150.00	*-27.80270%*
June 1998	5.24%	0.12%	*-4.86508%*	4744.61	14,700.00	*-24.14966%*
July 1998	4.64%	0.12%	*-4.31958%*	4958.81	13,100.00	12.21374%
August 1998	8.56%	0.12%	*-7.77451%*	5376.83	10,900.00	20.18348%
September 1998	3.75%	0.12%	*-3.49880%*	5571.77	10,675.00	2.10772%

Source of inflation data for United States: United State Bureau of Labor Statistics, United States Department of Labor. Source of inflation data for Indonesia: Badan Pusat Statistik. Source of currency exchange rate data: GoCurrency.com.

Table 5 demonstrates the increase in the inherent discrepancies between the local value of the IDR against the local value of the USD and the international value of the IDR against the USD during the period of monetary system instability that resulted from the Asian Financial Crisis in 1997. For example, the relatively minor decrease of the local value of the IDR against the local value of the USD in December of 1997 was accompanied by a decrease in the international value of the IDR against the USD of 32.99679%, while an 11.07660% decrease in the local value of the IDR against the local value of the USD was accompanied by 5.83850% increase in the international

value of the IDR against the value of the USD. Furthermore, the rapid decline in the international value of the IDR during the period examined in the table demonstrates that the resulting decrease in the international value of the IDR against the USD was almost two times the actual decrease in local value of the IDR against the local value of the USD in September of 1998; and over three times the actual decrease in local value of the IDR against the USD in June of 1998. In short, during times of monetary system instability, the changes in the local values and international values of two currencies can cease to correspond in any rational fashion, making it impossible to determine the value of affected moneys for the purposes of international economic transactions.

The resulting effects of the use of contemporary moneys in international economic transactions have several implications in light of *Shariah* prohibitions against *gharar* and *riba al-fadl*. While international economic transactions involving spot exchanges can be Shariah compliant in relation to normative standards concerning *gharar* if the transactions are completed immediately, this is not always the case. Due to practical considerations relating to international economic transactions, a spot exchange can be completed at any point within a 48-hour period. The period of time is sufficient for fluctuations of value during times of monetary system stability and results in uncertainty concerning the actual value of the remuneration received, albeit arguably relatively minor. In case of deferred payments and international economic transactions occurring or extending into periods of monetary instability, the risk and uncertainty associated with the use of contemporary moneys in international economic exchanges increases exponentially. In the case of international economic transactions involving forward contracts, the uncertainty rises due to potentially drastic fluctuations in the value of contemporary moneys within the international market, which is often accompanied by disparate and contradictory fluctuations in the local value of a monetary standard, particularly during times of monetary system instability. As a result, while international economic transactions involving spot exchanges between two parties operating within relatively stable monetary systems arguably does not result in *gharar* due to the significance of the level of uncertainty, all other transactions will inevitably incur significant risk and uncertainty regarding the future value of the remuneration to be paid/received.

In regards to *riba al-fadl*, a nuanced set of issues arises in relation to the use of contemporary moneys in international economic transactions. Little or no risk of the two scales of the balance not carrying the same value[79] exists where international spot exchanges are concluded immediately between two parties operating within relatively stable monetary systems, as the values of the goods and services; and the respective local moneys involved can be ascertained. International economic transactions involving spot exchanges that are concluded over any period of time during a period of relative monetary system stability are certain to incur an additional benefit/loss for one of the parties to the transaction. Although one could argue that international economic transactions involving spot exchanges occurring during a period of monetary system instability for one of the parties could be completed without the risk of incurring riba al-fadl, this does not hold true in light of the disparities between the local value and the international value of monetary standards affected by monetary system instability. The resulting disparity creates an environment where the value of the local money is seemingly impossible to determine for purposes of international economic transactions and such transactions would inevitably incur some degree of *riba al-fadl*, due to the fact the value of the money affected by monetary system instability cannot be accurately ascertained. However, international economic exchanges involving forward contracts will invariably incur *riba al-fadl* due to the demonstrated and unpredictable fluctuations of value which inevitably occur during both periods of relative monetary system stability and monetary system instability and result in additional benefit/loss for one party to the transaction. Another interesting issue that arises in relation to *riba al-fadl* relates to the determination of whether the scales of the balance carry the same balance in cases of monetary system instability. As noted above, if the local value and international value of a monetary standard are disparate and contradictory, the empirical evaluation of the additional benefit/loss incurred in the transaction as a result of the use of contemporary moneys becomes arduous, if not impossible, to assess. As a result, albeit for different underlying rationale, the only international economic transactions that will arguably not incur *riba al-fadl* are spot exchanges concluded immediately between two parties operating within relatively stable monetary systems.

[79] Chapra, *op. cit*., p. 52.

By-Products of Contemporary Moneys: Speculation and Speculative Markets

The resulting fluctuations in value of contemporary moneys, due to the nature of the moneys, have also contributed to extrinsic issues of economic transactions arising from the use of contemporary moneys. While the issues surveyed thus far are intrinsic, or arising due to the fundamental nature of contemporary moneys, further issues have arisen that are not extrinsic, or issues that are not essential elements, to economic transactions. Extrinsic issues are examined in light of their emergence in local economic transactions and international economic transactions, followed by an analysis of the issues in light of *Shariah* normative standards relating to *maysir*.

Extrinsic issues related to domestic economic transactions involving deferred payments include the speculation of the participants to the transaction, whose expectations of the value of local money have been demonstrated to have effects on the future value of local money, as noted above. While domestic spot exchanges are inherently free from uncertainty and risk arising from the value of local moneys, domestic transactions involving deferred payments and international transactions generally require the parties to the transaction to engage in speculation regarding the value of the local moneys involved in the economic transaction. The participants to the transaction essentially need to attempt to account for the unforeseeable and unpredictable future value of local moneys when negotiating and concluding a transaction. Any local economic transaction involving a deferred payment therefore requires speculation on the part of both parties to the transaction. While the nature of any commercial or business transaction will necessarily involve an assessment of the potential value of the goods or services in relation to supply and demand forces within the market, the nature of contemporary moneys further requires an additional element: the attempted prediction of the value of the money utilized in the transaction at a point in the future, which, as demonstrated, cannot be accurately forecasted.

International economic transactions encounter similar issues relating to the uncertainty of the future value of contemporary moneys as encountered during local economic transactions, but with an additional set of consequences. Extrinsic issues related to international economic transactions include foreign currency trading and the related trading of futures and forwards contracts. Foreign currency trading basically

involves the purchase of a sum of a different local money, with the ambit of reselling the sum at a later date to make a profit as a result of international exchange rate fluctuation. The trading of futures and forward contracts is essentially premised upon the same concept, but the futures and forwards contracts are initially traded into the market by participants of international economic transactions seeking to minimize the risks that arise from the fluctuation of values of local moneys within the international market by trading the forwards contracts or futures agreements now, rather than waiting until the date of maturity to determine whether they have incurred a benefit or a loss due to the fluctuation of the value of the local money during the period in which the contract matures. The act of hedging allows them to accept a sum of local money at present based upon the perceived potential for benefit or loss resulting in the fluctuation of the value of the local money utilized in the contract at a future date. As noted above, speculation concerning the international valuation of local moneys also plays a role in the international valuation of local moneys. Essentially, the existence of uncertainty in regards to the international valuation of local moneys has created and encouraged the growth of a speculation-based market, which is, in some instances, utilized as a means to reduce the risks and uncertainty associated with the fluctuation of the international valuation of local moneys by participants to international economic transactions involving deferred payments, while at the same time affecting the resulting outcomes concerning the international value of a local money in the international market.

In contradistinction to *gharar*, prohibitions against *maysir* and *riba* are rather absolute, as the determination of *riba* is made in relation to the empirical existence of an excess arising from the transaction and *maysir* is determined in accordance with whether the transaction inherently involves enrichment arising purely from chance. Speculation simply involves the attempt to determine an outcome that, in actuality, cannot be precisely determined and involves substantial elements of risk and uncertainty. While Islamic scholars and jurists acknowledge that risks can never fully be excluded, the prohibition of *maysir* applies to transactions and circumstances where the element of risk or gambling can reasonably be avoided.[80] Although Uberoi and Khadem note contention exists among scholars regarding whether speculation

[80] Visser, *op. cit*., pp. 45-46.

constitutes *maysir*,[81] speculation is generally seen as constituting *maysir*[82] if not constitutive of *prima facie* evidence of both *gharar* and *maysir*.[83] The absolutism associated with *maysir* has been demonstrated in the writings of scholars and decisions of national fatwa councils condemning practices associated with foreign currency trading under Shariah law. As such, economic transactions involving the use of contemporary moneys will inevitably incur some degree of *riba al-fadl* and *maysir*, while continuing to foster and encourage the development of speculation-based markets.

The Relationship between Riba al-Fadl, Gharar and Maysir Resulting from the Use of Contemporary Moneys in Economic Transactions

The resulting relationship between the *Shariah* prohibitions against *riba al-fadl*, *gharar* and *maysir* that emerges as a result of the use of contemporary moneys in economic transactions is of particular interest. The inherent *gharar* in economic transactions involving contemporary moneys, resulting from the uncertainty and risks associated with the value of local moneys in the future, inevitably results in *riba al-fadl*, as one party will potentially enjoy an excess arising from the transaction, resulting either from an excess in terms of the type of local money received from the economic transaction or an excess of goods or services in relation to the value of the sum of local money originally agreed to when the transaction was negotiated. The relationship between *riba al-fadl* and *gharar*, however, differs from the relationship between *gharar* and *maysir*. The intrinsic and extrinsic elements of *gharar* associated with international economic transactions and domestic economic transactions involving deferred payments inherently serve as the basis for *maysir*, arising from the need of participants to economic exchanges to engage in speculation; the emergence of speculation-based markets, involving activities such as foreign currency trading and the trading of futures and forwards contracts; and providing a means by which participants to an economic exchange can attempt to reduce or offset the inherent uncertainty and risks associated with the fluctuations in the international valuation of

[81] Uberoi and Khadem, *op. cit*., pp. 156-157.

[82] Visser, *op. cit.*, p. 45.

[83] Uberoi and Khadem, *op. cit*., pp. 155-156.

local moneys. The relationship is distinct from that of *riba al-fadl* because the resulting *maysir* effectively influences the level of *gharar* involved in economic transactions, due to the manner in which local moneys attain their relative values within the international market. Therefore, the resulting relationship consists of *gharar* serving as basis for both *riba al-fadl* and maysir in economic transactions, while the level of *gharar* encountered is constantly affected by extrinsic elements of maysir.

5. CONCLUSION

The present article considers the effects of the use of contemporary moneys in economic transactions in light of *Shariah* prohibitions against *riba*, *gharar* and *maysir*. The use of contemporary moneys, universally consisting of fiat-based moneys, inherently results in domestic economic transactions involving deferred payments and international economic transactions, in general, incurring *riba al-fadl*, *gharar* and *maysir*, irrespective of whether all other components of the transactions are *Shariah* compliant. Additionally, the nature of contemporary moneys has encouraged and led to the development of international speculative markets, premised upon activities amounting to *maysir*. As a result, the theoretical model of the relationship between *riba al-fadl*, *gharar* and *maysir* differs from the relationship between the three cornerstones in practice, as the theoretical relationship depicts *gharar* as a bridge between prohibitions against *riba al-fadl* and *maysir*; while the practical relationship demonstrates that *gharar* serves as the principal basis for both *riba al-fadl* and *maysir* in economic transactions – due to issues associated with the nature, value and founction of contemporary moneys –with *gharar* being reciprocally affected by extrinsic elements of *maysir*. The situation results from the fact that the only certainty concerning contemporary moneys is that their future values are uncertain.

The nature of contemporary moneys was also considered in relation to the moneys depicted in *Shariah* sources at various points throughout the present article. The most similar counterpart of contemporary moneys, consisting universally of fiat moneys, in *Shariah* studies of numismatics would appear to be that of *fulus* and *maghshush*, whose values were established by the government or issuing authority. The issues

faced in relation to contemporary moneys inherently support the practices of early Islamic societies in relation to such forms of money, utilizing such moneys solely for small local spot exchanges and relying upon more stable commodity-based moneys for the purposes of large domestic transactions and international transactions. Such practices inherently avoided the issues concerning the use of contemporary moneys in economic transactions.

Despite the incurrence of *riba al-fadl*, *gharar* and *maysir* as a result of the use of contemporary moneys in economic transactions, it is important to note, that as a result of the universal use of fiat money-based local moneys, that economic transactions involving the use of local moneys cannot be deemed impermissible under *Shariah* law. In light of the contemplation of the prohibition against *gharar* by scholars, since all contemporary moneys inherently share the same issues, the resulting *gharar* cannot be considered avoidable. Likewise, the inherent *maysir* associated with the inherent need to speculate regarding the future value of contemporary moneys when engaging in economic transactions cannot be deemed as being 'excessive', nor can the incurrence of *riba al-fadl* be deemed 'unjustifiable'. This, however, does not suggest that the existence of *riba al-fadl*, *gharar* and *maysir* in economic transactions involving fiat money-based local moneys can or should be ignored. Although this is a general rule where economic transactions incur *riba al-fadl* and *gharar* purely as a result of the use of contemporary moneys in such transactions, the application of the rule to *maysir* is nuanced in the sense that speculation is inherently required when engaging in economic transactions due to uncertainty of the future value of a monetary unit is permissible, while engaging in speculation within a speculative market is a conscious decision on the part of the individual and therefore avoidable.

The present study demonstrates the issues that arise in relation to the uncertainty of value of contemporary moneys in light of *Shariah* prohibitions prescribed in *fiqh muamalat*. The recommendations of the present study consist of preferable courses of future action regarding the nature of local moneys and future research. *Shariah* boards and councils should begin considering the nature of contemporary moneys in concert with economic experts, governmental agencies and central banks in an effort to determine whether a means can be developed to establish a *Shariah* compliant fiat-based monetary system. Additionally, the means by which contemporary moneys are

valued, particularly in regards to the international valuation methods associated with international currency exchange rates, should be re-evaluated in an effort to reduce or eliminate the *gharar* arising from the inherent variances in value that arise from the variety of factors and methods applied to the valuation of contemporary moneys. Furthermore, the creation of a universal monetary standard, similar to that which existed with commodity-based moneys, should be examined for the purposes of conducting more *Shariah* compliant international economic exchanges. Finally, a gradual movement towards the creation of novel primary or secondary monetary standard within an economic territory should be considered – such as the *dinar* and *dirham* standards that have recently been introduced in Kelantan, Malaysia – where the introduction of such standards is determined to be preferable and viable.

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WHY FINANCIAL DERIVATIVES MARKETS IN MALAYSIA UNDERPERFORMED: SWOT ANALYSIS

Yusmani Mohd Yusoff[1]

Abstract

Derivatives have grown to be an essential part of the financial markets because they can provide a number of economic functions. When used accurately, derivative products can turn into efficient tools in managing business risks. In the marketplace, derivatives can be used to develop product offerings to customers, deal with capital and funding costs, and modify the risk-reward profile of a particular item or an entire balance sheet. Most importantly, derivative transactions offer the prospect for financial institutions to diminish risks in the marketplace. Malaysia has shown improvement in using derivatives. However based on the studies by Bartram, Brown and Fehle (2003), 59.8 percent of 7,292 non-financial firms used derivatives. However in Malaysia, Malaysian firms only 20. 9 percent used derivatives. In term of ranking, Korea Exchange ranked first, India ranked fifth, China ranked eleven and twelve, Taiwan at seventeenth and Singapore ranked twenty-eight. Although Malaysia is among the earliest countries to introduce derivatives exchange but Malaysia is still not performing compared to other Asian countries and ranked only at forty-two. In view of that this paper intends to examine what are the problems that have hindered the performance of derivatives in Malaysia.

Keywords: Financial Derivatives, SWOT analysis

1. INTRODUCTION

Globalization has initiated lots of corporations to penetrate into global market and created new markets in derivatives trading. The improved new market has created wealth for corporations and created bigger risks. Corporations face variety of financial risks, which in some cases can be controlled and some cannot be controlled. Corporations must manage their risks, maximise company's value and improve management efficiency. In order to remain competitive and increase awareness in managing these risks, corporations need to focus in risk management in the financial derivatives. The use of financial derivatives to hedge against rising interest rate and foreign exchange exposure has become a common game.

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In recent years, market deregulation, expansion in global trade and advance technology has led to a consequent increase in demand for risk management products. This demand is reflected in the development of financial derivatives from the uniform futures and options products in the 1970s to an ample spectrum of over-the-counter (OTC) products that are accessible in the markets. Numerous products and instruments are frequently expressed as derivatives by the monetary press and market participants. Financial derivatives are generally defined as the instruments that mainly derive their value from the performance of an underlying asset or item, usually in interest or foreign exchange rates, equity, or commodity prices. Financial derivatives consist of futures, swaps, options, structured debt obligations and forward rate agreements. Lately, credit derivatives have been used progressively more by financial institutions to moderate potential financial problems experienced as a result of the breakdown of borrowers to perform in terms of loan transactions.

Derivatives have grown to be an essential part of the financial markets because they provide a number of economic functions. When used accurately, derivative products can turn into efficient tools in managing business risks. In the marketplace, derivatives can be used to develop product offerings to customers, deal with capital and funding costs, and modify the risk-reward profile of a particular item or an entire balance sheet. Most importantly, derivative transactions offer the prospect for financial institutions to diminish risks in the marketplace.

In Malaysia, financial derivatives have been introduced, since 1980's, when The Kuala Lumpur Commodity Exchange (KLCE) was structured to develop the marketing efficiency of a crude palm oil. The first futures contract traded on the KLCE was palm oil which was launched on October 23, 1980. Derivative market in Malaysia plays a significant role in the financial sector. Derivatives also help to enhance economic growth. In Malaysia, growth of the derivatives market may be attributed to three contracts: the CPO futures, KLCI Index futures and 3-Month KLIBOR futures. Malaysia market for derivatives has seen phenomenal growth over recent years. According to The World Bank, The Korean Stock Exchange has become the largest derivatives exchange in the world, and the rapid growth rates in Brazil, Mexico, China, India and Malaysia have propelled to the world’s top-2. Malaysia has improved in the growth of derivatives, although Malaysia was one of earlier markets

introduced derivatives instruments, there are several Asian exchanges have outperformed compared to Malaysia. In term of trading activity, exchanges in Korea, India, China and Taiwan have all outperformed Malaysia. The amount of trading on derivatives exchanges in the Asia-Pacific region grew by 42.8% in 2010 and most of the increase in volume came from exchanges in China, India and Korea[2] .

2. PROBLEM STATEMENT

In 1988, according to The International Finance Corporation (IFC) which is the private sector lending arm of the World Bank Group, Malaysia ranked second in the International Finance Corporation Index (IFCI Index) scoring 22 percent of size of derivatives market. But in the year 2010, the ranking fell to forty-two. However, other Asian countries such as Singapore experienced rapid growth. In 2000, the Singapore Exchange became the first publicly held stock exchange (SGX) in the Asia-Pacific, and listed its shares on its own exchange. As of 30 April 2010, the SGX had 757 listed companies with a combined market capitalization of US$490 billion and average daily turnover of US$1.1 billion[3]. According to Brown (2006), in 1980s Singapore ranked third as a trading centre for over the-counter energy products, after London and New York. Furthermore, Singapore focused on energy futures rather than commodity and grown in tandem with the growth in industrialization, shipping, and the accelerated economic changes in South East Asia since 1980 (Brown, 2006). Unfortunately Malaysia appeared to be lagging substantially compared to the performance of Singapore although Malaysia is the oldest and has long been involved in derivatives exchanges in Asia. Malaysia also introduced KLCI Futures ahead after Taiwan, India and Korea however the trading volume in these three countries are higher than compared to Malaysia. Why Malaysia's derivatives market is not performing? What are the causes that affect the performance of derivatives market in Malaysia?

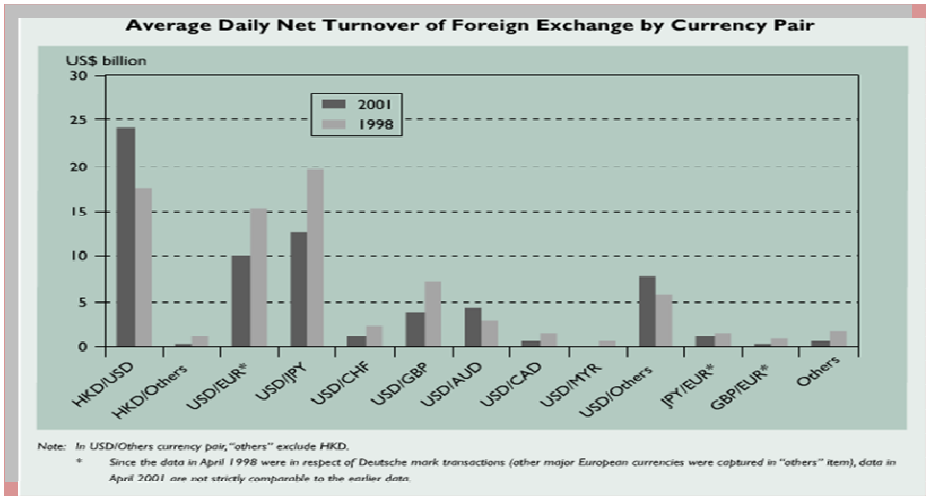
Bank Negara Malaysia has taken liberalisation measures to enhance competitiveness in the economy and to develop the domestic financial markets by allowing licensed onshore banks to trade in foreign currencies against other currencies and offer ringgit-

[2] Futures Industry Association (FIA) www.futuresindustry.org

[3] http://www.stocks-for-beginners.com/singapore-stock-exchange.html

based interest rate derivatives to non-bank of the non-residents. According to Bank Negara Malaysia, the measures would contribute towards increasing liquidity, depth and participation of a wider range of players in the domestic financial markets. However, will the introduction of these liberalisation measures would it enhance the growth of derivatives exchange in Malaysia? What are the indicators used to measure the growth of derivatives exchange? According to Bacha & Merican (2003), to measure the successful growth in derivatives exchange is that the turnover value should be equal to the value of turnover in the underlying market. The measurement is based on the nominal value of turnover that provide the most accurate indicator of the relative size of exchanges although trading is more easily compared on the basis of the number of contracts traded. According to the Bank of International Settlements (BIS), trading volume in the Asian region has raised around 150 per cent since 2004 and the average daily turnover in 2010 stood at US$515 billion. If so what is the percentage contributed by Malaysia in the trading volume? Figure 1, indicated that Malaysia is underperforming in term of average daily turnover of foreign exchange by currency pair since 1998 compared to other countries. In answering the questions, this paper is using SWOT analysis to examine the internal and external factors that contributed to the backwardness in the performance of the financial derivatives exchange in Malaysia.

Figure 1: Average Daily Net Turnover of Foreign Exchange by Currency Pair



(Source: Hong Kong Monetary Authority)

3. GROWTH OF FINANCIAL DERIVATIVES MARKET IN ASIA AND MALAYSIA

In 2010, Asian OTC foreign derivatives turnover account for US$442 billions and this represents 83% of the total turnover of OTC foreign exchange derivatives in the emerging markets (BIS, 2010). The fastest growth in equity derivative markets has been recorded in Asia. Korean Stock Exchange has become the largest derivatives exchange in the world, followed by India and Taiwan (Table 1). Asian derivative markets can be divided in three tiers; first tier is the major Asian exchanges which has already been demutualized. It consists of exchanges in Australia, Hong Kong and Singapore. The second tier exchanges are in the process of being demutualized and they are Korea, India, China and Malaysia. Table 1 shows that the Korean Futures Exchange has become the largest futures exchange in the world in terms of trading volume (FIA, 2010). The third tier exchanges consist of Thailand, Indonesia and Philippines. According to Ameer (2010), in Singapore and Hong Kong, foreigners can freely trade in the onshore market because they do not have any restrictions. The size of financial derivatives in Singapore is US$50 million and daily volume of forwards contract trading in Hong Kong is US$6 billion. In 2010, OTC foreign exchange derivatives turnover in Hong Kong is US$194 billion, while total OTC foreign exchange derivatives turnover in Singapore is US$175 billion (BIS, 2010).

Malaysia is the world's leader in the development of oil palm trees and producers of crude palm oil. Palm Oil contributes about 5-6 % of Malaysian GDP in 2007 and also provides employment to 1.4 million workers in the related industry[4]. Presently, Malaysia accounts for 41% of the world palm oil production and 47% of exports around the world. Malaysia is a global leader in oil palm plantations, production & export of palm products[5] . In order to ensure this industry grow rapidly and to meet the needs for price discovery, hedging mechanism to protect this industry, the trading of crude palm oil in the form of futures contracts have introduced in October 1980 (Bursa Malaysia's Crude Palm Oil Futures Contact (CPO) . The CPO has been traded on Malaysian derivative exchange via KLCE which has been established in 1980.

[4] World Development Bank Indicator 2007

[5] http://www.americanpalmoil.com/pdf/USITCpre-PublicHearing-V2.pdf

CPO futures contract was then the only one of its kind in the world. Several other commodity derivatives; rubber, tin and cocoa were introduced, but Malaysia failed to develop future market for these commodities. Crude palm oil remains as the main product.

Table 1: Top Derivatives Exchanges Worldwide (Ranked by Number of Futures and Options Traded and/or Cleared in 2010)

Rank	Exchange	Jan-Dec 2009	Jan-Dec 2010	% Change
1	Korea Exchange	3,102,891,777	3,748,861,401	20.80
2	CME Group (includes CBOT and Nymex)	2,589,555,745	3,080,492,118	19.00
3	Eurex (includes ISE)	2,647,406,849	2,642,092,726	-0.20
4	NYSE Euronext (includes U.S. and EU markets)	1,729,965,293	2,154,742,282	24.60
5	National Stock Exchange of India	918,507,122	1,615,788,910	75.90
6	BM&FBovespa	920,375,712	1,422,103,993	54.50
7	CBOE Group (includes CFE and C2)	1,135,920,178	1,123,505,008	-1.10
8	Nasdaq OMX (includes U.S. and Nordic markets)	815,545,867	1,099,437,223	34.80
9	Multi Commodity Exchange of India (includes MCX-SX)	385,447,281	1,081,813,643	180.7
10	Russian Trading Systems Stock Exchange	474,440,043	623,992,363	31.50
11	Shanghai Futures Exchange	434,864,068	621,898,215	43.00
12	Zhengzhou Commodity Exchange	227,112,521	495,904,984	118.40
13	Dalian Commodity Exchange	416,782,261	403,167,751	-3.30
14	Intercontinental Exchange (includes U.S., U.K. & Canadian markets)	263,582,881	328,946,083	24.80
15	Osaka Securities Exchange	166,085,409	196,350,279	18.20
16	JSE South Africa	174,505,220	169,898,609	-2.60
17	Taiwan Futures Exchange	135,125,695	139,792,891	3.50
18	Tokyo Financial Exchange	83,678,044	121,210,404	44.90
19	London Metal Exchange	111,930,828	120,258,119	7.40
20	Hong Kong Exchanges and Clearing	98,538,258	116,054,377	17.80
21	ASX Group (includes ASX and ASX 24)	82,200,578	106,386,077	29.40
22	Boston Options Exchange	137,784,626	91,754,121	-33.40
23	Tel-Aviv Stock Exchange	70,914,245	80,440,925	13.40
24	London Stock Exchange Group (includes IDEM and EDX)	77,490,255	76,481,330	-1.30
25	Mercado Español de Opciones y Futuros Financieros	93,057,252	70,224,176	-24.50
26	Turkish Derivatives Exchange	79,431,343	63,952,177	-19.50
27	Mercado a Término de Rosario	51,483,429	62,046,820	20.50
28	Singapore Exchange (includes Sicom and AsiaClear)	53,237,389	61,750,671	16.00
42	Malaysia Derivatives Exchange	6,137,827	6,154,745	0.30

In 1995, Malaysia introduced the KLSE CI Stock Index Futures contracts and then the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) as financial derivatives. Furthermore, in 1997, the Malaysian Monetary Exchange (MME) was launched to introduce the 3 month KLIBOR contract and this resulted Malaysia had three exchange trading with three derivatives products; CPO futures on the KLCE, Stock Index Futures on KLOFFE and 3 month KLIBOR futures on MME (Bacha and Merican, 2003). The three exchanges, KLCE, KLOFFE and MME have now been consolidated into a single exchange, the Malaysian Derivatives Exchange (MDEX) in June 2001.

Today, in Malaysia, derivatives exchange is Bursa Malaysia Derivatives Berhad (BMD), formerly known as Malaysia Derivatives Exchange Berhad (MDEX), is a 75% owned subsidiary of Bursa Malaysia Berhad which provides, operates and maintains futures and options exchanges[6] . In 2010, CME Group, the world's largest derivatives exchange bought 25 per cent stake in the local derivatives market, a wholly-owned subsidiary of Bursa Malaysia Bhd, expanding trading of commodity futures, increase the volume of existing products and introduce new products, would drive the market's growth[7] .

Derivative market in Malaysia plays an important role in the financial sector and it also helps to increase economic growth. The Malaysia market for derivatives has seen a phenomenal growth over recent years. According to The World Bank, The Korean Stock Exchange has become the largest derivatives exchange in the world, and extremely rapid growth rates in Brazil, Mexico, China, India and Malaysia have propelled their exchanges to the world's top-2 (Table 1). As we can see from Table 1, Malaysia has increased in the growth of derivatives, but based on the studies conducted by Bartram, Brown and Fehle (2003), across the whole sample of 7,292 non-financial firms, more than half (59.8%) use some kind of derivative, but only 20.9% of Malaysian firms in the sample use derivatives. In term of trading activity, exchanges in Korea, India, China and Taiwan have all outperformed Malaysia. In term of ranking, Korea Exchange ranked first, India was ranked fifth, China ranked

[6] Bursa Malaysia

[7] http://smeinternational.org/2011/03/bursa-malaysia-derivatives-to-up-daily-trade/

eleven and twelve, Taiwan was ranked seventeenth, and Singapore ranked twenty-eight. As we can see, even though Malaysia is among the earliest countries to introduce derivatives exchange, but Malaysia failed to performed compared to other Asian countries and ranked only forty-two.

4. SWOT ANALYSIS

Strengths

a) Financial Derivatives Provides Mechanism for Hedging

Financial derivatives in Malaysia provide a mechanism for hedging and risk reallocating among financial market participants, help to make financial markets more comprehensive. The main advantages of derivatives are to allow individuals and firms to achieve their payoff that they are not be able to achieve without derivatives, or can only be achieved at greater cost. Derivatives make it possible to hedge the risk that will not likely to hedge. The economic players should manage risk better as the risks should be borne by those who are in the best position to bear them and firm should take more risky projects with more profits by hedging. Smith and Stulz (1985) suggested that to maximize firm value is to hedge as hedging is part of overall corporate financing policies. Hedging can affect the value of the firm, through changes in tax liabilities, changes in stakeholder contract costs or the choice of monetary policy and the actual results of future investments. This implies that hedging could increase firm's value and reduce external demands such as the taxes paid to the government; bankruptcy costs (direct and indirect) and / or cost of the agency to coordinate the interests of management with the interests of capital providers. Financial derivatives in Malaysia play a role as an excellent hedging tool for institutional and corporate users for Malaysian bond and money markets for their short term, medium term long term interest rate exposure.

b) Pricing Benchmark

Financial derivatives in Malaysia serve as a pricing benchmark as well as a price discovery tool. Price discovery is important for the efficiency of the economy and it is imperative that the integrity of prices be protected (Dodd, 2002). Derivatives could provide the economic benefits by helping to complete imperfect commodity or

securities markets. Derivatives could also arbitrage between markets so that prices could be more efficiently reflect all the relevant information in the market.

c) Electronic Trading Platform

Trading for financial derivatives in Malaysia is traded on the electronic trading platforms. In 2008, Bursa Malaysia introduced the Electronic Trading Platform (ETP) for the Malaysian derivatives market and boosted the transparency and liquidity as well as increased trading efficiency. The implementation of this platform is to further improve market accessibility and increase trading efficiencies via infrastructure enhancement initiatives. This platform has been developed and adapted based on the Korea Exchange's bond trading system. It allows merchants to easily reconcile the bid with the offer, negotiate the offer, report transactions over-the-counter and access historical data through a common computerized network. ETP also offers real-time quotes to investors, financial institutions and money brokers benefit from a transparent business. ETP was built in collaboration with Korea Exchange's technology subsidiary KOSCOM which was instrumental in assisting Bursa Malaysia with the system development.

Weaknesses

a) Foreigners Freely Trade in the Onshore Market Only

A weakness of financial derivatives in Malaysia, in terms of foreign investors is that foreigners can freely trade in the onshore market only. Foreigners can only access the onshore forward market for the purpose of purchasing Malaysia securities listed on the stock exchange. As an example, non resident investors of MYR-denominated bonds issued by multilateral development banks and multinational corporations are only allowed to enter into forward foreign exchange contracts with onshore licensed banks to hedge currency risks. Otherwise, they can only enter into forwards of up to three working days' maturity for settlement purposes. This is because the government still maintains some strict regulations on the currency market.

b) Small Investors

The main investors in Malaysia financial derivatives are banks and Employee Provident Fund (EPF) or institutional investors. Only a small group of Malaysian firms such life and asset managers insurers being small investors hedged market risks.

This situation happened because Malaysian managers are risk disinclined and do not understand the advantage of taking position in derivatives market (Ameer, 2010). Malaysian Government Securities (MGS) dominate the bond market and are primarily issued to EPF to meet its investment needs and to finance government expenditures. At least about 85 percent MGS holders comprises the EPF, insurance companies, and commercial banks. More involvement of institutional investors should be encouraged in order to further enhance the trading activities.

c) A Cross-currency Swap Does Not Exist in Malaysia

A cross currency swap is an agreement between two parties to swap interest payments and principal on loans denominated in two different currencies. In a cross currency swap, a loan's interest payments and principal in one currency would be exchanged for an evenly valued loan and interest payments in a different currency. However in Malaysia, a cross-currency swap market does not exist. Interest rate swap is the only active over-the-counter derivatives products in the onshore market. Cross-currency swap allows the firm to switch its loan from one currency to another and allow them to choose whether it has a fixed or floating-rate interest.

d) Doing Business in Malaysia is still too Difficult

Many complicated bureaucratic procedures and long procedures would be encountered in doing business in Malaysia. This complex procedure has affected the cost of investment and potential return on investment. According to the New Economic Model, Malaysia's position in the Global Competitiveness Index fell from 21 to 24 in the 2010 report. The report showed that the country has lost its attractiveness as an investment destination. Although Malaysia stood at 23 out of 183 countries, doing business in Malaysia is still difficult compared to than that of the competitors such as Singapore and Thailand, particularly in the aspects of entry and exit of firms. Malaysia still has problem as regard to starting a business, registering property and dealing with construction permits. As a result Malaysia is left behind after Singapore and Thailand as indicated in Table 2. Institutional structures, processes and policies also contributed to the difficulty of doing business in Malaysia. The inconsistencies such as government policies such as corruption, tax regime, labour policy and inflation have been the main obstacles to establishing a business in Malaysia.

Table 2: Doing Business 2010 Report (Global ranking)

	Ease of Doing Business	Starting a Business	Dealing with construction permits	Registering property	Trading across borders	Enforcing contracts
Singapore	1	4	2	16	1	13
New Zealand	2	1	5	3	26	10
Hong Kong	3	18	1	75	2	3
US	4	8	25	12	18	8
UK	5	16	16	23	16	23
THAILAND	12	55	13	6	12	24
JAPAN	15	91	45	54	17	20
S. KOREA	19	53	23	71	8	5
MALAYSIA	23	88	109	86	36	59

Opportunities

a) Rising Awareness of Importance of Financial Derivatives as Risk Management Tool

Since the fall of Bretton Woods System in the middle of 1970s, risk management has been a matter of continuous concern to most corporations. The study by Ameer (2010) indicated the importance of risk management and derivatives usage. The study found that 59 percent of respondents mentioned that the main purposed of risk management in their organization is to reduce volatility, while 19 percent of the respondents stated that they used risk management to increase profit and 7 percent is used to manage their performance. Although the number of corporations in Malaysia using derivatives as risk management tool is still low but it has shown an improvement. This reflects the awareness by the investors that financial derivatives are one of the best ways to control risks.

b) Liberalisation Measures

Malaysia announced further steps to liberalize its domestic foreign exchange and interest rate derivatives markets, including allowing residents to buy and sell foreign currencies through licensed onshore banks. According to Bank Negara Malaysia, to further deepen the domestic interest rate derivatives market, a licensed onshore bank is allowed to offer ringgit-denominated interest rate derivatives to a non-bank non-resident (Bank Negara Malaysia, 2012).

c) ASEAN Capital Markets Forum (ACMF)

ASEAN Capital Markets Forum (ACMF) comprises securities regulators from 10 ASEAN jurisdictions, namely Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. ACMF proposed to establish a Group of Experts (GOE) to assist in drafting a proposal for Implementation Plan. This is done in order to promote the Development of an Integrated Capital Market to achieve the objectives of the AEC Blueprint 2015 (Implementation Plan 2015). The AEC Blueprint 2015 pertaining to capital markets seeks to achieve significant progress in building a regionally integrated market within the region: i) capital can move freely; ii) issuers are free to raise capital anywhere; and iii) investors can invest anywhere. In such a market, anyone would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market intermediaries being able to provide services throughout ASEAN based on home country approval.

Threats

a) Asian Currency Crisis

Malaysia's economy slowing down, especially since the Asian financial crisis in 1997-1998 in which Malaysia's position as a leading economy in Asia has been drastically eroded. Malaysia's real GDP growth is 5.0 percent for year 2011, lower than other countries such as Indonesia (6.2 percent), Cambodia (6.8 percent) and Vietnam (6.8 percent) are also affected by the crisis. Total investment did not increase when private investors took the approach to reduce investment and the generators of the aggregate investment to GDP in Malaysia also continued to decline. Investment was 40 percent of GDP in Malaysia in the mid 1990s; however since 1997 it has steadily fallen, reaching just 20 percent of GDP right before the 2008 global financial crisis. Since the Asian financial crisis, Malaysia has undergone a great change in the aggregate investment trend. But other Asian countries like Indonesia has shown a significant recovery in investment levels since the crisis took place, but in contrast, Malaysia level of aggregate investment as a percentage of GDP continued to decline as indicated in Figure 2. Contraction in aggregate investment in Malaysia, mostly driven by the decline in private investment has stagnated. On the other hand, Singapore and Thailand experienced a strong recovery in private investment since the Asian financial crisis. According to Bacha & Merican (2003), during this period, the

Asian currency crisis, Malaysia has started the process of market liberalization. What it does is to increase the risk exposure for the benefit of companies and entrepreneurs. These companies and entrepreneurs have the benefit to borrowing in local currency and foreign currency rather than equity assets. Policy responses to financial crises have significant implications for derivatives market. As a result derivatives market in Malaysia suffered a decline after the Asian financial crisis due to the merger of the three exchanges into Malaysia Derivatives Exchange, which is a commodity and equity futures in equal proportions.

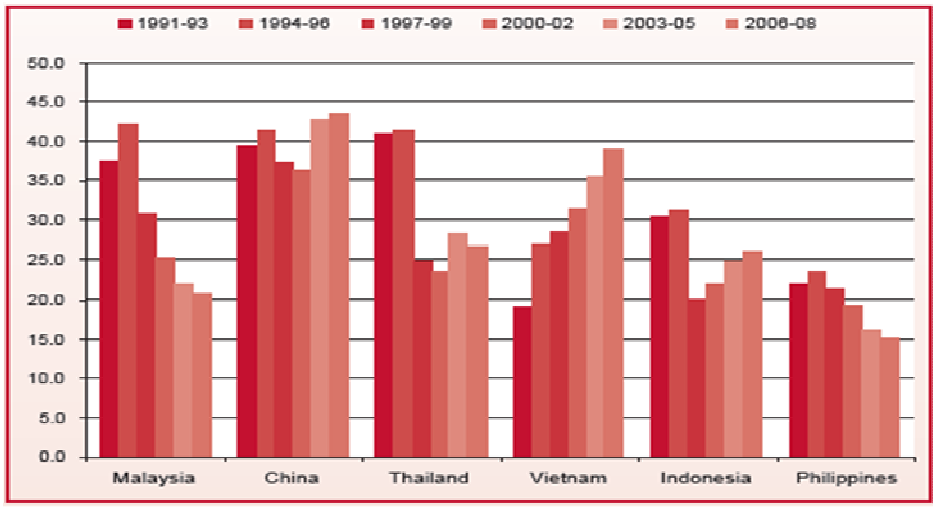


Figure 2 Investment as percent of GDP, average (1991-2008 ;%)
(Source: Malaysia New Economic Model)

b) Globalization

Globalization has brought many benefits to emerging countries, especially Malaysia. However, globalization has also increased volatility and uncertainty of financial instruments prices. After global financial crisis, differences in the growth and interest rate differential have resulted in uncertainty and strong capital flows in Malaysia. These capital flows could pose a risk to our economy if not dealt with carefully as disorderly movement in the exchange rate will cause higher hedging cost, push down interest rate in the bond market which will lead to complicate monetary policy (Bank Negara Malaysia).

c) Competition from Other Regional Financial Derivatives Markets.

SGX-Derivatives (formerly the Singapore International Monetary Exchange, SIMEX) offer a portfolio of foreign products which are able to attract foreign investors to use

their derivatives. The exchange is unique among its world peers in having a predominantly foreign product portfolio. With its base established in the Eurodollar contract, the Singapore exchange was able to exploit less sophisticated neighbouring markets.

5. RECOMMENDATION

a) Ongoing Awareness Campaign about the Advantages of Financial Derivatives

One of the great opportunities for financial derivatives in Malaysia is the rising awareness of the importance of financial derivatives as risk management tool. This opportunity should be taken by the Bursa Malaysia and the Malaysian government to conduct various awareness campaigns about the advantages of financial derivatives, especially when financial derivatives could provide hedging mechanisms which mean derivatives make it possible to hedge the risk that will not likely to hedge. The economic players could manage risk better as the risks will be borne by those who are in the best position to bear them and the firm could invest in more risky projects and will still be profitable by hedging.

b) Offer Product that Meet the Needs of Different Groups of Customers

There is vast potential market for financial derivatives when Malaysia announced further steps to liberalize its domestic foreign exchange and interest rate derivatives markets and this include allowing residents to buy and sell foreign currencies through licensed onshore banks. Financial derivatives play an important role for the group of investors to benefit from this new liberalisation. Where this is the opportunity for Bursa Malaysia to identify what products can really attract these investors? Current liberalisation will help to find a single product that has mass demand for this group of investors and launching the product in a manner that will capture the demand.

c) Opportunity of Establishment of ASEAN Capital Markets Forum (ACMF)

With the establishment of ASEAN Capital Markets Forum (ACMF), where anyone would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market

intermediaries being able to provide services throughout ASEAN based on home country approval. This Global integration will remove barriers such as capital controls and withholding taxes and opening the domestic markets and institutions to the free cross border flow of capital and financial services. It will directly enhance the role of financial derivatives as risk management through hedging as it could increase firm's value. At the same time it will reduce external demands such as the taxes paid to the government; bankruptcy costs (direct and indirect) and/or agency cost to coordinate the interests of management with the interests of capital providers.

d) Increase the Number of Investors through Liberalisation

When the Malaysian government announced further steps to liberalize its domestic foreign exchange and interest rate derivatives markets, including allowing residents to buy and sell foreign currencies through licensed onshore banks. This could increase the number of derivatives investors in the financial markets in Malaysia. This is could be done by offering ringgit-denominated interest rate derivatives to a non-bank non-resident (Bank Negara Malaysia).

e) Re-evaluate Procedures of Doing Business in Malaysia

With new liberalisation, probability for the increasing number of investors is large, Malaysian government need to look back procedures of doing business in Malaysia. It is pointless in introducing new liberalisation if there are many complicated bureaucratic procedures and long waiting to be encountered for doing business in Malaysia. Therefore government has to reduce the bureaucracy and re-evaluate the current procedures to be able to attract foreign investors so as to enhance the growth of financial derivatives in Malaysia. Government could offer grants and financial incentives for financial firms that need to set up in the Malaysia.

f) Develop New Growth Product

Response to the Asian financial crisis has resulted in pressure on the derivative market in Malaysia. Three derivatives exchange now has been incorporated into the Malaysia Derivatives Exchange. The merger is to simplify the stock market intermediaries to trade in derivatives. Indirectly, the crisis has been the impetus of efforts to improve derivative market as a mechanism for a more comprehensive risk management by hedging. Financial derivatives used hedging mechanism in order to

mitigate risks. Malaysia should look at the latest trends which offer dividend futures and options as a new sophisticated trading in hedging.

g) Improve Bursa Malaysia's Volatility

Globalization has increased volatility and uncertainty of financial instruments prices. Bursa Malaysia has volatility at 13 percent which is the least volatile exchange in the region compared to Singapore, Hong Kong and Japan. Singapore, Hong Kong and Japan volatility rate stood at 25 percent, 22 percent and 23 percent respectively (Economic Transformation Program). While Malaysia may have benefited from low volatility during the global financial crisis, the current low-level volatility has resulted in low trading activities and low liquidity impacting the overall attractiveness of the market. Malaysia therefore needs to allow more volatility and open it to the market to determine the pricing and with not too rigid control so that its developments will not be hindered because of the constraints. This is required if Malaysia need to see more active trading in derivatives markets.

h) Integrate with Leading Exchanges

After global financial crisis, differences in growth and interest rate differential have resulted in uncertainty and strong capital flows in Malaysia, these capital flows can pose a risk to our economy if not dealt with carefully. In an effort to address the issue of globalization, which could contribute to Malaysia's financial crisis, hence Bursa Malaysia needs to integrate with other leading exchanges. The integration will allow Bursa Malaysia to get access to a larger demand pool as well as an intermediary base and open up a wider spectrum of product offerings.

6. CONCLUSION

One of the great opportunities for financial derivatives in Malaysia is the rising awareness of the importance of financial derivatives as risk management tool. This opportunity should be taken by the Bursa Malaysia and the Malaysian government to conduct various awareness campaigns. The information about the advantages of financial derivatives, especially when financial derivatives could provide hedging mechanisms and derivatives make it possible to hedge the risk that will not likely to

hedge. In order to become more competitive, financial derivatives market in Malaysia has to find a single product that has mass demand and launch the product in a manner that will capture the demand. Government could arrange for seminars to investors to promote the understanding of the available derivative products. Malaysia government has to reduce bureaucracy and re-evaluate the current procedures to be able to attract foreign investors and can directly increase the growth of financial derivatives in Malaysia. Government could provide grants and financial incentives for financial firms to be setting up in the Malaysia. In an effort to address the issue of globalization, which can contribute to Malaysia's financial crisis, Bursa Malaysia needs to integrate with other leading exchanges. The integration will allow Bursa Malaysia to get access to a larger demand pool as well as an intermediary base and open up a wider spectrum of product offerings.

Figure 3: SWOT Analysis of Financial Derivatives Market in Malaysia



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WHY FINANCIAL DERIVATIVES MARKETS IN MALAYSIA UNDERPERFORMED: SWOT ANALYSIS

Yusmani Mohd Yusoff[1]

Abstract

Derivatives have grown to be an essential part of the financial markets because they can provide a number of economic functions. When used accurately, derivative products can turn into efficient tools in managing business risks. In the marketplace, derivatives can be used to develop product offerings to customers, deal with capital and funding costs, and modify the risk-reward profile of a particular item or an entire balance sheet. Most importantly, derivative transactions offer the prospect for financial institutions to diminish risks in the marketplace. Malaysia has shown improvement in using derivatives. However based on the studies by Bartram, Brown and Fehle (2003), 59.8 percent of 7,292 non-financial firms used derivatives. However in Malaysia, Malaysian firms only 20. 9 percent used derivatives. In term of ranking, Korea Exchange ranked first, India ranked fifth, China ranked eleven and twelve, Taiwan at seventeenth and Singapore ranked twenty-eight. Although Malaysia is among the earliest countries to introduce derivatives exchange but Malaysia is still not performing compared to other Asian countries and ranked only at forty-two. In view of that this paper intends to examine what are the problems that have hindered the performance of derivatives in Malaysia.

Keywords: Financial Derivatives, SWOT analysis

1. INTRODUCTION

Globalization has initiated lots of corporations to penetrate into global market and created new markets in derivatives trading. The improved new market has created wealth for corporations and created bigger risks. Corporations face variety of financial risks, which in some cases can be controlled and some cannot be controlled. Corporations must manage their risks, maximise company's value and improve management efficiency. In order to remain competitive and increase awareness in managing these risks, corporations need to focus in risk management in the financial derivatives. The use of financial derivatives to hedge against rising interest rate and foreign exchange exposure has become a common game.

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In recent years, market deregulation, expansion in global trade and advance technology has led to a consequent increase in demand for risk management products. This demand is reflected in the development of financial derivatives from the uniform futures and options products in the 1970s to an ample spectrum of over-the-counter (OTC) products that are accessible in the markets. Numerous products and instruments are frequently expressed as derivatives by the monetary press and market participants. Financial derivatives are generally defined as the instruments that mainly derive their value from the performance of an underlying asset or item, usually in interest or foreign exchange rates, equity, or commodity prices. Financial derivatives consist of futures, swaps, options, structured debt obligations and forward rate agreements. Lately, credit derivatives have been used progressively more by financial institutions to moderate potential financial problems experienced as a result of the breakdown of borrowers to perform in terms of loan transactions.

Derivatives have grown to be an essential part of the financial markets because they provide a number of economic functions. When used accurately, derivative products can turn into efficient tools in managing business risks. In the marketplace, derivatives can be used to develop product offerings to customers, deal with capital and funding costs, and modify the risk-reward profile of a particular item or an entire balance sheet. Most importantly, derivative transactions offer the prospect for financial institutions to diminish risks in the marketplace.

In Malaysia, financial derivatives have been introduced, since 1980's, when The Kuala Lumpur Commodity Exchange (KLCE) was structured to develop the marketing efficiency of a crude palm oil. The first futures contract traded on the KLCE was palm oil which was launched on October 23, 1980. Derivative market in Malaysia plays a significant role in the financial sector. Derivatives also help to enhance economic growth. In Malaysia, growth of the derivatives market may be attributed to three contracts: the CPO futures, KLCI Index futures and 3-Month KLIBOR futures. Malaysia market for derivatives has seen phenomenal growth over recent years. According to The World Bank, The Korean Stock Exchange has become the largest derivatives exchange in the world, and the rapid growth rates in Brazil, Mexico, China, India and Malaysia have propelled to the world’s top-2. Malaysia has improved in the growth of derivatives, although Malaysia was one of earlier markets

introduced derivatives instruments, there are several Asian exchanges have outperformed compared to Malaysia. In term of trading activity, exchanges in Korea, India, China and Taiwan have all outperformed Malaysia. The amount of trading on derivatives exchanges in the Asia-Pacific region grew by 42.8% in 2010 and most of the increase in volume came from exchanges in China, India and Korea[2] .

2. PROBLEM STATEMENT

In 1988, according to The International Finance Corporation (IFC) which is the private sector lending arm of the World Bank Group, Malaysia ranked second in the International Finance Corporation Index (IFCI Index) scoring 22 percent of size of derivatives market. But in the year 2010, the ranking fell to forty-two. However, other Asian countries such as Singapore experienced rapid growth. In 2000, the Singapore Exchange became the first publicly held stock exchange (SGX) in the Asia-Pacific, and listed its shares on its own exchange. As of 30 April 2010, the SGX had 757 listed companies with a combined market capitalization of US$490 billion and average daily turnover of US$1.1 billion[3]. According to Brown (2006), in 1980s Singapore ranked third as a trading centre for over the-counter energy products, after London and New York. Furthermore, Singapore focused on energy futures rather than commodity and grown in tandem with the growth in industrialization, shipping, and the accelerated economic changes in South East Asia since 1980 (Brown, 2006). Unfortunately Malaysia appeared to be lagging substantially compared to the performance of Singapore although Malaysia is the oldest and has long been involved in derivatives exchanges in Asia. Malaysia also introduced KLCI Futures ahead after Taiwan, India and Korea however the trading volume in these three countries are higher than compared to Malaysia. Why Malaysia's derivatives market is not performing? What are the causes that affect the performance of derivatives market in Malaysia?

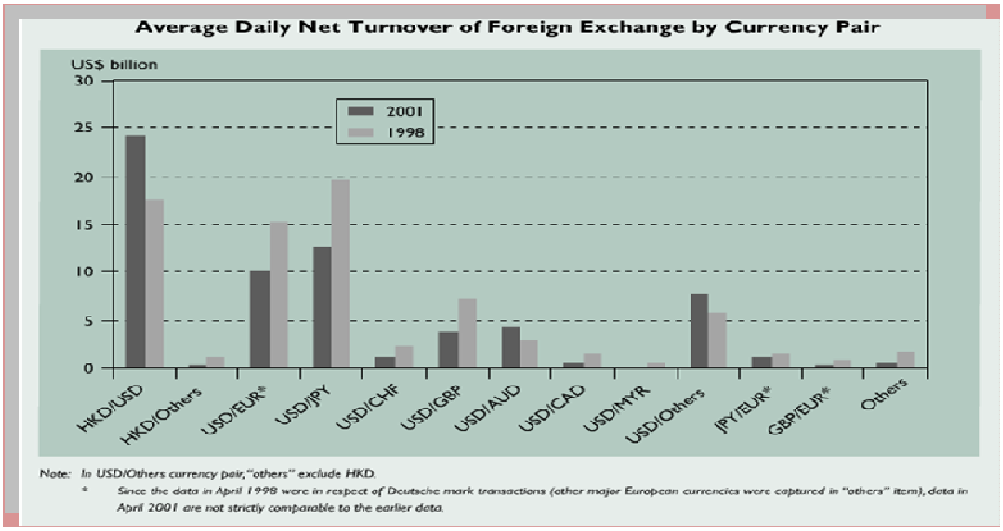
Bank Negara Malaysia has taken liberalisation measures to enhance competitiveness in the economy and to develop the domestic financial markets by allowing licensed

[2] Futures Industry Association (FIA) www.futuresindustry.org

[3] http://www.stocks-for-beginners.com/singapore-stock-exchange.html

onshore banks to trade in foreign currencies against other currencies and offer ringgit-based interest rate derivatives to non-bank of the non-residents. According to Bank Negara Malaysia, the measures would contribute towards increasing liquidity, depth and participation of a wider range of players in the domestic financial markets. However, will the introduction of these liberalisation measures would it enhance the growth of derivatives exchange in Malaysia? What are the indicators used to measure the growth of derivatives exchange? According to Bacha & Merican (2003), to measure the successful growth in derivatives exchange is that the turnover value should be equal to the value of turnover in the underlying market. The measurement is based on the nominal value of turnover that provide the most accurate indicator of the relative size of exchanges although trading is more easily compared on the basis of the number of contracts traded. According to the Bank of International Settlements (BIS), trading volume in the Asian region has raised around 150 per cent since 2004 and the average daily turnover in 2010 stood at US$515 billion. If so what is the percentage contributed by Malaysia in the trading volume? Figure 1, indicated that Malaysia is underperforming in term of average daily turnover of foreign exchange by currency pair since 1998 compared to other countries. In answering the questions, this paper is using SWOT analysis to examine the internal and external factors that contributed to the backwardness in the performance of the financial derivatives exchange in Malaysia.

Figure 1: Average Daily Net Turnover of Foreign Exchange by Currency Pair



(Source: Hong Kong Monetary Authority)

3. GROWTH OF FINANCIAL DERIVATIVES MARKET IN ASIA AND MALAYSIA

In 2010, Asian OTC foreign derivatives turnover account for US$442 billions and this represents 83% of the total turnover of OTC foreign exchange derivatives in the emerging markets (BIS, 2010). The fastest growth in equity derivative markets has been recorded in Asia. Korean Stock Exchange has become the largest derivatives exchange in the world, followed by India and Taiwan (Table 1). Asian derivative markets can be divided in three tiers; first tier is the major Asian exchanges which has already been demutualized. It consists of exchanges in Australia, Hong Kong and Singapore. The second tier exchanges are in the process of being demutualized and they are Korea, India, China and Malaysia. Table 1 shows that the Korean Futures Exchange has become the largest futures exchange in the world in terms of trading volume (FIA, 2010). The third tier exchanges consist of Thailand, Indonesia and Philippines. According to Ameer (2010), in Singapore and Hong Kong, foreigners can freely trade in the onshore market because they do not have any restrictions. The size of financial derivatives in Singapore is US$50 million and daily volume of forwards contract trading in Hong Kong is US$6 billion. In 2010, OTC foreign exchange derivatives turnover in Hong Kong is US$194 billion, while total OTC foreign exchange derivatives turnover in Singapore is US$175 billion (BIS, 2010).

Malaysia is the world's leader in the development of oil palm trees and producers of crude palm oil. Palm Oil contributes about 5-6 % of Malaysian GDP in 2007 and also provides employment to 1.4 million workers in the related industry[4]. Presently, Malaysia accounts for 41% of the world palm oil production and 47% of exports around the world. Malaysia is a global leader in oil palm plantations, production & export of palm products[5] . In order to ensure this industry grow rapidly and to meet the needs for price discovery, hedging mechanism to protect this industry, the trading of crude palm oil in the form of futures contracts have introduced in October 1980 (Bursa Malaysia's Crude Palm Oil Futures Contact (CPO) . The CPO has been traded on Malaysian derivative exchange via KLCE which has been established in 1980. CPO futures contract was then the only one of its kind in the world. Several other

[4] World Development Bank Indicator 2007

[5] http://www.americanpalmoil.com/pdf/USITCpre-PublicHearing-V2.pdf

commodity derivatives; rubber, tin and cocoa were introduced, but Malaysia failed to develop future market for these commodities. Crude palm oil remains as the main product.

Table 1: Top Derivatives Exchanges Worldwide (Ranked by Number of Futures and Options Traded and/or Cleared in 2010)

Rank	Exchange	Jan-Dec 2009	Jan-Dec 2010	% Change
1	Korea Exchange	3,102,891,777	3,748,861,401	20.80
2	CME Group (includes CBOT and Nymex)	2,589,555,745	3,080,492,118	19.00
3	Eurex (includes ISE)	2,647,406,849	2,642,092,726	-0.20
4	NYSE Euronext (includes U.S. and EU markets)	1,729,965,293	2,154,742,282	24.60
5	National Stock Exchange of India	918,507,122	1,615,788,910	75.90
6	BM&FBovespa	920,375,712	1,422,103,993	54.50
7	CBOE Group (includes CFE and C2)	1,135,920,178	1,123,505,008	-1.10
8	Nasdaq OMX (includes U.S. and Nordic markets)	815,545,867	1,099,437,223	34.80
9	Multi Commodity Exchange of India (includes MCX-SX)	385,447,281	1,081,813,643	180.7
10	Russian Trading Systems Stock Exchange	474,440,043	623,992,363	31.50
11	Shanghai Futures Exchange	434,864,068	621,898,215	43.00
12	Zhengzhou Commodity Exchange	227,112,521	495,904,984	118.40
13	Dalian Commodity Exchange	416,782,261	403,167,751	-3.30
14	Intercontinental Exchange (includes U.S., U.K. & Canadian markets)	263,582,881	328,946,083	24.80
15	Osaka Securities Exchange	166,085,409	196,350,279	18.20
16	JSE South Africa	174,505,220	169,898,609	-2.60
17	Taiwan Futures Exchange	135,125,695	139,792,891	3.50
18	Tokyo Financial Exchange	83,678,044	121,210,404	44.90
19	London Metal Exchange	111,930,828	120,258,119	7.40
20	Hong Kong Exchanges and Clearing	98,538,258	116,054,377	17.80
21	ASX Group (includes ASX and ASX 24)	82,200,578	106,386,077	29.40
22	Boston Options Exchange	137,784,626	91,754,121	-33.40
23	Tel-Aviv Stock Exchange	70,914,245	80,440,925	13.40
24	London Stock Exchange Group (includes IDEM and EDX)	77,490,255	76,481,330	-1.30
25	Mercado Español de Optiones y Futuros Financieros	93,057,252	70,224,176	-24.50
26	Turkish Derivatives Exchange	79,431,343	63,952,177	-19.50
27	Mercado a Término de Rosario	51,483,429	62,046,820	20.50
28	Singapore Exchange (includes Sicom and AsiaClear)	53,237,389	61,750,671	16.00
42	Malaysia Derivatives Exchange	6,137,827	6,154,745	0.30

In 1995, Malaysia introduced the KLSE CI Stock Index Futures contracts and then the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) as financial derivatives. Furthermore, in 1997, the Malaysian Monetary Exchange (MME) was launched to introduce the 3 month KLIBOR contract and this resulted Malaysia had three exchange trading with three derivatives products; CPO futures on the KLCE, Stock Index Futures on KLOFFE and 3 month KLIBOR futures on MME (Bacha and Merican, 2003). The three exchanges, KLCE, KLOFFE and MME have now been consolidated into a single exchange, the Malaysian Derivatives Exchange (MDEX) in June 2001.

Today, in Malaysia, derivatives exchange is Bursa Malaysia Derivatives Berhad (BMD), formerly known as Malaysia Derivatives Exchange Berhad (MDEX), is a 75% owned subsidiary of Bursa Malaysia Berhad which provides, operates and maintains futures and options exchanges[6] . In 2010, CME Group, the world's largest derivatives exchange bought 25 per cent stake in the local derivatives market, a wholly-owned subsidiary of Bursa Malaysia Bhd, expanding trading of commodity futures, increase the volume of existing products and introduce new products, would drive the market's growth[7] .

Derivative market in Malaysia plays an important role in the financial sector and it also helps to increase economic growth. The Malaysia market for derivatives has seen a phenomenal growth over recent years. According to The World Bank, The Korean Stock Exchange has become the largest derivatives exchange in the world, and extremely rapid growth rates in Brazil, Mexico, China, India and Malaysia have propelled their exchanges to the world's top-2 (Table 1). As we can see from Table 1, Malaysia has increased in the growth of derivatives, but based on the studies conducted by Bartram, Brown and Fehle (2003), across the whole sample of 7,292 non-financial firms, more than half (59.8%) use some kind of derivative, but only 20.9% of Malaysian firms in the sample use derivatives. In term of trading activity, exchanges in Korea, India, China and Taiwan have all outperformed Malaysia. In term of ranking, Korea Exchange ranked first, India was ranked fifth, China ranked

[6] Bursa Malaysia

[7] http://smeinternational.org/2011/03/bursa-malaysia-derivatives-to-up-daily-trade/

eleven and twelve, Taiwan was ranked seventeenth, and Singapore ranked twenty-eight. As we can see, even though Malaysia is among the earliest countries to introduce derivatives exchange, but Malaysia failed to performed compared to other Asian countries and ranked only forty-two.

4. SWOT ANALYSIS

Strengths

d) Financial Derivatives Provides Mechanism for Hedging

Financial derivatives in Malaysia provide a mechanism for hedging and risk reallocating among financial market participants, help to make financial markets more comprehensive. The main advantages of derivatives are to allow individuals and firms to achieve their payoff that they are not be able to achieve without derivatives, or can only be achieved at greater cost. Derivatives make it possible to hedge the risk that will not likely to hedge. The economic players should manage risk better as the risks should be borne by those who are in the best position to bear them and firm should take more risky projects with more profits by hedging. Smith and Stulz (1985) suggested that to maximize firm value is to hedge as hedging is part of overall corporate financing policies. Hedging can affect the value of the firm, through changes in tax liabilities, changes in stakeholder contract costs or the choice of monetary policy and the actual results of future investments. This implies that hedging could increase firm's value and reduce external demands such as the taxes paid to the government; bankruptcy costs (direct and indirect) and / or cost of the agency to coordinate the interests of management with the interests of capital providers. Financial derivatives in Malaysia play a role as an excellent hedging tool for institutional and corporate users for Malaysian bond and money markets for their short term, medium term long term interest rate exposure.

e) Pricing Benchmark

Financial derivatives in Malaysia serve as a pricing benchmark as well as a price discovery tool. Price discovery is important for the efficiency of the economy and it is imperative that the integrity of prices be protected (Dodd, 2002). Derivatives could provide the economic benefits by helping to complete imperfect commodity or

securities markets. Derivatives could also arbitrage between markets so that prices could be more efficiently reflect all the relevant information in the market.

f) Electronic Trading Platform

Trading for financial derivatives in Malaysia is traded on the electronic trading platforms. In 2008, Bursa Malaysia introduced the Electronic Trading Platform (ETP) for the Malaysian derivatives market and boosted the transparency and liquidity as well as increased trading efficiency. The implementation of this platform is to further improve market accessibility and increase trading efficiencies via infrastructure enhancement initiatives. This platform has been developed and adapted based on the Korea Exchange's bond trading system. It allows merchants to easily reconcile the bid with the offer, negotiate the offer, report transactions over-the-counter and access historical data through a common computerized network. ETP also offers real-time quotes to investors, financial institutions and money brokers benefit from a transparent business. ETP was built in collaboration with Korea Exchange's technology subsidiary KOSCOM which was instrumental in assisting Bursa Malaysia with the system development.

Weaknesses

e) Foreigners Freely Trade in the Onshore Market Only

A weakness of financial derivatives in Malaysia, in terms of foreign investors is that foreigners can freely trade in the onshore market only. Foreigners can only access the onshore forward market for the purpose of purchasing Malaysia securities listed on the stock exchange. As an example, non resident investors of MYR-denominated bonds issued by multilateral development banks and multinational corporations are only allowed to enter into forward foreign exchange contracts with onshore licensed banks to hedge currency risks. Otherwise, they can only enter into forwards of up to three working days' maturity for settlement purposes. This is because the government still maintains some strict regulations on the currency market.

f) Small Investors

The main investors in Malaysia financial derivatives are banks and Employee Provident Fund (EPF) or institutional investors. Only a small group of Malaysian firms such life and asset managers insurers being small investors hedged market risks.

This situation happened because Malaysian managers are risk disinclined and do not understand the advantage of taking position in derivatives market (Ameer, 2010). Malaysian Government Securities (MGS) dominate the bond market and are primarily issued to EPF to meet its investment needs and to finance government expenditures. At least about 85 percent MGS holders comprises the EPF, insurance companies, and commercial banks. More involvement of institutional investors should be encouraged in order to further enhance the trading activities.

g) A Cross-currency Swap Does Not Exist in Malaysia

A cross currency swap is an agreement between two parties to swap interest payments and principal on loans denominated in two different currencies. In a cross currency swap, a loan's interest payments and principal in one currency would be exchanged for an evenly valued loan and interest payments in a different currency. However in Malaysia, a cross-currency swap market does not exist. Interest rate swap is the only active over-the-counter derivatives products in the onshore market. Cross-currency swap allows the firm to switch its loan from one currency to another and allow them to choose whether it has a fixed or floating-rate interest.

h) Doing Business in Malaysia is still too Difficult

Many complicated bureaucratic procedures and long procedures would be encountered in doing business in Malaysia. This complex procedure has affected the cost of investment and potential return on investment. According to the New Economic Model, Malaysia's position in the Global Competitiveness Index fell from 21 to 24 in the 2010 report. The report showed that the country has lost its attractiveness as an investment destination. Although Malaysia stood at 23 out of 183 countries, doing business in Malaysia is still difficult compared to than that of the competitors such as Singapore and Thailand, particularly in the aspects of entry and exit of firms. Malaysia still has problem as regard to starting a business, registering property and dealing with construction permits. As a result Malaysia is left behind after Singapore and Thailand as indicated in Table 2. Institutional structures, processes and policies also contributed to the difficulty of doing business in Malaysia. The inconsistencies such as government policies such as corruption, tax regime, labour policy and inflation have been the main obstacles to establishing a business in Malaysia.

Table 2: Doing Business 2010 Report (Global ranking)

	Ease of Doing Business	Starting a Business	Dealing with construction permits	Registering property	Trading across borders	Enforcing contracts
Singapore	1	4	2	16	1	13
New Zealand	2	1	5	3	26	10
Hong Kong	3	18	1	75	2	3
US	4	8	25	12	18	8
UK	5	16	16	23	16	23
THAILAND	12	55	13	6	12	24
JAPAN	15	91	45	54	17	20
S. KOREA	19	53	23	71	8	5
MALAYSIA	23	88	109	86	36	59

Opportunities

d) Rising Awareness of Importance of Financial Derivatives as Risk Management Tool

Since the fall of Bretton Woods System in the middle of 1970s, risk management has been a matter of continuous concern to most corporations. The study by Ameer (2010) indicated the importance of risk management and derivatives usage. The study found that 59 percent of respondents mentioned that the main purposed of risk management in their organization is to reduce volatility, while 19 percent of the respondents stated that they used risk management to increase profit and 7 percent is used to manage their performance. Although the number of corporations in Malaysia using derivatives as risk management tool is still low but it has shown an improvement. This reflects the awareness by the investors that financial derivatives are one of the best ways to control risks.

e) Liberalisation Measures

Malaysia announced further steps to liberalize its domestic foreign exchange and interest rate derivatives markets, including allowing residents to buy and sell foreign currencies through licensed onshore banks. According to Bank Negara Malaysia, to further deepen the domestic interest rate derivatives market, a licensed onshore bank is allowed to offer ringgit-denominated interest rate derivatives to a non-bank non-resident (Bank Negara Malaysia, 2012).

f) ASEAN Capital Markets Forum (ACMF)

ASEAN Capital Markets Forum (ACMF) comprises securities regulators from 10 ASEAN jurisdictions, namely Brunei Darussalam, Cambodia, Indonesia, Laos PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam. ACMF proposed to establish a Group of Experts (GOE) to assist in drafting a proposal for Implementation Plan. This is done in order to promote the Development of an Integrated Capital Market to achieve the objectives of the AEC Blueprint 2015 (Implementation Plan 2015). The AEC Blueprint 2015 pertaining to capital markets seeks to achieve significant progress in building a regionally integrated market within the region: i) capital can move freely; ii) issuers are free to raise capital anywhere; and iii) investors can invest anywhere. In such a market, anyone would be able to trade in ASEAN capital market products freely in any ASEAN market at a competitive fee from a single access point, with capital market intermediaries being able to provide services throughout ASEAN based on home country approval.

Threats

d) Asian Currency Crisis

Malaysia's economy slowing down, especially since the Asian financial crisis in 1997-1998 in which Malaysia's position as a leading economy in Asia has been drastically eroded. Malaysia's real GDP growth is 5.0 percent for year 2011, lower than other countries such as Indonesia (6.2 percent), Cambodia (6.8 percent) and Vietnam (6.8 percent) are also affected by the crisis. Total investment did not increase when private investors took the approach to reduce investment and the generators of the aggregate investment to GDP in Malaysia also continued to decline. Investment was 40 percent of GDP in Malaysia in the mid 1990s; however since 1997 it has steadily fallen, reaching just 20 percent of GDP right before the 2008 global financial crisis. Since the Asian financial crisis, Malaysia has undergone a great change in the aggregate investment trend. But other Asian countries like Indonesia has shown a significant recovery in investment levels since the crisis took place, but in contrast, Malaysia level of aggregate investment as a percentage of GDP continued to decline as indicated in Figure 2. Contraction in aggregate investment in Malaysia, mostly driven by the decline in private investment has stagnated. On the other hand, Singapore and Thailand experienced a strong recovery in private investment since the Asian financial crisis. According to Bacha & Merican (2003), during this period, the

Asian currency crisis, Malaysia has started the process of market liberalization. What it does is to increase the risk exposure for the benefit of companies and entrepreneurs. These companies and entrepreneurs have the benefit to borrowing in local currency and foreign currency rather than equity assets. Policy responses to financial crises have significant implications for derivatives market. As a result derivatives market in Malaysia suffered a decline after the Asian financial crisis due to the merger of the three exchanges into Malaysia Derivatives Exchange, which is a commodity and equity futures in equal proportions.

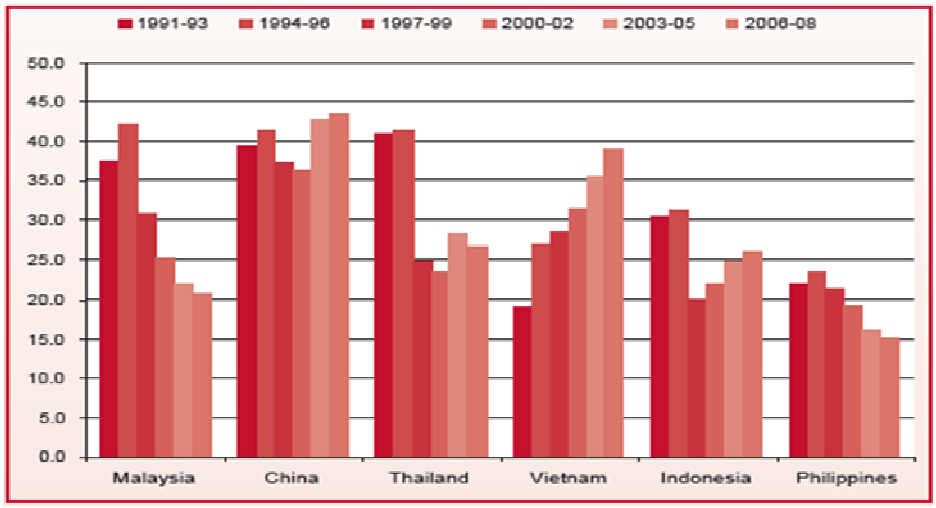


Figure 2 Investment as percent of GDP, average (1991-2008 ;%)
(Source: Malaysia New Economic Model)

e) Globalization

Globalization has brought many benefits to emerging countries, especially Malaysia. However, globalization has also increased volatility and uncertainty of financial instruments prices. After global financial crisis, differences in the growth and interest rate differential have resulted in uncertainty and strong capital flows in Malaysia. These capital flows could pose a risk to our economy if not dealt with carefully as disorderly movement in the exchange rate will cause higher hedging cost, push down interest rate in the bond market which will lead to complicate monetary policy (Bank Negara Malaysia).

f) Competition from Other Regional Financial Derivatives Markets.

SGX-Derivatives (formerly the Singapore International Monetary Exchange, SIMEX) offer a portfolio of foreign products which are able to attract foreign investors to use

their derivatives. The exchange is unique among its world peers in having a predominantly foreign product portfolio. With its base established in the Eurodollar contract, the Singapore exchange was able to exploit less sophisticated neighbouring markets.

5. RECOMMENDATION

a) Ongoing Awareness Campaign about the Advantages of Financial Derivatives

One of the great opportunities for financial derivatives in Malaysia is the rising awareness of the importance of financial derivatives as risk management tool. This opportunity should be taken by the Bursa Malaysia and the Malaysian government to conduct various awareness campaigns about the advantages of financial derivatives, especially when financial derivatives could provide hedging mechanisms which mean derivatives make it possible to hedge the risk that will not likely to hedge. The economic players could manage risk better as the risks will be borne by those who are in the best position to bear them and the firm could invest in more risky projects and will still be profitable by hedging.

b) Offer Product that Meet the Needs of Different Groups of Customers

There is vast potential market for financial derivatives when Malaysia announced further steps to liberalize its domestic foreign exchange and interest rate derivatives markets and this include allowing residents to buy and sell foreign currencies through licensed onshore banks. Financial derivatives play an important role for the group of investors to benefit from this new liberalisation. Where this is the opportunity for Bursa Malaysia to identify what products can really attract these investors? Current liberalisation will help to find a single product that has mass demand for this group of investors and launching the product in a manner that will capture the demand.

c) Opportunity of Establishment of ASEAN Capital Markets Forum (ACMF)

With the establishment of ASEAN Capital Markets Forum (ACMF), where anyone would be able to trade in ASEAN capital market products freely in any ASEAN

market at a competitive fee from a single access point, with capital market intermediaries being able to provide services throughout ASEAN based on home country approval. This Global integration will remove barriers such as capital controls and withholding taxes and opening the domestic markets and institutions to the free cross border flow of capital and financial services. It will directly enhance the role of financial derivatives as risk management through hedging as it could increase firm's value. At the same time it will reduce external demands such as the taxes paid to the government; bankruptcy costs (direct and indirect) and/or agency cost to coordinate the interests of management with the interests of capital providers.

d) Increase the Number of Investors through Liberalisation

When the Malaysian government announced further steps to liberalize its domestic foreign exchange and interest rate derivatives markets, including allowing residents to buy and sell foreign currencies through licensed onshore banks. This could increase the number of derivatives investors in the financial markets in Malaysia. This is could be done by offering ringgit-denominated interest rate derivatives to a non-bank non-resident (Bank Negara Malaysia).

e) Re-evaluate Procedures of Doing Business in Malaysia

With new liberalisation, probability for the increasing number of investors is large, Malaysian government need to look back procedures of doing business in Malaysia. It is pointless in introducing new liberalisation if there are many complicated bureaucratic procedures and long waiting to be encountered for doing business in Malaysia. Therefore government has to reduce the bureaucracy and re-evaluate the current procedures to be able to attract foreign investors so as to enhance the growth of financial derivatives in Malaysia. Government could offer grants and financial incentives for financial firms that need to set up in the Malaysia.

f) Develop New Growth Product

Response to the Asian financial crisis has resulted in pressure on the derivative market in Malaysia. Three derivatives exchange now has been incorporated into the Malaysia Derivatives Exchange. The merger is to simplify the stock market intermediaries to trade in derivatives. Indirectly, the crisis has been the impetus of efforts to improve derivative market as a mechanism for a more comprehensive risk

management by hedging. Financial derivatives used hedging mechanism in order to mitigate risks. Malaysia should look at the latest trends which offer dividend futures and options as a new sophisticated trading in hedging.

g) Improve Bursa Malaysia's Volatility

Globalization has increased volatility and uncertainty of financial instruments prices. Bursa Malaysia has volatility at 13 percent which is the least volatile exchange in the region compared to Singapore, Hong Kong and Japan. Singapore, Hong Kong and Japan volatility rate stood at 25 percent, 22 percent and 23 percent respectively (Economic Transformation Program). While Malaysia may have benefited from low volatility during the global financial crisis, the current low-level volatility has resulted in low trading activities and low liquidity impacting the overall attractiveness of the market. Malaysia therefore needs to allow more volatility and open it to the market to determine the pricing and with not too rigid control so that its developments will not be hindered because of the constraints. This is required if Malaysia need to see more active trading in derivatives markets.

h) Integrate with Leading Exchanges

After global financial crisis, differences in growth and interest rate differential have resulted in uncertainty and strong capital flows in Malaysia, these capital flows can pose a risk to our economy if not dealt with carefully. In an effort to address the issue of globalization, which could contribute to Malaysia's financial crisis, hence Bursa Malaysia needs to integrate with other leading exchanges. The integration will allow Bursa Malaysia to get access to a larger demand pool as well as an intermediary base and open up a wider spectrum of product offerings.

6. CONCLUSION

One of the great opportunities for financial derivatives in Malaysia is the rising awareness of the importance of financial derivatives as risk management tool. This opportunity should be taken by the Bursa Malaysia and the Malaysian government to conduct various awareness campaigns. The information about the advantages of financial derivatives, especially when financial derivatives could provide hedging

mechanisms and derivatives make it possible to hedge the risk that will not likely to hedge. In order to become more competitive, financial derivatives market in Malaysia has to find a single product that has mass demand and launch the product in a manner that will capture the demand. Government could arrange for seminars to investors to promote the understanding of the available derivative products. Malaysia government has to reduce bureaucracy and re-evaluate the current procedures to be able to attract foreign investors and can directly increase the growth of financial derivatives in Malaysia. Government could provide grants and financial incentives for financial firms to be setting up in the Malaysia. In an effort to address the issue of globalization, which can contribute to Malaysia's financial crisis, Bursa Malaysia needs to integrate with other leading exchanges. The integration will allow Bursa Malaysia to get access to a larger demand pool as well as an intermediary base and open up a wider spectrum of product offerings.

Figure 3: SWOT Analysis of Financial Derivatives Market in Malaysia



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PERANAN DAN APLIKASI *AL-QAWA'ID AL-FIQHIYYAH* DALAM SISTEM KEWANGAN ISLAM DI MALAYSIA

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Abstrak

Kertas kerja ini menumpukan perbincangkan mengenai peranan dan aplikasi *al-Qawa'id al-Fiqhiyyah* dalam Sistem Kewangan Islam di Malaysia. Sistem kewangan Islam di Malaysia telah mengalami evolusi yang begitu ketara melalui penawaran produk-produk kewangan yang menepati perkembangan dan keperluan semasa. Perkembangan sistem kewangan Islam ini sudah pastinya memerlukan sandaran yang kukuh dari sudut ilmu-ilmu pengajian perundangan Islam yang pelbagai seperti *al-Fiqh, Usul al-Fiqh* dan termasuk *al-Qawa'id Fiqhiyyah. Qawa'id Fiqhiyyah* yang merujuk kepada prinsip-prinsip utama dan pecahan dari setiap prinsip tersebut, mampu untuk merumus dan mensabitkan hukum berkaitan pelaksanaan urusniaga produk-produk kewangan dengan penggunaan instrumen yang sesuai. Antara contoh yang boleh diberikan adalah, penawaran produk-produk yang berasaskan kepada jual beli kredit dan pinjaman oleh institusi-institusi perbankan Islam serta kegilaan pengguna untuk melanggan produk-produk tersebut bagi mendapatkan sesuatu perkhidmatan atau barangan dengan cepat dan mudah. Merujuk kepada persoalan ini, terdapat beberapa kaedah dan prinsip fiqh yang boleh dijadikan panduan terhadap pelaksanaan urusniaga tersebut sama ada ia boleh diteruskan atau sebaliknya seperti kaedah yang menyatakan "*darurat adalah berasaskan kadar yang diperlukan sahaja"* serta "*sesuatu kesempitan dan kepayahan boleh diperluaskan*. Justeru itu, *Qawa'id Fiqhiyyah* perlu dijadikan asas serta panduan kepada pelaksanaan amalan kewangan dan perbankan oleh institusi-institusi kewangan Islam di Malaysia.

Keywords: *Qawa'id al-Fiqhiyyah*, Perbankan Islam, *Usul al-Fiqh*

1. PENDAHULUAN

Perundangan Islam dengan konsep dan strukturnya yangbegitu jelas sangat sesuai dan menepati semua situasi kehidupan manusia dari semasa ke semasa. Konsep ini perlu difahami dengan strukturnyayang merangkumi dalil primer darisumber-sumber yang bersandarkan kepada nas-nas al-Quran dan al-Sunnah dan dalil sekunder yang terhasil dari sumber-sumber *ijma`*[3], *qiyas*[4], *maslahah*[5], *istihsan*[6] dan sebagainya

[1] Kolej Universiti Islam Melaka
[2] Universiti Teknikal Malaysia, Melaka
[3] Merupakan sumber perundangan Islam yang ketiga iaitu kesepakatan para ulama` setiap zaman terhadap permasalahan hukum syara` selepas kewafatan Nabi SAW.

(Zaydan:1993). Kewujudan sumber-sumber dalam perundangan Islam sebagaimana yang telah dinyatakan memberikan ruang kepada manusia yang hidup bermasyarakat untuk menyelesaikan permasalahan-permasalahan yang timbul kesan dari kehidupan mereka yang semakin kompleks dan pelbagai. Untuk itu, maka wujudlah teori-teori fiqh yang telah dikemukakan oleh para ulama` sejak dari zaman tabi`in dan tabi` tabi`in hinggalah kini berpandukan kepada sumber-sumber yang pelbagai dalam perundangan Islam. Teori-teori fiqh yang telah dihasilkan tidak hanya tertumpu kepada satu aliran pemikiran sahaja, bahkan ia terus berkembang dan bercambah kepada beberapa aliran utama antaranya*Hanafiyyah, Malikiyyah, Syafi`iyyah* dan *Hanabilah.* Mereka semua telah memainkan peranan yang sangat penting dalam mengistinbat serta merumuskan hukum terhadap permasalahan-permasalahan yang timbul dan seterusnya mencipta teori-teori tertentu sebagai landasan kepada para ulama` kontemporari untuk terus berijtihad dan berfatwa.

Sebahagian dari pengamalan hukum adalah berasaskan kepada *taqlid* iaitu dengan berpegang kepada ijtihad dan fatwa-fatwa daripada imam-imam mazhab tertentu. Namun begitu, pengamalan terhadap sesuatu hukum secara bertindan atau bertindih dengan pelbagai mazhab dalam masa yang sama adalah dibenarkan, dengan syarat-syarat yang telah ditetapkan contohnya ketika berada dalam keadaan darurat atau dengan tujuan untuk meluaskan lagi pengamalan hukum yang telah sedia ada. Konsep pengamalan hukum secara bertindan dan bertindih ini dalam pengajian perundangan Islam dinamakan sebagai *talfiq*[7]*(*al-Sayyidiy:1994*)*. Kesan dari itu, proses-proses ijitihad dan penfatwaan sangat perlu buat masa ini kerana pelbagai permasalahan

[4] Merupakan sumber perundangan Islam yang keempat iaitu menyamakan sesuatu permasalahan baru yang tidak mempunyai nas dengan permasalahan yang telah tersedia ada hukumnya disebabkan persamaan illah.

[5] Iaitu sesuatu perkara yang membawa kepada kebaikan dan menolak dar berlakunya kemudaratan dan kerosakan.

[6] Banyak pentakrifan telah dibuat oleh para ulama` terhadap pengertian istihsan ini. Penulis mengambil satu sahaja pentakrifan yang telah diberikan oleh para ulama` tersebut iaitu pentakrifan daripada al-Bazdawiy: Menukar hukum yang dikiaskan kepada hukum kias yang lebih kuat daripadanya atau mengkhususkan hukum qiyas disebabkan kewujudan dalil yang lebih kuat daripadanya.

[7]*Talfiq*" pada bahasa Arab bermaksud himpun dan cantum. Manakala pada istilah pula membawa erti: Menghimpunkan pandangan mazhab-mazhab yang berbeza pada satu masalah, sehinggakan terhasil amalan yang tidak diakui oleh mana mujtahid.

hukum yang timbul berkaitan urusan harian penghidupan manusia yang terhasil dari kemajuan semasa sama ada yang melibatkan tuntutan individu terhadap individu lain mahupun tuntutan yang melibatkan masyarakat dalam kelompok yang lebih besar termasuklah hal-hal yang berkaitan dengan urusan kewangan dan perbankan.

Sistem kewangan dan perbankan Islam kini diperbincangkan secara meluas dan ia sedang mengalami perkembangan yang sangat pesat dari semasa ke semasa kesan dari kesedaran dan keinginan sebahagian masyarakat dunia kepada Islam. Antara permasalahan berkaitan kewangan dan perbankan Islam timbul disebabkan oleh beberapa faktor dengan mengambilkira terhadap kehendak masyarakat Islam khususnya yang berteraskan kepada ketaatan kepada agama dan kemahuan yang tinggi kepada kesucian harta. Selain dari itu dalam masa yang sama, penubuhan sesebuah institusi kewangan dan perbankan juga didorong oleh keinginan untuk mendapatkan keuntungan dalam aktiviti perniagaan yang dijalankan serta keberkatan terhadap perolehan harta kekayaan tersebut. Justeru itu, perkembangan sistem kewangan dan perbankan yang sangat pesat ini memerlukan kepada usaha-usaha ijtihad dan penfatwaan baru bagi membantu dunia Islam amnya dan umat Islam Malaysia khasnya untuk membuat penilaian dan melibatkan diri dalam sistem kewangan dan perbankan yang boleh menjamin kebahagiaan mereka di dunia dan di akhirat.

2. PENGENALAN KEPADA *QAWAID FIQHIYYAH*

Kajian dan pengajian dalam disiplin ilmu al-fiqh yang telah dikembangkan oleh para ulama` al-Syafi`iyyah salah satu daripadanya adalah *al-Qawaid al-Fiqhiyyah*. Ia merupakan gabungan dua perkataan yang menjadi satu rangkai kata iaitu *al-Qawaid* dan *al-Fiqh*. *Al-Qawaid* menurut pengertian bahasa adalah kata nama jama' dari perkataan kaedah yang membawa pengertian asas kepada sesuatu(Kamil:2006). Menurut istilah *al-Fiqh* pula, ia merupakansatu kaedah umum yang dipecahkan menjadi kaedah-kaedah secara khusus yang lebih terperinci (Kamil:2006). *Al-Fiqh* pula menurut pengertian bahasa adalah faham,dan secara istilahnyaia membawa pengertian memahami hukum hakam syara` yang berkaitan dengan perbuatan mukallaf yang dirumuskan daripada dalil-dalil yang terperinci (Zaydan:1993). Oleh

itu, pengertian rangkap kata *al-Qawaid al-Fiqhiyyah* adalah kaedah-kaedah asas permasalahan hukum syara` yang umum untuk mendapatkan natijah permasalahan hukum syara` yang lebih terperinci dan khusus (Kamil:2006).

Seterusnya kita boleh mendapatkan banyak hasil-hasil penulisan para ulama' daripada empat mazhab mu`tabar berkaitan pengajian dan pengkajian ilmu *al-Qawaid al-Fiqhiyyah*. Antara karya-karya hasil dari penulisan tersebut adalah (Kamil:2006):

a. Mazhab Hanafiy
   i. *Uṣūl al-Karhiy* (261 H. – 340 H). Kitab ini telah dibuat kajian lanjutan oleh al-Imam Najm al-Din al-Nasafiy (537).
   ii. *Ta`sīs al-Naẓar*, dikarang oleh Abu Zayd al-Dabūsiy (430 H).
   iii. *Al-Asybāh wa al-Nazā'ir*, karangan Zayn al-Din Ibrahim Bin Muhammad al-Syahīr (970 H).

b. Mazhab Malikiy
   i. *Uṣūl al-Fatāyā* oleh Imam Muhammad al-Harith Bin Asad al-Khasyani (361 H).
   ii. *Al-Furūq* oleh Abu al-Abbas Ahmad Bin Idris al-Qarafi (684 H).
   iii. *Al-Qawā'id*, dikarang oleh Muhammad Bin Muhammad al-Muqarri al-Maliki (758 H).

c. Mazhab Syafi`i
   i. *Qawā'id al-Aḥkām fi Maṣālih al-Anām* oleh al-Imam `Iz al-Din Bin Abd al-Salam (660H).
   ii. *Al-Asybāh wa al-Nazā'ir*, karangan oleh Ibn al-Wakil al-Syafi`e (716 H.). Kitab ini merupakan kitab yang pertama mengunapakai nama al-Asybah wa al-Nazair. Kitab ini telah dibuat kajian lanjutan oleh ramai ulama` mazhab Syafi`iyyah iaitu Ibn al-Subki (771 H), al-Zarkasyi (794 H) dan Ibn al-Mulqin (804 H).
   iii. *Majmū` al-Muhadhdhab fi Qawā'id al-Madhhab* oleh al-Hafiz Khalil Bin Kaikalidi al-`Alai (671 H).
   iv. *Al-Asybāh wa al-Nazā'ir*, karangan Taj al-Din Ibn al-Subki (771 H).

v. *Al-Manthūr fi Tartīb al-Qawa᷾id al-Fiqhiyyah*, karangan oleh al-Imam al-Zarkasyi (794 H).

iv. *Al-Asybaẖ wa Al-Naẓa᷾ir*, karangan oleh Imam Jalal al-Din Abd al-Rahman al-Suyuti (911 H).

d. Mazhab Hanbali

i. *Al-Qawa᷾id al-Nūrāniyyah al-Fiqhiyyah* oleh Imam Ibn Taimiyyah (727 H).

ii. *Al-Qawa᷾id al-Fiqhiyyah* oleh Ibn al-Qadhi al-Jabal (771 H).

iii. *Taqrīr al-Qawa᷾id wa Taḥrīr al-Fawa᷾id* oleh Ibn Rajb (795 H).

Sekiranya kita melihat kepada karya-karya hasil penulisan para ulama` sebagaimana yang telah dinyatakan, hasil karya penulisan oleh Imam al-Suyuti dari mazhab al-Syafi`iyboleh dianggap sebagai penulisan yang terbaik dari sudut penyusunannya kerana ia merupakan kajian lanjutan terhadap empat karya ulama` terdahulu iaitu Ibn al-Wakil (716 H), Ibn al-Subki (771 H), al-Zarkasyi (794 H) dan Ibn al-Mulqin (804 H). (Kamil:2006)

3. PERKEMBANGAN SISTEM KEWANGAN ISLAM DI MALAYSIA

Kesedaran umat Islam Malaysia terhadap pengamalan sistem kewangan Islam bukanlah satu fenomena yang baru. Ia telah dipraktikkan seawal abad ke 16 lagi dan perkara ini dapat dilihat dalam undang-undang Melaka yang telah memperuntukkan satu fasal berkaitan larangan mengamalkan riba. Begitu juga dengan pengamalan masyarakat petani di sebelah utara semenanjung Malaysia seperti Kedah, Perak dan Perlis serta pantai timur semenanjung Malaysia iaitu Kelantan yang telah menerima pakai amalanmenjual sesuatu (barangan atau harta) yang membolehkan mereka membuat pilihan untuk membeli semula barangan atau harta tersebut pada masa akan datang dan ia dipanggil sebagai jualbeli janji *(Bay` al-Wafa᷾).* Amalanjualan beli dengan pilihan seperti ini *(Bay` al-Wafa᷾)* diamalkan kerana golongan petani tidak mahu terlibat dengan urusniaga pembiayaan atau pinjaman yang berasaskan riba. Pada tahun 1969, Kerajaan Malaysia telah menubuhkan Lembaga Urusan dan Tabung

Haji atau sebelumnya dikenali sebagai Perbadanan Wang Simpanan Bakal-bakal Haji bagi membolehkan umat Islam menyimpan wang dan menanam modal dengan pengamalan yang bertepatandengan sistem muamalat Islam tanpa melibatkan sebarang unsur-unsur riba. Seterusnya usaha yang berterusan telah dilakukan untuk menubuhkan sebuah Bank Islam di Malaysia dan ia telah bermula sejak tahun 1970an lagi di mana perwakilan daripada Mesir dan Pakistan dalam Mesyuarat Kedua Menteri-menteri Luar pada tahun 1971 telah mengusulkan dan mengemukakan cadangan agar ditubuhkan bank Islam di negara-negara Islam. Oleh itu, pada bulan Julai 1983 kerajaan telah meluluskanpenubuhan sebuah bank Islam di Malaysia dengan menggunakanjenama Bank Islam Malaysia Berhad (BIMB). Setelah itu dengan perkembangan sistem perbankan Islam yang semakin meluas, maka pada 1 Oktober 1999 sebuah lagi institusi perbankan Islam telah ditubuhkan iaitu Bank Muamalat Malaysia Berhad (BMMB) dania merupakan bank Islam kedua di Malaysia selepas BIMB. Sehingga tahun 2012, terdapat empat kategori institusi perbankan yang berdaftar dengan Bank Negara Malaysia iaitu : (Sumber Bank Negara Malaysia:2012)

i. Institusi Perbankan Islam tempatan berjumlah 16 buah bank.
ii. Institusi Perbankan Islam Antarabangsa berjumlah 5 buah bank.
iii. Institusi Perbankan Perdagangan berjumlah 23 buah bank.
iv. Institusi Perbankan Pelaburan berjumlah 15 buah bank.

Berdasarkan tinjauan melalui maklumat di atas, terdapat sebanyak 21[8]buah institusi perbankan Islam yang berdaftar di Malaysia dan bergerak secara aktif dengan menawarkan produk-produk kewangan melalui instrumen-instrumen yang berteraskan muamalat Islam sama ada yang melibatkan kepada simpanan, pembiayaan (pinjaman) mahupun pelaburan. Produk-produk tersebut perlu sentiasa mengalami proses-proses evolusi untuk membolehkannya berkembang dari semasa ke semasa kerana tuntutan masyarakat yang pelbagai dan persaingan di kalangan institusi-institusi perbankan tersebut. Oleh itu, pelaksanaan dalam urusniaga bagi produk-produk tersebut memerlukan kajian demi kajian dari perspektif syariah untuk memastikan pelaksanaannya tidak tersasar dariyang telah digariskan dalam *al-Fiqh al-Islāmiy*.

[8] Jumlah ini adalah mengambilkira jumlah institusi perbankan Islam tempatan dan antarabangsa seperti yang tercatat pada perenggan sebelumnya.

Oleh kerana sistem kewangan Islam merupakan satu sistem yang melibatkan transaksi dan urusniaga yang begitu pesat berkembang, makakajian bagi penambahbaikan terhadap produk-produk yang ditawarkan dari semasa ke semasa agar selari dengan perkembangan dan kemajuan umat manusia di di seluruh dunia adalah satu keperluan. Dalam konteks Malaysia, kesedaran umat Islam terhadap penghayatan Islam secara total telah mewarnai dan mempengaruhi pihak kerajaan kepada usaha- usaha untuk menawarkan alternatif dalam amalan perbankan dan kewangan yang tidak bercanggah dengan prinsip-prinsip syari`ah. Ini dapat dilihat dengan kewujudan insitusi-institusi perbankan menawarkan produk-produk yang berteraskan sistem muamalat Islam sepenuhnya seperti Bank Islam Malaysia Berhad, Bank Rakyat dan Bank Muamalat serta kewujudan institusi-institusi perbankan yang beroperasi secara dualisme sistem dengan menawarkan kedua-dua sistem perbankan iaitu Islamik dan konvensional secara serentak seperti CIMB, May Bank Public Bank dan lain-lain. Walaupun begitu, dengan perkembangan situasi semasa dan perjalanan operasi sesebuah institusi perbankan, mereka akan terus berusaha untuk menawarkan produk-produk yang berteraskan sistem muamalat Islam kerana permintaan dan sambutan yang menggalakkan sama ada darikalangan umat Islam sendiri khususnya mahupun dikalangan bukan Islam. Perkembangan ini adalah selaras dengan aspirasi kerajaan Malaysia yang ingin menjadikan Malaysia sebagai hub kewangan dan perbankan Islam terulung di dunia. Oleh itu, pelbagai teori fiqh perlu diaplikasi untuk merumuskan dan mengistinbat hukum-hukum berkaitanamalan perbankan dan produk-produk yang ditawarkan dalam sistem perbankan Islamdi Malaysia yang semakin berkembang dan perkembangan ini dari semasa ke semasa memerlukan juga perkembangan dari sudut kajian terhadap disiplin-disiplin ilmu *al-Fiqh seperti Uṣūl al-Fiqh, Maqāṣid al-Syar`iyyah* dan*al-Qawa᾽id al-Fiqhiyyah.*

4. APLIKASI *AL-QAWA᾽ID AL-FIQHIYYAH*

Bahagian ini akan membincangkan secara umum mengenai aplikasi *al-Qawa᾽id al-Fiqhiyyah* dalam sistem kewangan Islam di Malaysia dengan mengambil contoh berdasarkan kaedah-kaedah dasar sebagai landasan pokok perbincangan.

Al-`Umūr bi Maqāṣidihā **(Setiap perkara dinilai berdasarkan tujuannya)**

Kaedah ini merupakan kaedah yang pertama dalam senarai kaedah-kaedah dasar dalam perbincangan berkaitan al-fiqh. Ia merujuk kepada setiap amalan atau tindakan manusia akan dinilai melihat kepada tujuan amalan atau tindakan tersebut dilakukan sama ada ia melibatkan hubungan manusia dengan Allah SWT mahupun hubungan sesama manusia. Aplikasi kaedah ini banyak berlaku dalam pelaksanaan akad transaksi berkaitan kewangan seperti jualbeli, pemilikan harta, perwakilan dalam urusniaga, amanah dan jaminan (al-Suyutiy:1991). Oleh itu, pelaksanaan amalan sistem kewangan Islam tidak terkecuali dari membincangkan kaedah ini yang melibatkan beberapa kaedah pecahan hasil daripada kaedah dasar bagi menjelaskan dan merumuskan persoalan-persoalan timbul dalam masyarakat.

Al-`Ibrah fi al-`Uqūd li al-Maqāṣid wa al-Ma`ānī la li al-alfāẓ wa al-Mabānī (Perkara yang diambilkira dalam pelaksanaan akad adalah tujuan dan pengertiannya bukan pada lafaz dan bentuk perlakuannya)

Kaedah ini menjelaskan mengenai peranan tujuan dan hasrat seseorang dalam melaksanakan sesuatu transaksi itu diterimapakai dalam urusan seharian. Situasi ini mestilah disertai dengan petunjuk-petunjuk yang menggambarkan wujudnya keredaan untuk membuat pertukaran hak milik sesuatu pemilikan serta ia tidak menimbulkan keraguan[9](Kamil:2006). Pelaksanaan transaksi seperti ini sering dilakukan oleh masyarakat Malaysia sebagai dan merupakan satu amalan yang telah diterimapakai dalam urusaniaga jual beli yang melibatkan penggunaan wang seperti :

i. Jualbeli makanan di gerai

Pelanggan hanya memilih makanan yang disediakan dan membungkusnya sendiri seterusnya mengajukan kepada peniaga. Peniaga akan mengira dan menyatakan harga seterusnya mengambil wang bayaran harga tersebu daripada pelanggan tanpa wujudnya penggunaan lafaz tertentu sebagai penawaran (al-ijab) dan penerimaan (al-qabul) bagi menunjukkan berlakunya transaksi tersebut.

[9] Tidak menimbulkan syak dan keraguan terhadap tujuan transaksi yang dilaksanakan seperti salah seorang yang berakad tidak faham mengenai tujuan mereka.

ii. Jualbeli minuman dan makanan melalui mesin

Pelanggan hanya memilih minuman atau makanan yang tertera di mesin jualan tersebut seterusnya memasukkan jumlah wang mengikut harga yang telah ditetapkan tanpa adanya sebarang ucapan dan lafaz yang menggambarkan penawaran dan penerimaan dari kedua-dua pihak yang melaksanakan urusniaga.

iii. Bersedekah

Pemberi sedekah hanya menghulurkan wang sebagai penukaran pemilikan harta tanpa adanya pernyataan lafaz pemberian dan pertukaran milik terhadap penerima sedekah.

iv. Pembelian tiket

Urusniaga semasa dewasa ini juga sebagai cara untuk memudahkan urusan masyarakat, wujudnya banyak mesin-mesin yang disediakan untuk membolehkan orang ramai membuat urusan pembelian dengan cepat tanpa melibatkan individu yang membuat penawaran (*al-ījāb)* dalam majlis akad tersebut seperti jualbeli tiket kenderaan awam, jualbeli tiket wayang dan sebagainya.

v. Urusan pembayaran pinjaman dan penghantaran wang melalui mesin ATM *(Autoteller Machine).*

Transaksi untuk urusan pembayaran balik pinjaman (pembiayaan) dan penghantaran wang kepada pihak ketiga juga tidak memerlukan kepada dua pihak yang berakad (*al-āqidān*), tetapi dengan hanya melalui transakasi yang telah dilakukan di mesin ATM sahaja apabila tujuan dan maksud transaksi tersebut telah tercapai dengan penerimaan dan resit-resit yang telah dikeluarkan.

Seterusnya bagi transaksi yang melibatkan jumlah wang yang besar serta urusniaga yang lebih kompleks seperti gadaian (*al-Rahn*), urusan pembiayaan perumahan dan sebagainya, buat masa ini ia masih lagi memerlukan kepada dua pihak yang berakad supaya kontrak tersebut memberikan kesan-kesan perundangan dan sah menurut syara`. Kemungkinan juga pada suatu hari nanti, dengan perkembangan teknologi yang semakin maju dan berlaku anjakan paradigm dalam pelaksanaan urusniaga yang melibatkan transaksi dengan jumlah wang yang besar dapat dilakukan tanpa melibatkan dua pihak yang berakad secara berdepan seperti amalan sekarang.

Al-Yaqīn la Yuzālu bi al-Syak **(Keyakinan (sesuatu yang pasti) tidak boleh dihilangkan oleh syak (sesuatu yang tidak pasti).**

Ia merupakan kaedah dasar yang kedua dalam pengkajian *al-Qawa̅`id al-Fiqhiyyah* iaitu kewujudan sesuatu yang pasti secara asal akan berterusan walaupun timbulnya satu keadaan lain yang tidak pasti berkaitan perkara tersebut sebagai contoh; seseorang yang telah berwudu' dikira kekal berada dalam keadaan wudu` sehinggalah ia pasti telah berlaku sesuatu perkara yang boleh membatalkan wudu' pada dirinya. Kaedah dasar ini juga mempunyai beberapa pecahan kecil bagi menjelaskan situasi-situasi yang berlaku. Beberapa contoh yang boleh diambil seperti :

Al-Aṣl Baqa̅' Ma Kāna `ala̅ Ma̅ Kāna (sesuatu keadaan yang asal akan kekal mengikut keadaan asalnya)

Kaedah menerangkan bahawa sekiranya berlaku sebarang keraguan selepas wujudnya sesuatu hukum berkaitan, maka ia perlu kembali kepada yang hukum asal tersebut. Contohnya:

i. Seseorang yang berhutang dan telah meninggal dunia, tidak dapat dipastikan sama ada ianya telah membayar hutang ataupun belum, maka hendaklah diambil hukum yang asal iaitu si mati berhutang dan ahli-ahli waris si mati perlu mengambil tanggung jawab untuk membayar balik hutang tersebut. Dalam pengamalan sistem kewangan Islam terutama di institusi-institusi perbankan Islam, setiap pembayaran yang telah dibuat hendaklah mempunyai slip bayaran serta perlu direkodkan sebagai bukti pembayaran telah dibuat. Sekiranya masih lagi wujud keraguan yang tidak boleh dielakkan lagi, maka kaedah ini boleh dirujuk untuk merumuskan keadaan tersebut.

ii. Pelanggan yang datang memulangkan semula barangan yang telah dibeli kerana wujud kerosakan. Oleh itu, apa yang perlu diambilkira adalah keadaan asal barangan tersebut iaitu semasa barangan tersebut dijual ia berada keadaan yang baik sehinggalah benar-benar wujud kerosakan pada barangan tersebut. Situasi seperti ini banyak berlaku dalam urusniaga jualbeli kredit yang biasa diamalkan oleh masyarakat Malaysia seperti Court Mammoth, Seng Heng dan sebagainya. Kes seperti ini juga boleh berlaku di restoran-restoran apabila pelanggan memulangkan semula makanan yang dikatakan telah tercemar dan rosak.

Al-Aṣl fi al-Umūr al-`Āriḍah al-`Adam (Keadaan asal bagi perkara baru yang mendatang adalah tidak wujud)

Kaedah ini menjelaskan bahawa perkara baru yang timbul selepas daripada kewujudan sesuatu secara asal adalah dianggap tidak wujud. Situasi seperti ini hampir sama dengan situasi di para 4.1.1. Contohnya :

i. Seseorang yang berhutang mendakwa bahawa ia telah menjelaskan hutang tersebut, maka ia dikira sebagai belum lagi membayar hutang sehinggalah adanya bukti yang menunjukkan bahawa ia telah menjelaskan hutang tersebut. Kaedah ini juga boleh dirujuk sebagai panduan kepada pihak institusi perbankan dan pelanggan sekiranya berlaku kecuaian dan penipuan dalam urusan pembayaran semula sesuatu pinjaman atau pembiayaan.

ii. Pendeposit/pencarum mendakwa bahawa perniagaan yang dijalankan oleh institusi/syarikat pelaburan telah memperolehi keuntungan. Namun begitu, pihak institusi/syarikat telah membantah dakwaan tersebut dengan sumpah serta bukti dan perakuan serta bukti inilah yang diterima berdasarkan kepada kaedah tersebut kerana keuntungan adalah tidak wujud pada asalnya. Konsep ini diamalkan di institusi-institusi perbankan Islam pada produk-produk yang berasaskan kepada prinsip *al-muḍārabah* iaitu perkongsian untung dan rugi dengan perolehan keuntungan akan dimaklumkan melalui laporan tahunan seperti amalan di Lembaga Tabung Haji dan Bank Kerjasama Rakyat Malaysia.

Al-Aṣl fi al-Kalām al-Ḥaqīqah (Pengertian asal dalam sesuatu pernyataan adalah berdasarkan makna secara hakiki)

Kaedah ini menjelaskan mengenai penggunaan sesuatu perkataan dalam pernyataan adalah berdasarkan makna secara hakiki bagi lafaz tersebut. Contohnya:

i. Di Malaysia kini, banyak tawaran dan iklan untuk mewaqafkan harta di Jalan Allah seperti yang diamalkan oleh Jabatan Agama Islam Johor. Oleh itu, lafaz waqaf bagi urusan untuk mewaqafkan harta adalah mengikut pengertian asal perkataan waqaf berdasarkan maknanya secara hakiki sebagaimana yang telah dijelaskan oleh syara'.

Oleh itu, amalan urusniaga kewangan di institusi-institusi perbankan Islam mestilah melalui proses-proses dan prosedur-prosedur perundangan dengan penggunaan terma-terma yang betul agar tidak berlaku dakwaan dan anggapan salah terhadap institusi perbankan Islam daripada pelbagai pihak. Walaupun begitu dakwaan dan anggapan terhadap sesuatu itu belum cukup untuk diambilkira melainkan dengan adanya bukti serta keterangan yang tepat dan kukuh mengenainya.

Al-Masyaqqah Tajlib al-Taysīr **(Kesukaran membawa kepada keringanan)**

Kaedah ini menjelaskan mengenai keringanan yang diberikan oleh Islam kepada umat manusia apabila berlakunya sesuatu perkara menyukarkan yang boleh mendatangkan kemudaratan. Oleh itu, melihat kepada perkembangan kehidupan manusia yang semakin kompleks dengan kehendak dan keperluan semasa yang pelbagai, kaedah ini boleh diaplikasi dalam menyelesaikan permasalahan-permasalahan berkaitan kemasyarakatan yang dalam masa yang sama masih lagi terikat dengan kaedah pecahan kecil sebagaimana contoh di bawah iaitu;

i. *Mā Jāza li `udhr Batala bi Zawālihi* (Sesuatu perkara yang diharuskan kerana wujudnya keuzuran akan terbatal selepas hilangnya keuzuran tersebut).

Sebelum wujudnya Bank Islam Malaysia Berhad (BIMB) pada tahun 1983, telah wujud terlebih dahulu institusi-institusi perbankan konvensional seperti Maybank dan sebagainya. Untuk itu, sebagai langkah keselamatan bagi simpanan wang, adalah dibenarkan untuk menyimpan wang di institusi-institusi perbankan konvensional kerana tiada pilihan (darurat). Selepas tertubuhnya BIMB, maka darurat tersebut juga telah tiada dan umat Islam tidak diharuskan menyimpan wang di institusi perbankan konvensional atas alasan darurat.

ii. *Al-Ḍarūrah Tuqaddar bi Qadarihā*atau *Mā Ubīḥ al-Ḍarurah Yuqaddar bi Qadarihā*(Darurat dinilai berdasarkan kadar kemudaratannya atau apa yang diharuskan kerana darurat dinilai mengikut kadarnya).

iii.

Keperluan untuk melakukan transaksi urusniaga jualbeli secara tangguh seperti jualbeli *salam* dan *istiṣnā`*. Transaksi ini diharuskan kerana keperluan manusia masa

kini kepada urusniaga yang melibatkan penangguhan dalam penyerahan barangan atau hasil kerja dalam bentuk bangunan atau sebagainya. Oleh itu pengharusan dalam urusniaga seperti ini hanya terhad pada transaksi bagi barangan yang dibenarkan sahaja tanpa melibatkan barangan-barangan *ribawiy.*

Secara keseluruhannya dalam apa sahaja transaksi urusniaga jualbeli seharian yang menghadapi kesusahan dan kepayahan adalah termasuk dalam pengamalan kaedah ini. Oleh itu, kaedah ini boleh diaplikasi untuk menyelesaikan permasalahan berkaitan urusniaga harian manusia seperti jualbeli kelapa, durian dan sebagainya. Kesukaran timbul dari sudut kemampuan untuk mengukur ketebalan isi dan kulit buah-buahan tersebut bagi menetapkan harganya secara tepat.

Al-Ḍarar Yuzāl **(Kemudaratan perlu dihindarkan)**

Kaedah ini menjelaskan bahawa sesuatu darurat yang dialami perlu dihindarkan dan dijauhkan dengan membuat pilihan terhadap perkara-perkara yang lebih ringan daripadanya. Kaedah ini sama dengan konsep *Akhaf al-Ḍararayn* (Yang lebih ringan di antara dua kemudaratan) dalam kajian berkaitan *al-Fiqh al-Awlāwiyyat* (Fiqh keutamaan). Sebagai contoh; penubuhan institusi perbankan Islam adalah berdasarkan kepada kebajikan, namun begitu, tidak salah kalau institusi perbankan Islam juga mengejar keuntungan kerana keperluan sara diri dan persaingan dengan institusi perbankan konvensional yang mengamalkan kadar faedah kerana kemudaratan faedah (riba) adalah lebih besar berbanding keuntungan.

***Al-`Āḏah Muhakkamah*** **(Adat menentukan hukum syara`)**

Kaedah ini diaplikasi dengan mengambilkira amalan dan kebiasaan masyarakat setempat sebagai sesuatu yang diiktiraf oleh syara` dalam menentukan hukum selagi ianya tidak bercanggah dengan ketetapan syara` seperti penentuan jangka masa *sīghah ījāb* dan *qabūl* dalam majlis akad jualbeli. Beberapa kaedah pecahan yang terhasil daripada kaedah dasar ini adalah:

Isti`māl al-Nās Hujjah Yajibu al-`Amal Bihā(Pengamalan masyarakat setempat adalah hujah yang wajib diamalkan)

Contoh bagi kaedah pecahan ini adalah seperti amalan biasa dalam urusniaga jualbeli salam dan jual beli istisna` kerana ia merupakan sebahagian dari kegiatan ekonomi masyarakat yang diperlukan oleh mereka dan ia tidak bercanggah dengan ketentuan hukum-hukum syara`.

Ta`āmul al-Nas Min Ghair Nakir wa Munkar Asl min al-Uṣūl Kabir (Urusan sesama manusia yang tidak dibantah dan ditolak merupakan asas yang utama)

Contoh bagi kaedah ini adalah seperti urusniaga jualbeli yang dilaksanakan oleh masyarakat selagi ia tidak bercanggah dengan ketetapan syara` serta mendapat keredaan dari kedua-dua belah pihak, maka ia adalah diterima dan diharuskan oleh syara`, seperti pelaksanaan urusniaga jualbeli tanpa menggunakan lafaz dalam ijab dan qabul dalam situasi kedua-dua individu yang berakad reda dengan urusniaga tersebut. Kaedah ini juga bertepatan dengan kaedah *Al-Isyārah al-Ma`hūdah min al-Ahras ka al-Bayān bi al-Lisān* (Isyarat yang ditunjukkan oleh orang bisu adalah seperti pernyataan secara lisan) dan kaedah *al-Aṣl anna al-Bayān bi al-Kitāb bi Manzilah al-Bayān bi al-Lisān* (Asas keterangan melalui penulisan adalah sama kedudukannya dengan pernyataan lisan).

5. PENUTUP

Sistem kewangan Islam di Malaysia telah mengalami perkembangan yang pesat dari semasa ke semasa. Permintaan terhadap produk-produk yang berteraskan kepada kewangan Islam adalah amat tinggi disebabkan kesedaran umat Islam kepada amalan-amalan yang menepati ajaran Islam dan semangat keagamaan yang tinggi. Selain dari itu, penawaran pelbagai produk berkaitan kewangan Islam dengan penjenamaan baru yang menarik telah dapat diterima walaupun dari kalangan pelanggan yang bukan Islam. Keadaan ini disebabkan oleh kemampuan institusi-institusi perbankan untuk menawarkan produk-produk kewangan Islam yang berdaya saing kerana ia lebih menguntungkan pihak pelanggan dan dalam masa yang sama ia juga boleh menghasilkan pulangan yang baik kepada institusi perbankan Islam. Justeru itu

dengan kewujudan produk-produk yang pelbagai, selain dari memesatkan lagi sistem perbankan Islam di Malaysia, ia juga memerlukan kepada kajian-kajian akademik dari sudut fiqh termasuk juga kaedah-kaedah fiqh. Kaedah fiqh yang menyatakan *Jalb al-Masalih wa dar` al-Mafasid* (Menghasilkan kemaslahatan dan menolak kerosakan) merupakan antara kaedah asas yang boleh dijadikan panduan dalam menentukan hala tuju sistem kewangan Islam khususnya di Malaysia dan di seluruh dunia amnya.

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FACTORS INFLUENCING HOME REFINANCING DECISION AMONG MALAYSIAN MUSLIM CUSTOMERS WITHIN THE ISLAMIC BANKING INDUSTRY

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Abstract

This study examines factors influencing home refinancing among Muslim customers in Malaysia. The focus of this study is on refinancing activities within the Islamic banking industry, either the refinancing activity is made with the same or different Islamic banks. While interest rate and monthly payment reduction of the loan become the main factors for refinancing activities in conventional banking, the result is expected to be relatively dissimilar in the Islamic banking industry. For the purpose of this study, questionnaires have been distributed to Islamic banking customers who involved in refinancing at 11 states and Federal Territory of Kuala Lumpur in February to March 2011. Findings of this study do not only provide indications on market factors (such as based financing rate) and demographic factors that influence the refinancing activities, furthermore, it also explains other factors such as Islamic banks' internal factors (in the previous and currents individual banks). The results can be used to help these banks to understand reasons for refinancing and improve their operation related to their home financing products and banking services. It is suggested that the future research can be done to compare reasons for home refinancing activities between the conventional and Islamic banks.

Keywords: Home Refinancing, Islamic Banks, Muslim Customers

1. INTRODUCTION

In general, house is one of basic high value property which are must be owned in today's environment. Still not all people are able to have their own houses in short period due to financial status, especially for those who are just finishing their studies and starting career. External funding, specifically bank financing is one of the common options available to them. With the expansion of the Islamic banking industry, Muslim customers

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have range of financing products based on Islamic principles to be chosen. For example, since the interest rate is prohibited in Islam, other contracts such as sales and partnership contracts are used in home financing product to adhere to this principle.

There are several factors affecting selection decision of Islamic home financing. Ayesha Hamid and Omar Masood (2011) identified Shariah principle, fast and efficient services, price, bank reputation, and terms and conditions of product flexibility as among the factors affecting the selection criteria of Islamic home financing in Pakistan. Mohamad, A.H., et al. (2011) listed consumers' awareness, individual and financial institution factors as factors that influence consumers in adopting Islamic home financing in Malaysia. Even though there are several studies on home refinancing activities, there is a gap in the study on these activities among Muslims, which related to Islamic refinancing product. Except for a few such as Nathasa Mazna et..al. (2011), not much known on why Muslim customers refinance their houses after several years of having home financing and whether their reasons for refinancing activities are the same with the standard literature.

Refinancing simply means to the replacement of an existing debt obligation with a debt obligation under different term. Thus, it is reasonable to assume, home refinancing activities starts after a few years of financing, due to many reasons such as lower interest rate, reduction of monthly payment, raise cash, reduce risk, shorten payback period and etc. The literature offers two main perspectives, the first one relates to economic theory and the second is related to marketing theory. While economic theory assumes that the banking activity is influenced by the fluctuation of interest rates where the customers refinance to earn lower rate of financing, the switching cost theory of marketing relates the activity to the perception of the customer on new and current banks in several aspects such as image, service quality, location and price.

Differently from Nathasa Mazna et.al (2011) that studied on home refinancing activities from conventional banks to Islamic banks, this study focuses on refinancing activities within the Islamic banking industry, either the refinancing activity is made with the same

or different Islamic banks. The main objective of the study is to examine factors influencing home refinancing among Muslim customers in Malaysia. Findings of this study may help the banks to understand reasons for refinancing and improve their operation related to their home financing products and banking services.

The remainder of this paper is structured as follows; background of Islamic home financing products in Malaysia, review of prior literature, data and research methodology adopted in this study, results and the discussion, and conclusion.

1.1 Background of Islamic Home Financing Product

Islamic home financing as offered by local Islamic banks adopts several established hybrid contracts such as *bay' bitham ajil* (BBA) and *musharakah mutanaqisah* (diminishing *musharakah*), in which the *musharakah mutanaqisah* product is accepted widely compared to BBA (Table 1 shows total home financing 1st quarter of 2008-2nd quarter of 2012). In the Islamic banking industry, the term of 'interest rate on loan' is replaced as 'profit rate' given that the interest rate is regularly linked to *riba'* and the dissimilarity of their practices. Further, financing products in Islamic banks use the sales-based and partnership contracts for home financing activities, and BFR (based financing rate) is used only as a benchmark to determine for banks' profit. Since Muslims are urged to apply financing activities based on Islamic teachings, their financing activities are assumed to be influenced by this factor of choices.

Bay' bitham ajil (BBA) financing is the earliest home financing product that was offered by Islamic banks in Malaysia. The product is based on the sale contract with the deferred payment. A *musharakah mutanaqisah (diminishing musharakah)* financing product is initially introduced in Malaysia in 2006 by Kuwait Finance House as the alternative for BBA financing (Osmani & Abdullah 2010). Yet the BBA financing is much preferable in Malaysia, with 32.2 percent of the total Islamic financing come from the BBA financing (other types of financing based on concepts are *al-ijarah thumma al-bay'*, *al-ijarah*, *musharakah* etc.) (Bank Negara 2012).

Table 1: Commercial Banks and Islamic Banks: Classification of Financing by Purpose

End of period		*Total*	*< =25K*	*> 25K to 60K*	*> 60K to 100K*	*> 100K to 150K*	*> 150K to 250K*	*> 250K*
2008	1Q	176,510.5	1,267.8	10,733.9	22,007.4	27,999.9	47,232.8	67,268.7
	2Q	180,529.5	1,163.2	10,602.0	21,825.9	28,069.6	47,702.9	71,165.8
	3Q	186,243.8	1,224.7	10,504.5	21,770.6	28,335.6	48,485.1	75,923.3
	4Q	191,047.4	1,190.3	10,373.8	21,690.4	28,569.2	49,224.5	79,999.3
2009	1Q	194,668.0	1,175.2	10,399.2	21,489.6	28,901.0	49,514.5	83,188.5
	2Q	199,097.9	1,222.3	10,305.5	21,351.9	29,867.7	50,857.0	85,493.5
	3Q	204,584.3	1,110.9	10,263.0	21,330.1	30,150.7	51,707.8	90,021.8
	4Q	209,619.9	1,052.4	10,041.8	20,967.6	30,071.2	52,391.9	95,095.0
2010	1Q	215,452.0	1,111.5	9,848.2	20,692.3	30,033.6	53,025.2	100,741.1
	2Q	222,057.2	1,593.5	9,742.4	20,578.4	30,195.2	53,816.3	106,131.5
	3Q	229,960.8	1,517.2	9,670.5	20,555.6	30,602.3	55,034.2	112,581.0
	4Q	237,380.0	1,568.2	9,562.9	20,482.5	30,800.4	55,871.1	119,094.9
2011	1Q	243,998.5	1,667.7	9,406.1	20,293.4	30,821.3	56,404.9	125,405.1
	2Q	251,334.4	1,874.9	9,247.7	20,095.3	30,862.1	57,029.7	132,224.7
	3Q	260,090.7	2,181.9	9,114.7	19,953.5	31,005.8	57,782.2	140,052.6
	4Q	268,763.5	2,265.0	8,995.8	19,825.3	31,076.3	58,530.9	148,070.2
2012	1Q	278,192.6	2,561.0	9,080.8	19,931.5	31,204.4	59,331.5	156,083.4
	2Q	285,480.8	2,789.6	8,895.6	19,637.3	31,139.3	59,647.0	163,372.0

Source: Bank Negara Malaysia (2012)

2. LITERATURE REVIEW

As can be found in the standard literature, there are several decisions that have to be considered by a potential home loan customer such as the amount of initial down payment, the appropriate loan term and decision between fixed rate and adjustable rate loan products. These complex financial decisions are carefully look by the potential home loan customer based on his or her current financial condition. Homeowners however, after several period of time, might reconsider their initial decision relating to home loan. Thus, they have the option to refinance their home loans or mortgages.

There are several reasons that may lead to homeowners' decision to refinance. Firstly, current economic factors are noted as one of the factor of home refinancing. G-Yohanes

(1988) list seven economic factors that could influence the decision to refinance, namely (1) closing costs and prepayment penalties, (2) the difference between the interest rate on the existing loan and the interest rate on the new loan, (3) the holding period, (4) the opportunity discount rate, (5) income taxes, (6) the age of the existing loans and the remaining balance, and (7) the term of the new loan. Bennet, Peach and Peristiani (2001) mentioned that homeowners have the motivation to refinance their home loan when the market rate decline. This is because homeowners are required to pay a lower monthly home loan payment. Decisions to refinance home loans however, are quite complicated for homeowners. The homeowner though, have to incur additional costs such as costs associated with origination fees, attorney fees, title insurance, documentation fees and others.

The benefit of refinance had become smaller due to technological advancement, regulatory and refinance awareness among homeowners (Bennett et al., 2001). The probabilities to refinance by homeowners are found to effect by the homeowners' credit rating and home equity. Bennet et. al. (2001) also observed that homeowners' postpone their decision to refinance when there is volatility in interest rates. Gallay (2005) highlighted that the decision to refinance is a trade-off between certain factors, i.e.home owners' decisions whether owners want to choose a lower monthly payment, or faster payoff that lowered interest cost and increase in equity or a mixture of all these combinations.

Canner, Dynan and Passmore (2002)studied the occurrence of home refinancing, the changes in terms and condition of home loans after refinancing and the amount of funds homeowners raised in refinancing activity. Decisions to refinance is observed to be influenced by the desire of homeowners desire to reduce their monthly loan payments. This is obtains either from acquiring a lower interest rates loan or by lengthening the loan maturity date.

Secondly the reason of home loan refinancing is due to demographic reasons, such as change in family size or status or career based relocations (Archer & Ling, 1991).

Dickinson and Henson (1993), extended Archer and Ling (1991) study and observed that refinancing are motivated by movement in the level of interest rates and by borrowers' desires to change their capital structures in the face of changing income and housing wealth. In addition, Campbell (2006) examines the effect on refinancing behaviour including the loan problem and the income problem. Among others, the author contended that the young, smaller, better educated and better off homeowners are more likely to refinance their home loans.

Thirdly, the decisions to refinance home loans can be look from the marketing perspective. There are many researches that look on bank selection from the point of basic transaction banking services. However, there are limited studies that analyse the factors influencing choice of home loan, especially the reasons or choices of refinance activity from marketing perspectives have been largely overlooked.

Boyd et al. (1994) found that customers select banks based on several factors, namely banks' reputation, modern facilities, location, opening hours and friendliness of the staff as factors in selecting banks. In addition, Elliot et al. (1996)and Reeves and Bednar (1996) found additional factors that influence the decision of bank selection, which are speed, access and customer services were important factors in selecting banks. Ford and Jones (2001) showed that customers choose their home loans with the same organisation which they have previously have a home loan. In addition, the bank's reputation is also a factor for customers in selecting home loan.

Nathasa Mazna et. al. (2011) is among scarce studies that looked at on the home refinancing activities among Muslims. They examined the reasons for home refinancing activities from the conventional banks to Islamic banks. Their main finding showed that religion is the main factor for the changes in home refinancing from conventional banks to Islamic banks.

In can be concluded that homeowners take into several factors when considering to refinance a home loan. The decision to refinance is indeed, not easy to make. Basciano,

Jackson and Grayson (2008) highlighted that a degree of awareness and sophistication is needed for a homeowner to make a right refinancing decision.

3. RESEARCH METHODOLOGY

This study adopted a quantitative research approach, with a cross-sectional research design was adopted for data collection purposes (Malhotra 1996). The questionnaire survey was chosen in the study since it is an approach that uses several basic procedures to obtain information from people in the natural environment (Graziano & Raulin 2004). Data were collected using self-administered questionnaires with a total of 200 questionnaires were distributed in 11 states and Federal Territory of Kuala Lumpur in February to March 2011. Since this is a preliminary study, a simple random sampling technique was used in distributing the questionnaires.

The questionnaire consist of four sections. The first section includes demographic information of the respondents: age, gender, highest qualification level, residential state, household income when applying for home financing, household income when applying for home refinancing, and the price range of the house. All the demographic questions in this section are in close-ended form. The second section asks about home refinancing. The third section is on the reasons for home refinancing and the fourth section has an open-ended question on intention to refinance. Second and third section employs both close-ended and open-ended questions.

4. RESULTS AND DISCUSSION

From 160 of the received questionnaires, only 111 (69.4 per cent) questionnaires have been included in the analysis. Another 49 (39.6 per cent) questionnaires were excluded due to more than 50 percent of incompleteness in their answers.

4.1 Respondent Profile

As shown in Table 1, most of respondents ages within 31-50 years and hold a diploma and other higher education. In term of the price of the house, most of respondents (80.5 per cent) bought the house in the range of RM200, 000- RM400, 000. Other demographic profiles are shown in Table 2.

Table 2: Respondent Profile

Variable	Frequency	Percentage
Age (years):		
Below 30	12	10.8
31 to 40	41	36.9
41 to 50	53	47.7
51 to 60	5	4.5
Gender:		
Male	90	81.1
Female	21	18.9
Highest education level:		
SPM and below	9	8.1
Diploma	13	11.7
Bachelor degree	45	40.5
Master degree	42	37.8
PhD	2	1.8
Residential state:		
Selangor	42	37.8
Negeri Sembilan	10	9.0
Melaka	4	3.6
Johor	11	9.9
Pahang	4	3.6
Terengganu	4	3.6
Kelantan	7	6.3
Pulau Pinang	1	0.9
Kedah	5	4.5
Perak	3	2.7
Sabah	1	0.9
Kuala Lumpur	17	15.3
Putrajaya	2	1.8

Household income when applying housing loan:		
RM1,500 and below	5	4.5
RM1,501 - RM3,000	28	25.2
RM3,001 - RM4,500	29	26.1
RM4,501 - RM6,000	25	22.5
RM6,001 - RM7,500	8	7.2
RM7,501 and above	16	14.4
Household income when applying house refinancing:		
RM1,500 and below	2	1.8
RM1,501 - RM3,000	27	24.3
RM3,001 - RM4,500	21	18.9
RM4,501 - RM6,000	14	12.6
RM6,001 - RM7,500	30	27.0
RM7,501 and above	17	15.3
Price range of the house:		
Below RM100,000	15	13.5
RM100,001 - RM200,000	61	55.0
RM200,001 - RM300,000	28	25.2
RM300,001 - RM400,000	4	3.6
RM400,001 - RM500,00	1	0.9
RM500,001 and above	2	1.8

4.2 Home Loan Refinancing

This paper studies on refinancing activities within the Islamic banking industry, whereby the refinancing activities are made from one Islamic bank to another Islamic bank. Based on the data, all the refinancing activities by the respondents are made between different Islamic banks. The data shows that 90 (81.1 per cent) of respondents asserted that the house as their first houses, and 21 respondents did not. In term of the home financing product that they used in the previous housing loan, 94.6 per cent of respondents have BBA financing and only 5.4 per cent using the *musharakah mutanaqisah*. There is an increase in the usage of the *musharakah mutanaqisah* in the current home loan. 9.9 per cent of respondents used *musharakah mutanaqisah* in their current home financing, and the rest (90.1 per cent) used the BBA financing. It can be said that, even though the BBA financing continuously becomes the main product for home financing, the data shows there is a changes in the current home refinancing trends.

4.3 The Reasons for Loan Refinancing

Table 3 shows close ended given answers for loan refinancing that focuses on the economic factors, adapted from G-Yohanes (1988) and Bennett, Peach and Peristiani (2001)[2]. The data shows that majority of respondents (58.6per cent) changed their financing from adjustable rate loan to fixed rate loan. The findings show similar results with Nathasa Mazna et.al (2011) and Canner, Dynan and Passmore (2005) even though this study looked at the different context of activities. Based on their study, more than 50 per cent of the respondents changed from adjustable rate loan to fixed rate loan. The results also demonstrate that 52.3 per cent respondents refinanced for longer maturity loan. Consistently with the previous answer on maturity term, 69.4 per cent of respondents changed to get the lower monthly payment.

Table 3: Reasons for loan refinancing

Variable	Frequency	Percentage
Rate of the housing loan:		
Change from adjustable rate loan to fixed rate loan	65	58.6
Change from fixed rate loan to adjustable rate loan	24	21.6
Others	22	19.8
Maturity:		
Change to a longer maturity loan	52	46.8
Change to a shorter maturity loan	58	52.3
*Missing (did not answer the question)	1	0.9
Maturity (years):		
Less than 20 years	53	47.7
More than 20 years	50	45.0
*Missing (did not answer the question)	8	7.2
Monthly payment:		
Change to higher monthly payment	34	30.6
Change to lower monthly payment	77	69.4

In addition to the above answers, respondents also responded to the open ended questions on other economic factors that influenced them to refinance. Some of respondents stated that the rate offered by current bank is cheaper compared to the previous bank. Similarly,

[2] To fit with Islamic financing, the term of 'interest rate on loan' is changed to the 'profit rate' given that the interest rate is linked to *riba'* and the dissimilarity of their practices.

some of them change because the ceiling rate of the current bank is much more attractive compared to the previous bank. Regarding the cost that incurred within the process of refinancing, the respondents listed legal fees, MRTA, penalty (for financing within the locking period), service charges, home evaluation fee and stamp duties as the costs that they need to pay for refinancing. These findings are similar with Bennett, Peach and Peristiani (2001) and Nathasa Mazna et.al (2011).

This study also captured other reasons for home refinancing in addition to economic factors. Open ended questions have also been given to respondents related to other factors that can encourage them to refinancing. Some of respondents listed (i) better quality and good reputation of the current banks (convenient facilities, near to the respondents), (ii) dissatisfaction with the previous banks (ie. staff attitude) (iii) current bank staff's attitude and capabilities (awareness and responsiveness on customers, ability to provide advice on Islamic financial products) of the current banks and (iv) word of mouth (family and friends) are among factors encouraged them to refinance. These findings which are related to marketing perspective are also supported by the previous studies such as Boyd et al. (1994), Elliot et al. (1996) and Reeves and Bednar (1996).

5. CONCLUSION

This study focused on factors influencing refinancing activities by Muslims within the Islamic banking industry. This study is significant as it offers a new insight of refinancing activities as the activities are made from one Islamic bank to another Islamic bank. Religion thus is not become the main factor in this study for the changes since the activities are made in the same industry (Islamic bank with Islamic bank).

The results show apparent evidence that, even though the respondents concern with Islamic teachings, they in fact consider the economic factors in their financial decision. Similar with previous studies, fluctuation of home financing profit rate, reducing the maturity period and monthly payment and, good reputation of the current banks and, staff

attitude and capabilities become the main factors for refinancing activities. The result also indicates that economic and marketing factors are both considered by most of respondents thus should not be ignored by the financial service providers. The result also hints the policy makers to provide mechanisms to help public to have their own houses that are affordable and not burden them.

Future research should be done to compare reasons for home refinancing activities between the conventional and Islamic banks. This will help policy makers and industrial players (banks) understand in depth on factors of refinancing activities among Muslims.

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MAQASID AL-SHARI'AH – ONE OF THE VERY IMPORTANT SHARI'AH ASPECTS IN ISLAMIC FINANCE

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Syadiyah Abdul Shukor[2]

Abstract

This paper aims at analysing the importance of *maqasid al-Shari'ah* in Islamic finance in particular its application on *Takaful*. *Maqasid al-Shari'ah,* or the goals and objectives of Islamic law, is considered to be the guiding principle of Islamic finance. It applies to everything: laws, conduct, opinions, products, transactions, activities, and services. It outlines the objectives and wisdom (*hikmah*) as prescribed by *Shari'ah* in all its rulings to protect and preserve the benefits and interests (*maslahah*) of society. The application of *maqasid al-Shari'ah* is a very important element that needs to be incorporated by all Muslims in facing or solving current issues in the aspects of social, economics, politics including finance. Hence, there should be a continuous emphasize given on the importance of *maqasid al- Shari'ah* in all Islamic finance fields. It must be underlined through recommendation to all relevant financial bodies to promote these gracious *Shari'ah* objectives in the markets and provide application for them correspondingly in the relevant industries for better future of Islamic finance.

1. INTRODUCTION

Islamic banking and finance is focused on three main areas; Islamic banking, capital markets and insurance (*takaful*). *Maqasid al-Syari'ah,* or the goals and objectives of Islamic law, is considered to be the guiding principle of Islamic finance. It applies to every aspect: laws, conduct, opinions, products, transactions, activities, and services. It outlines the objectives and wisdom (*hikmah*) as prescribed by *Syari'ah* in all its rulings to protect and preserve the benefits and interests (*maslahah*) of society. Also, *maqasid al-Syari'ah* facilitates the needs of human being, ensure the wealth is circulated among as many as possible in a fair way, avoid dispute and ensure stability, promote *maslahah* and

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avoid harm, promote transparency and accountability, and uphold and promote justice in acquiring wealth (Vejzagic and Smolo, 2011).

Every law is oriented towards certain purposes. The *Syari'ah*, being a divinely inspired code for human conduct, also has its own aims and objectives. It is a system of laws, both moral and practical, which shows man the way towards spiritual fulfilment and social welfare. Its primary goal is to free man from the grips of his own whims and fancies so that he may become a true servant of God, as written in the Qur`an; *"Then we put thee in the right way of religion: so follow thou that way and follow not the desires of those who know not" (Al-Jathiyah :18).*

Islam incorporates permanent features and mechanisms for adapting to change. Its fundamental in teaching of *'aqidah* (creed), *'ibadah* (worship), and *akhlaq* (morality and ethics) never change. However, flexibility is needed to adapt successfully to the challenge of modernity in secondary areas such as economics, business, and other worldly activities. In depth understanding of the objectives of *Syari'ah* is important for analogical deduction and other human reasoning (Kamali, 1999). Indeed, *maqasid al-Syari'ah* allows flexibility, dynamism and creativity in social policy (Hallaq, 2004, Mumisa, 2002, Zuhrah, 1958).

Maqasid al-Shariah reflects the holistic view of Islam as a whole, not in parts, as Islam is a complete and integrated code of life. Its goal encompasses the whole life of individual and society, in this world and the hereafter (Dusuki and Abozaid, 2007). Hence *maqasid* in Islamic finance cannot be a mere maximisation of profits. Profit cannot be the ultimate goal of a Muslim society. It must be accompanied by efforts directed to ensure spiritual health of human, justice and fair play at all levels of human interaction. Only development of this kind would be in conformity with the *maqasid al-Shariah*.

According to Imam Al-Ghazāli (d.1111) "*The objective of the Syari'ah is to promote the well-being of all mankind, which lies in safeguarding their faith (din), their human self (nafs), their intellect ('aql), their posterity (nasl) and their wealth (mal). Whatever*

ensures the safeguard of these five serves public interest and is desirable." (Chapra, 2000). Thus, the principles set by *Syari'ah* have *maslahah* or benefit of people as the underlying basis and goal. The principle of *maqasid al-Syari'ah* establishes *maslahah* as its essential element and core of the theory.

This paper aims at analysing the importance of *maqasid al-Syari'ah* in Islamic finance. The paper begins by providing an overview of *maqasid al-Syari'ah.* This includes defining the concept of *maqasid al-Syari'ah* and a detailed discussion on classification of it namely the essentials *(daruriyyat)*, the complimentary *(hajiyyat)* and the embellishment (*tahsiniyyat)*. Then, the next section addresses the application of *maqasid al-Syari'ah* on Islamic Finance in general. This is followed with a thorough discussion on application of *maqasid al-Syari'ah* in *Takaful*; one of the most important component in the Islamic financial system. A final section provides the conclusion.

2. OVERVIEW OF MAQASID AL-SYARI'AH

Maqasid al-Syari'ah is one of the important pillars that should be considered for improvement of the Islamic financial system. Besides the *Syari'ah* rules and regulations, *maqasid al-Syari'ah* or the objectives of Islamic law can be the most comprehensive instrument for enhancing the Islamic finance and banking at present. However understanding the concept of *maqasid al-Syari'ah* and its underlying principles is very important before applying it in the current business scenario. The theory of *maslahah* is described as "seeking benefits or repelling harm" (Al-Zarqa, 1988). It can be understood that the *maslahah*, or public interest is the core of the theory of maqasid *al-Syari'ah*. The word *maslahah* – or interest, or benefit are treated synonymously and thus used interchangeable in the theory of *maslahah*. The general objective of *Syari'ah* is to preserve the society order of community and ensure the continuity of its healthy progress. Allah (s.w.t.) says,"*…I wish not, in contradiction to you, to do that which I forbid you. I only desire reform so far as I am able, to the best of My power, and My guidance cannot come except from Allah, in Him I trust and unto Him I repent*." *(Al-Hud: 88)*

The plural of the Arabic word *maslahah* is '*masalih*' which means welfare, interest or benefit. Literally, *maslahah* is defined as seeking benefit and preventing harm. Among the major Sunni schools of Islamic jurisprudence, Imam Malik is the leading promoter of upholding *maslahah* as one of the *Shari`ah's* sources.

Imam Malik defines *maslahah* as follows:

> *"Maslahah is essentially an expression for the acquisition of benefit or the repulsion of injury or harm, but that is not what we mean by it, because acquisition of benefits and the repulsion of harm represent human goals, that is, the welfare of humans through the attainment of these goals. What we mean by maslahah, however, is the preservation of the Shari`ah's objectives."*

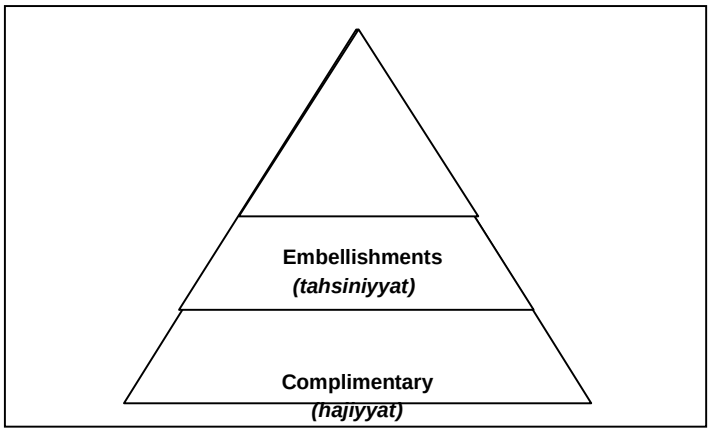
Maslahah sometimes connotes the same meaning as *maqasid* and the scholars have used the two terms almost interchangeably (AbdelKader, 2003). Hence, the following section will review classification of *maqasid al-Syari'ah* or *Maslahah.*

2.1 Classification of *Maqasid al-Syari'ah* or *Maslahah*

Muslim scholars have classified the entire range of *maslahah* into three (3) categories, in order of its priority and importance as shown in Figure 1 (Dusuki and Abdullah, 2009);

i) The Essentials *(daruriyyat)*
ii) The Complementary *(hajiyyat)*
iii) The Embellishments (*tahsiniyyat)*

Figure 1: The *Maslahah* Pyramid



Source: Dusuki & Abdullah (2009)

The *Maslahah* Pyramid depicted in Figure 1 functions as a general guideline to an ethical filter mechanism, providing three levels of judgment to resolve ethical conflicts that inadvertently emerge (Dusuki and Abdullah, 2009). The levels also reflect the different degrees of importance in terms of responsibility fulfilment. The bottom level, the Essentials, constitutes the most fundamental responsibility to be fulfilled, as compared to the Complementary and the Embellishments categories (Dusuki and Abdullah, 2009, Al-Allaf, 2003, Vejzagic and Smolo, 2011). As the pyramid moves higher, the degree of decision making will be less fundamental, so as to attain society's perfection and well-being (see Mumisa, 2002). It assumes that individuals will strive for the next level as soon as the previous one has been fulfilled. The next section will briefly describe each level of the *Maslahah* Pyramid.

i) Essentials (Daruriyyat)

The first level of the *Maslahah* Pyramid is the Essentials (*Daruriyyat*). The Essentials are absolutely necessary and considered as vital for the founding of wellbeing in this world and the hereafter. If a society neglects them, the outcome will be anarchy together

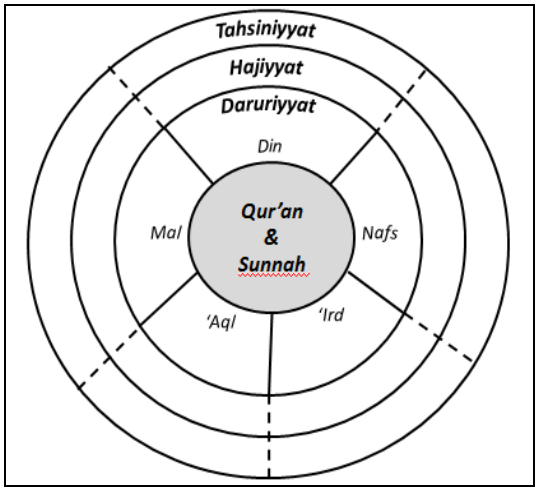
with disorder of the functionality of the society in which will result in total collapse (Vejzagic and Smolo, 2011).

The Essentials (*Daruriyyat*) are further divided into five (Lahsasna, 2011);

i) preservation of faith/religion (*Din*),
ii) preservation of the life (*Nafs*),
iii) preservation of dignity/ lineage (*'Ird*),
iv) preservation of intellect/reason (*'Aql*) and
v) preservation of property (*Mal*)

These five basic and universal necessities or priorities on which the lives of people depend, and whose neglect leads to total disruption and chaos (Al-Allaf, 2003).

Figure 2: The *Maqasid* Model



Source: Adapted from Lahsasna (2011)

As been illustrated in Figure 2, the existential structure consists of three main circles, with each of them orbiting around the central one which represents the Islamic doctrine as the main source of legislation (Al-Allaf, 2003). The *maqasid* principle is related with

the protection of the human basic elements while *maslahah* being the level of protection of those elements.

a) Preservation of faith/ religion (*Din*);

Faith (*Din*) is at the head of the list of *maqasid* because it is ingredient for human well-being within the Islamic perspective. All the required things that are needed as beneficial tools to establish and attain the necessity of spirituality were already contained in the *Syari'ah* law, such as the belief in angels, messengers, the Day of Judgment, and so on. All these things were mentioned to serve the purpose of establishing spirituality as a necessity in the existence of humans on earth. Each and every Muslim is obliged to protect his faith at every level for example his own '*ibadah*, and even going for a war for the sake of protecting *al-Din* from the enemy of Islam. *Al-Din* puts human relations on a proper foundation, enabling human beings to interact with each other in a balanced and mutually caring manner in ensuring the well-being of all.

b) Preservation of the life (*Nafs*);

Life (*Nafs*) is secured by obtaining lawful means of sustenance such as food and shelter. The way to protect it is through the enforcement of prescribed penalties provided by the *Syari'ah* Law. For example, adultery, false accusation, killing, and suicide are prohibited. According to the *Syari'ah* law, life is a necessity and it is one of the top priorities that must be preserved at all costs. After all murder is prohibited in Islam, and whoever murders a person, he or she as if has killed the entire human race. Every human is a unique representative of mankind, if all people died except one, then that person is going to be the only one representing mankind among other existences such as animals and trees. Since humans do not always respond to the rules of legislation and sometimes act against their own interests, thus the legislature made strict legislation to punish the act of killing.

c) Preservation of dignity/ lineage ('*Ird*);

Linegae ('*ird*). Protecting one's lineage and family is achieved by promoting marriage and encouraging that we respect and acknowledge where we have come from. Things that

upset the ability to distinguish between lineages, such as adultery and fornication are strongly forbidden and severely punished. Those things which can lead to this are also prohibited as are the killing of one's own descendents either by way of abortion or infanticide. It is also not permitted to insult or speak ill of people, living or dead.

d) Preservation of intellect/reason (*'Aql*);

Intellect (*'aql*) is necessary and essential to the existence of the human race. The benefit of reason to the human existence might be beyond reason. Thus, it is protected against destruction by a set of rules and punishments. For example, anything that diminishes the intellect's ability to function properly such as alcohol or drug is prohibited.

e) Preservation of property (*Mal*);

Property (*mal*) is very beneficial and necessary to the human life. The *Syari'ah* facilitates all lawful means for its acquisition, and secures it by defending the right of ownership through penalizing theft.

ii) Complimentary (Hajiyyat)

The second level of the *Maslahah* Pyramid is the Complimentary (*Hajiyyat*). It complements the Essentials and refer to those interests that, if neglected, would lead to hardship in life but not to the total disruption, as in the case of the Essentials. In other words, they are needed to alleviate hardship so that life may be free from distress and predicament.

As been mentioned in the Quran, "*Allah intends for you ease, and He does not want to make things difficult for you*." *(Al-Baqarah:185).* This verse is reflected in many aspects, for instance, in the area a *'ibadat*, *Syari'ah* has granted to the sick and to the traveler, permitting them not to observe the fast, and to shorten the *salah*, are aimed at preventing hardship. Similarly, in the sphere of economic transactions, where the *Syari'ah* validates such contracts as forward buying (*salam*) and lease and hire (*ijarah*), because people need them, in spite of a certain presence of anomaly in both.

iii) Embellishments (Tahsiniyyat)

The Embellishments refer to those interests that, if realized, would lead to refinement and perfection in the customs and conduct of the society. The rationale of all these are the accomplishment of integrity and perfection in entire fields of a person's behavior. However, without these values the society will still be able to function and normal life process will not be interrupted. For instance, the *Syari'ah* encourages voluntary charity (*sadaqah*), beyond the level of zakat, to those in need, urges politeness in behaviour and speech, avoiding extravagance in consumption.

The *Syari'ah* rules and regulations in whole provide practical measures to cater for all three levels of human interests, namely, the vital needs, the complementary needs and the betterment requirement. A day to day example that illustrates the existence of this hierarchy of human *maslahah* in the *Syari'ah* model is the following: One of man`s vital needs is a house, the existence of windows to allow for ventilation in the house is complementary to it, and to furnish the house, such as curtain is to enhance the quality of the house.

It can be observed that a systematic set of general legal rules and principles are being deduced (Al-Allaf, 2003);

i) Harm is removed.
ii) Public harm or loss is averted by the private assumption of loss.
iii) The greater of two harms is averted by assumption of the lesser.
iv) Averting harm is to be preferred over procuring benefits.
v) Cases of necessity make permissible what is normally forbidden or restricted.
vi) Necessity is determined by the particular circumstances.
vii) Hardship secures lenience.
viii) It is not permissible to do what will harm one's self.

3. MAQASID AL-SYARI'AH IN ISLAMIC FINANCE

The previous section has provided an overview of *maqassid al-Syari'ah*. This section will evaluate the application of the *Syari'ah* tools especially with respect to *maqasid al-Syari'ah* and *maslahah* in Islamic banking and finance. Based on the aforementioned facts, Islamic banking and finance should take into consideration the systematic and dynamic understanding of *maqasid*. Furthermore, the understanding of *maqasid al-Syari'ah* not only covers on individual oriented objectives but also include broader measures ensuring welfare in order to achieve justice and equity. Thus, objective of Islam as a whole and *maqasid al-Syari'ah* should be differentiated clearly because objective of Islam involves aspects of personality and society that its peer does not cover. Indeed, one of the biggest challenges of Islamic banking and finance industry today is to come up with products and services that is *Syari'ah* compliant or legitimate from Islamic point of view without undermining the business aspects of being competitive, profitable and viable in the long run.

3.1 The Importance of Maqasid in Islamic Finance

The importance of *maqasid* in developing Islamic finance products comes from the position of the wealth itself in Islamic law as well as *maqasid al-Syari'ah*. The preservation and protection of wealth is classified under the category of *daruriyyat* (essentials). The absence of protection of this interest would leads to total disruption and chaos in life. The classification and characterisation of *maqasid* have recognised the primary position of wealth and the importance of finance in Islamic law as a valuable aspect in life (Hassan and Mahlknecht, 2011).

The foundation of Islamic financial system goes beyond the conventional financial system. According to the general principle of *maqasid* as elaborated earlier, it can be seen that the Islamic system places equal emphasis on the ethical, moral, social and religion towards betterment of a society as a whole.

Maqasid al-Syari'ah aims at achieving various **objectives in a business transaction**, covering all aspects of financial activities and dealings such as trading, profit making, spending and consumption. These objectives are as the followings (Lahsasna, 2011);

i. Circulation of wealth in society so as to ensure equal distribution of wealth amongst all member of society and prohibition of monopolising the wealth and hoarding money amongst the rich.
ii. Continuity of investment of wealth. As the economy develops in line with the society, the wealth must be invested and made available to many hands for investment.
iii. Achieving the economics prosperity for the whole society by satisfying the basic needs of people
iv. Transparency in financial activities to avoid disputes
v. Permissibility of private and public ownership of the wealth

All the above objectives fall under the general meaning of this verse of the *Qur'an*, "*Allah does not want to place you in difficulty, but He wants to purify you, and to complete His favour to you that you may be thankful"* (al-Ma'idah 5:6). In another verse, *"…Allah intends for you ease, and He does not want to make things difficult for you...."* (al-Baqarah 2:185).

It is essentially important to stress on the implementation of *maqasid al-Syari'ah* in the current business transactions because of several important reasons. First, there is a proper matching and strong relationship between *maqasid al-Syari'ah* and the objectives of business transactions, as can be observed from the position of the wealth within Islamic law and *maqasid al-Syari'ah* that requests the preservation of wealth in everyday business activities and the promotion of socially responsible activities (Hassan & Mahlknecht, (2011). As a result, if objectives of *maqasid al-Syari'ah* in business transactions are ignored, it may result in poverty and chaos.

Secondly, the business transactions in domestic and international trade should be based on the principles of Islamic law, and the fundamental objectives of *maqasid al-Syari'ah* in finance and business shall be applied as the fundamental guidelines in implementing all types of financial transactions.

Third, the particular objectives of *maqasid al-Syari'ah* in business transactions must have continuation of the universal objectives of *maqasid al-Syari'ah*.

Lastly, the regulations of business transactions should be within the scope and the requirements of *maqasid al-Syari'ah* and Islamic law. *Maqasid al-Syari'ah* must administer and regulate the *Syari'ah* principle of the Islamic finance.

According to Hassan & Mahlknecht (2011), there are important **principles** which play significant role in understanding *maqasid al-Syari'ah,* helping the regulators and making for easy implementation of decisions in the Islamic finance industry by following these guidelines;

1) *Maqasid al-Syari'ah* has noble objectives in economics, finance, and business ransactions;
2) *Maqasid al-Syari'ah* objectives in business transactions create communal prosperity and happiness and satisfaction in society;
3) The concept of *maqasid al-Syari'ah* and its noble objectives are considered universal goals;
4) *Maqasid al-Syari'ah* creates balance between the private interest, by meeting the demands of the individual according to their self-interest, and the public interest, by catering to the needs of society and leading to welfare programmes;
5) The duty of implementation of *maqasid al-Syari'ah* in economics and finance is not the sole responsibility of scholars but of all members involved in finance, business and economic activities;
6) There is a mechanism and process that has to be taken into account in order to implement *maqasid al-Syari'ah* in finance, banking and business transactions;

7) It is very important to address *maqasid al-Syari'ah* in the current business scenario and apply it in all types of business activities;
8) *Maqasid al-Syari'ah* helps to enhance the financial market and banking system by making significant progress in the domestic market and international trade;
9) *Maqasid al-Syari'ah* helps to overcome the current issue in finance, banking and bunsiness transactions because it is about the essences and real attributes rather than names and forms;
10) It is recommended to promote *maqasid al-Syari'ah* as additional tools to understand finance and banking and to enhance the applications of business transactions and support and assist the rapid development of Islamic banking and finance;
11) *Maqasid al-Syari'ah* is a solid platform for the *Syari'ah* advisor to understand the current issues in finance and banking. It helps them in dealing with the current issues through a true examination and provides alternative solutions within the noble objectives of *Syari'ah*;
12) There must be full and comprehensive understanding of *maqasid al-Syari'ah* before the stage at which they are implemented in economics and finance.

Essentially, Islamic finance has provided its users with a set of rules and principles that if followed strictly, would have resulted in a fair system and equitable to all parties. By using the *maqasid* approach, which is one of the of the core elements of the *Syari'ah*, the stakeholders of the Islamic financial system, particularly the practitioners, are supposed to assess the positive (*manfa'ah*) and negative (*madarrah*) aspects of their operations, systems, products and all matters related to the provision of Islamic financial services. This is because the goal of the *maqasid* approach is to secure benefits and prevent harm. Hence, financial turmoils like the subprime crisis can be avoided, proving that *Syari'ah* can lead to better risk management.

Having established an understanding on the application of *maqasid al-Syari'ah* in Islamic finance, the following section will evaluate its implications on one of the most important component in Islamic finance; the Islamic insurance or *Takaful*.

4. OBSERVING THE MAQASID: IMPLICATIONS ON TAKAFUL

Islamic finance consists of Islamic banking, Islamic insurance and Islamic capital market. Being one of the major elements, *takaful* or the Islamic insurance does have a significant role in the industry. The concept of *takaful* is where a group of people participate in a scheme that enables them to share the burden should any misfortunes faced by any of the participants, and where appropriate, compensation are paid using the funds contributed by the participants.

As far as *takaful* operators are concerned, the protection of human religion, human intellect and human property are directly related to the provision of *takaful* service. These are in line with the essential principles laid down by *maqasid al-Syari'ah* which are classified into preservation of human religion, human life, human descendents, human intellect and human property.

Insurance is deemed important as a mechanism for risk management. Among scholars, the concept of insurance does not contradict with the *Syari'ah* laws because it is a mechanism which can manage and mitigate the economic losses associated with accident, poor health and so on. Muslim scholars support the compensation of victims of misfortune. However, many scholars consider some aspects of conventional insurance contracts as being prohibited from an Islamic law point of view. It is unacceptable in Islam due to the existence of prohibited elements such as *riba* (usury), *gharar* (uncertainty) and *maysir* (gambling) in its operation. Muslim scholars locally and internationally have rejected insurance because it involves *riba*, *gharar* and *maysir* in their operation (Hassan and Mahlknecht, 2011).

All economic activities are permissible as long as it conforms to the *Syari'ah* principles and rules. According to Islam, all forms of transactions that contain any unlawful elements like *riba'*, *maisir* and *gharar* are void. There is general agreement that they are to be avoided; a) *Riba* (Usury), b) *Gharar* (Uncertainty) and c) *Maysir* (Gambling).

Riba (Usury). The element of *riba* exists when the insurer invests the prepaid premiums on behalf of those insured and the underlying investments of many insurance companies are *riba*-based. A conventional endowment insurance policy promising a contractually-guaranteed payment also is violating the *riba* prohibition.

Gharar (Uncertainty). An insurance contract violates the prohibition of *gharar* since benefits to be paid depend on the outcome of future events that are unknown at the time of the contract signing. It also contains *gharar* because, when a claim is not made, one party (insurance company) may acquire all the profits (premium) gained whereas the other party (policy holder) may not obtain any profit whatsoever. Ibn Taimiyah, a leading Muslim scholar, further reasoned "*Gharar* found in the contract exists because one party acquired profit while the other party did not". The prohibition on *gharar* would require all investment gains and losses to eventually be apportioned in order to avoid excessive uncertainty with respect to a return on the policy holder's investment.

Maysir (Gambling). Insurance is regarded as *maysir* because the policy holders are held to be betting premiums on the condition that the insurer will make payment upon circumstances of a specified event. Islamic scholars have also stated that *maysir* and *gharar* are inter-related and usually co-exist. *Maysir* exists in an insurance contract when the policy holder contributes a small amount of premium in the hope to gain a larger sum, or the policy holder loses the money paid for the premium when the insured event does not occur. The insurance company will be in deficit if the claims are higher that the premium paid by the policy holders.

Hence, the demand of *maqasid al-Syari'ah* that encompasses the essence of peace and economic well being imposes an obligation on all Muslim to do their utmost best and seek cover against danger. *Takaful* in this regard adequately replaces the conventional insurance as it practically uses acceptable contracts such as *tabarru'*, *mudarabah*, *wakalah* and *waqf*. From the Islamic perspective, *takaful* is allowed by the *Syari'ah* law as a way to manage one's risk.

Takaful originates from the Islamic word *kafalah*, which means ‘guaranteeing each other’ or ‘joint guarantee’. In principle, *takaful* system is based on mutual co-operation, responsibility, assurance, protection and assistance between groups of participants. It is a form of mutual insurance (S. Saaty and Ahmad Ansari, 2009). The fundamental idea of *takaful* is to spread the risk among the members.

In Malaysia, Section 2 of the Malaysian Takaful Act 1984 defines *takaful* as a scheme based on brotherhood, solidarity and mutual assistance, which provides for mutual financial aid and assistance to the participants in case of any need, whereby the participants mutually agree to contribute for that purpose. The National Council for Islamic Religious Affairs of Malaysia has issued a fatwa that prohibited life insurance since it contains *gharar*, *maysir* and *riba* although there is no official fatwa issued on general insurance (Ab. Rahman, 2009).

Other than not being in conformity with the *Syari’ah* rules on the prohibited elements, another main distinction between conventional insurance and *takaful* is that in conventional insurance the risk is passed to the insurer. The insured substitutes certainty for uncertainty. In return for a predetermined payment (the premium), he transfers to the insurer the possible economic losses from stipulated risks. While in *takaful*, the risk is shared equally by the members of the *takaful* scheme; the participants share all risks mutually and no transfer of risk is involved. The participants of the group give consensus and pledge mutually that if any of them suffer a misery, he will be given a certain amount of money to compensate the loss and damage.

Takaful as an Islamic system of mutual insurance built around the concept of donation, or *tabarru’*. Each participant contributes to a fund to cover one another to cover expected claims, while also benefiting from a share of the investment returns. The underlying principles of *takaful* can be summarised as below;

- Participants co-operate among themselves for their common good by paying a part of the contribution as donation to help those need assistance. Losses are divided and liabilities are spread according to the community pooling system.
- Uncertainty is eliminated in respect of subscription and compensation.
- It does not seek to derive advantage at the cost of others

Therefore, *takaful* is perceived as cooperative insurance. The purpose of this system is not profits but to uphold the principle to stand shoulder-to-shoulder, side by side, enduring those burdens with togetherness.

Cooperative insurance being the main feature of *takaful* includes characteristic like self-responsibility, democracy, equality, equity, solidarity, honesty, openness, social responsibility, and caring for others. While mutuality or cooperative risk sharing is at the core of Islamic insurance, it cannot alone create an Islamic insurance operation. Islamic insurance is based on more than one contractual relationship: The first relationship is a mutual insurance contract between contributors (policy holders) and each other. This is similar to a pure mutual insurance relationship, taking into consideration the concept of donation (*tabarru*) instead of premiums and an ethical framework of Islamic transactions. The main features behind cooperative insurance are (White, *no date*):

- Policy holders pay premiums to a cooperative fund with the intention of it being a donation to those who will suffer losses (*tabarru*).
- Policy holders are entitled to receive any surplus resulting from the operation of the cooperative insurance investment.
- Policy holders are liable to make up for any deficits that result from the operation of the cooperative insurance investment.
- The amount of contribution (premium) differs from one participant to another, based on the degree of risk in general insurances and actuarial principles in life assurance.

Under Islamic insurance, the system is that the insurance company's role is restricted to managing the portfolio and investing the insurance contributions for and on behalf of the participants. They run the pure cooperative model (non-profit). "The overarching goal of Takaful is brotherhood, solidarity, protection and mutual cooperation between members" (Kassar, 2008).

Ethical insurers invest money in a responsible way in industries that are ethically sound and do not harm the environment or people. Islamic insurance is similar, except that the ethical considerations are extended to those which do not contravene the religion of Islam and are monitored by a *Syari'ah* board, which is part of the company structure. In particular, the investment and underwriting policies need to be free of any involvement with the prohibited activities such as gambling, alcohol, pork, armaments, tobacco, and interest bearing activities like loans and securities. Islamic insurance is a very close concept to those we call "ethical" insurers.

A good intention and act will always lead to a good life now and hereafter. This is in accordance to Islamic teaching and the *maqasid al-Syari'ah* whereby every human is required to protect themselves and their descendents.

Therefore, the distinguishing aspect of Islamic insurance is that it is not solely profit oriented, but rather essential purpose is self-help through cooperation. It advanced as a collective institution with objective to amortize the burden of an individual by splitting it among his fellow members. From a conventional perspective, insurance emerges as set of mutual contracts that transfer risk for the benefit of the individuals who choose to make that contract (Kwon, 2007). On the other hand, from an Islamic perspective, insurance appears as a foundation that removes risk for the benefit of a social group (*maslahah*). This is based on the principles of co-operation as mentioned in a *Qur'an,"help ye one another in righteousness and piety, but help ye not one another in sin and rancour..."* (Al-Ma'idah:2).

Any approach to Islamic insurance must acknowledge the importance of economic growth as well as social justice. *Takaful* is said to be based on the principles laid down by Islamic teachings, which is classified into: protection of human life; protection of human intellect; protection of human property; protection of human honour; and protection of human conscience (El-Sheikh, 1987). In line with *Syari'ah* requirements and the concept of *takaful*, risk management practice and management of a *takaful* operator should be better off than a conventional insurance operator.. *Takaful* operators need to be proactive in managing their risks as part of good governance and best practice code. Self regulatory is needed rather than depending on regulatory requirements. As risk is an on-going process, continuous development of knowledge is required in order to understand and manage the risks effectively. Irrespective of the various business model adopted by the *takaful* operators (*mudharabah* or *wakalah* or hybrid), the risk management will be the same since it lies on the same principle; *Syari'ah*.

5. CONCLUSION

Islamic financial system differs significantly from conventional system, not only in the ways it functions, but above all, the values in which guide its whole operation and outlook. Protection that is in accordance with *maqasid al-Syari'ah* needs to be integrated into the Islamic finance activities. Protection of the five values of faith, life, lineage, intellect, property and is of primary importance to the *Syari'ah.* Generally, Islamic financial services market is built on a societal foundation or religious principles that may help the institutions introduce products designed and priced based on the principle of member equality (Kwon, 2007).

The implications of the principles of *maqasid al-Syari'ah* on how an Islamic bank functions are clear. Invoking the *Syari'ah* and embracing the *maslahah* imply that such banks must not be solely oriented toward profit; rather, they must seek to promote the social welfare and protect the needs of society as a whole.

In addition, the Islamic banks should have a clear financing policy and guidelines to guide them while they are considering a commercial dealing proposal. For example, Islamic banks cannot finance a company dealing in gambling, pornography, alcohol, and other prohibited transactions like a company involved in activities deemed harmful to society (e.g., environmental degradation) or those abusing human rights. Protection that is in accordance with *maqasid al-Syari'ah* needs to be integrated into the Islamic finance activities. Moreover, Islamic banks cannot make excessive profits at their customers' expense and neglect their social responsibility and commitments to their stakeholders.

Islamic finance is more than only offering a *Sharia'h* compliant products but it is also comprehensive system which aims at making a positive contribution to the fulfilment of the socio-economic objectives of the community at large.

Islamic banking must take into consideration the universal and dynamic conception of *maqasid al-Syari'ah*. Banks must develop its role by embracing social objective, not only an individual objective. Islamic banks are envisaged to engage in endorsing social welfare. This view is embraced by the various Muslim scholars who are stating that Islamic banking is much more than providing *Syari'ah*-compliant products. It should be structured in such a way that its primarily goal is to achieve an positive contribution to the realization of the socio economic objectives of the society at large (Mohamed, 2007).

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ISLAMIC SOCIAL REPORTING IN SHARIAH COMPLIANT SECURITIES: A CASE STUDY IN A SOCIALLY ACCEPTED MARKET INVESTMENT HALAL FOOD INDEX COMPANY

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Abstract

The aim of this paper is to examine the Islamic Social Reporting (ISR) reporting in Sime Darby Berhad, a *Shariah*-compliant company listed on Bursa Malaysia and a also company under the Socially Accepted Market Investment (SAMI) Halal Food Index. The ISR variables examined in the case study were first identified in this study. The case study approach is employed to study the ISR variables in the company using secondary data from annual reports for three years. To identify the dimensions performed on the case, the study identifies the factors that may contribute to ISR practices among the top *Shariah*-compliant companies in Malaysia. The research findings reveal that Sime Darby Berhad reports more on ISR variables relates society and environment in its annual reports but less on corporate governance and products and services. None was reported in the annual reports on finance and investment. The ISR variables identified could be used for future research to learn about the non-financial performance of *Shariah*-compliant companies in term of their adherence to *Shariah* and their level of social responsibility practices.

Keywords: Islamic Social Reporting, Responsible Investment, Halal Food Index

1. INTRODUCTION

Over the years there has been an increase in the voluntary disclosures, with changes in the design and content to include graphics, photographs and disclosures relating to human resources, the environment and the community (Marino, 1995; Stanton and Stanton, 2002; Zéghal and Sadrudin, 1990). More recently, and coinciding with some major

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corporate ethical disasters, many companies have been including sections on governance, ethical practice and social responsibility.

Accordingly, Baydoun and Willet (2000), Haniffa and Hudaib (2002), and Haniffa (2002) suggested that from the perspective of corporate reporting, two essential principles underlie the concept of accountability in Islam, that are: the principle of full disclosure and the concept of social accountability. Both of these fundamental concepts are inter-related with the objective to serve the public interest. This is because full disclosure in the annual report of relevant and reliable information would assist the Muslim stakeholders to make both economic and religious decisions, as well as assist management in fulfilling their accountability to *Allah (subhanahu wa ta'ala)* and the society (Haniffa and Hudaib, 2002). Accordingly, the accounts prepared have to disclose everything that is believed to be "of importance to the Islamic users for purposes of serving God".

Thus, one of the ways to provide full disclosure in the Islamic context is by practicing Islamic Social Reporting (hereafter so-called as ISR) (Haniffa and Hudaib, 2001; Haniffa, 2002 and Othman *et al.,* 2009). According to (Maali *et al.,* 2006), the three key objectives of the ISR are: (1) to show whether the organization is compliant with Islamic principles; (2) to show how the operations of the organization has affected the well-being of the Islamic community; and, (3) to help Muslims perform their religious duties. Therefore, ISR is needed for the Muslim community with the objectives of demonstrating accountability to Allah and the community and to increase transparency of business activities by providing relevant information in conformance to the spiritual needs of the Muslim decision-makers (Haniffa, 2002).

Subsequently, with *Shariah*-compliant companies conducting their business in accordance with Islamic principles, one would thus expect their disclosure practices to be similarly aligned. As the Islamic organizations, *Shariah*-complaint companies are responsible to demonstrate their accountability and commitments in serving the needs of the Muslim community and society in general via disclosure of relevant and reliable information in the annual reports (Haniffa and Hudaib, 2004). However, recent anecdotal

evidence finds that the Islamic organizations may not be fulfilling their social role in accordance with the prescriptions of Islam because they disclosed less social responsibility information than expected (Metwally, 1992; Aggarwal and Youssef, 2000; Maali *et al.,* 2003).

2. ISLAMIC SOCIAL REPORTING IN *SHARIAH*-COMPLIANT COMPANIES IN MALAYSIA

Social reporting was originally voluntary; it is not required by any financial disclosure regime, accounting standards, the stock exchange rules and regulations, and the Companies Act in Malaysia. However, the government supported it strongly, feeling that disclosure would take deeper root and have more substance if it developed organically from within Malaysian companies.

Consequently, public listed companies (PLCs) in Malaysia would no longer be encouraged to disclose information on their social responsibility, but would be required to do so. In accordance with the government policy, Bursa Malaysia requires the companies which listed on their exchange to include additional information in their annual report:

> *"…a description of the corporate social responsibility activities or practices undertaken by a listed issuer and its subsidiaries or if there are none, a statement to that effect." (Bursa Malaysia Securities,* 2008).

Following this requirement, the Financial Reporting Standard (FRS) 101 has explicitly stated that additional information should be incorporated into their annual reports if the management believes that such information would assist their stakeholders to make better economic decisions (Zulkifli and Amran, 2006). Information is useful for decision-making when social and environmental information are provided according to the demand of the more influential users (Mohamed Zain, 1999). Although the law does not specify what such a description would look like, Bursa Malaysia and the Malaysian Institute of Accountants (MIA) published guidance focusing on social responsibility

activities and practice in four areas: “Marketplace”, “Environment”, “Workplace”, and “Community” (World Federation of Exchanges, 2009). Apparently, Bursa Malaysia will de-listed corporations that do not comply, but the “comply or explain” nature of the requirement makes it easy for corporations which not engaging in social responsibility to meet the basic standard of voluntary disclosure.

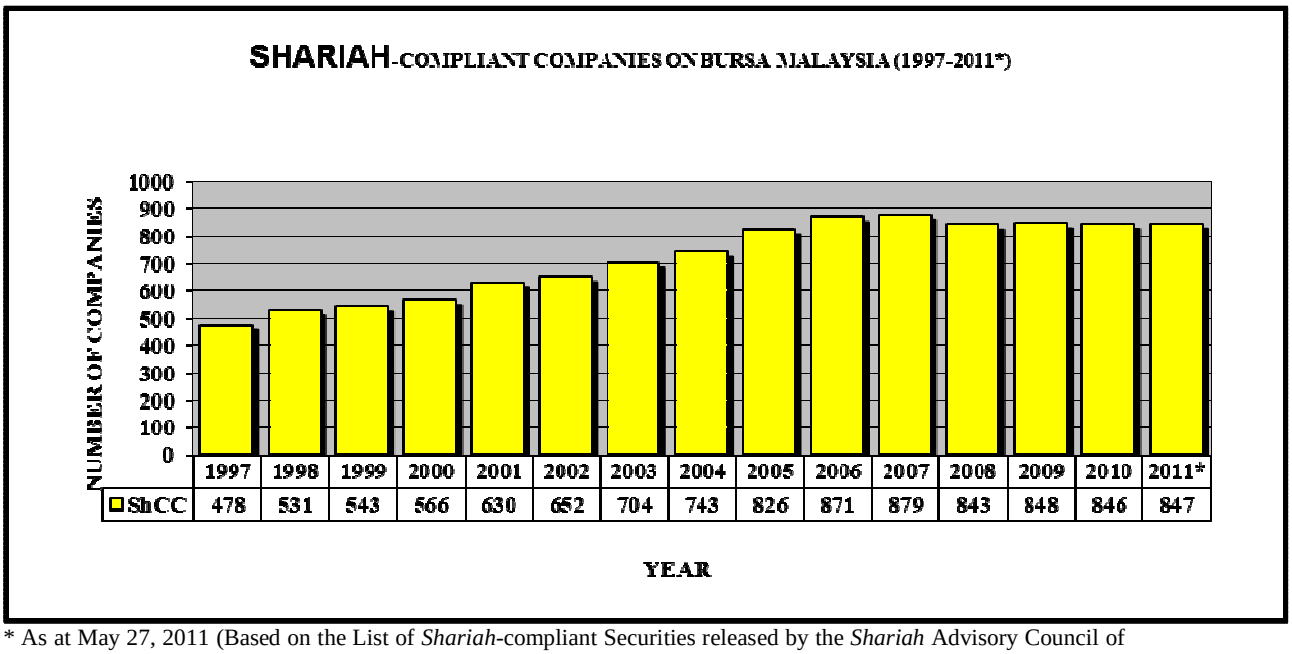
Such support from the government also plays a role in pushing through the social responsibility agenda among companies in Malaysia. Even though the extents to which the government support and initiative has been able to attract foreign investment and socially responsible investors are remain unclear[4], however to date it appears that Malaysia’s biggest success has been in the Islamic Capital Market (ICM), consisting *Shariah*-compliant funds and Islamic banking (EMDP/EIRIS Report, 2009 and Jamal *et. al*, 2010). Islamic Capital Market (ICM) was established, in which transactions and activities are based on *Shariah* principles, and are free from non-permissible elements. The aims of setting up the ICM are to establish Malaysia as a centre for ICM internationally, and to enable Muslims to recognize and build confidence in *Shariah* compliant investments (Securities Commission, 2002). In fulfilling this objective, it was reported that nearly 20 percent of the country’s banking industry is composed of *Shariah* assets and Malaysia has been particularly successful in *Shariah* finance, which may bode well for efforts to attract SRI investment (Permatasari, 2010).

In conjunction, there are nearly 150 *Shariah* investment funds in Malaysia, far more than the rest of the Asian community (The Rockefeller Foundation, 2011). The most popular type of Islamic funds in *Shariah* finance is the *halal* options offering by *Shariah* equity finances (Jamal *et al.*, 2010), which helps investors to invest in *Shariah*-complaint

[4] This is because, since the regulation was implemented, the global economy has been in a recession, affecting investors of all types. It is worth noting that the SRI market in Malaysia as of July 2008 was around $14 million (Cynthia Ann Peterson, 2008). However, within current economic growth and development, there is potential for Malaysia to attract funds from the area in future.

securities[5]. As a consequence, 89% (839 securities) out of the total 946 securities listed on Bursa Malaysia as at 31 December 2011 are *Shariah*-compliant (Bursa Malaysia, 2012). This figure represents around two-thirds of Malaysia's market capitalization (ibid). Figure 1 presents the number of *Shariah*-compliant companies on Bursa Malaysia for 15-year period from 1997 to May 27, 2011. The list is essential to drive for further growth in the Islamic capital market, especially in providing reference and guidance to the investing public and for the development of the Islamic management industry (Securities Commission, 2007).

Figure 1: Statistics of *Shariah*-compliant Companies on Bursa Malaysia



* As at May 27, 2011 (Based on the List of *Shariah*-compliant Securities released by the *Shariah* Advisory Council of the Securities Commission). **Source:** Securities Commission (2011.

[5] *Shariah*-compliant securities means the stocks (ordinary shares or equities) of a company listed on Bursa Malaysia are comply with Islamic principles of investment. In order to qualify as classified as *Shariah*-compliant securities, an investment must be free from interest or usury (*riba'*), gambling (*maisir*), uncertainty (*gharar*), and forbidden (*haram*) products or activities according to Islam (Ahmad and Ibrahim, 2002).

This data implies that *Shariah*-compliant securities represent around two-thirds of Malaysia's market capitalization (Permatasari, 2010; Securities Commission Malaysia, 2010). Notably, the number of *Shariah*-compliant securities was only 272 as at 31 December 1998 (that is, a few months prior to the launch of the *Shariah* Index (2004) by Bursa Malaysia), which represents 37% of the total listed securities (Bursa Malaysia, 2004). The rate of increase between the years 1998 and 2009 is 211%, thus indicating the importance of *Shariah*-complaint companies (ShCC)[6] as an important component of the overall capital market and the ICM in Malaysia.

With the supported by the country's large Muslim who seek to invest in companies which conduct their activities in strict accordance with Islamic principles, the number of *Shariah*-Complaint Companies is set to increase significantly in future. *Shariah*-Complaint Companies developed to be the favorable choice for investment in this country as both Islamic and non-Islamic investors become more aware of potential rewards from investing in Islamic funds which can only be invested in this type of companies.

3. SOCIALLY ACCEPTED MARKET INVESTMENT (SAMI) HALAL FOOD INDEX

The growth of Islamic banking and finance as financial services and *Halal* food and non-food manufacturing are seen as independent to each other. First is due to the different regulators dealing with the different market. One is financial services and the other is tangible product manufacturing and distribution. The closest integration of both markets is the *Shariah*-compliant securities offered in Bursa Malaysia via its *Shariah*-compliant securities, which includes the *Halal* manufacturing sector in the consumer goods section.

[6] Specifically, companies whose activities do not contravene the *Shariah* principles are classified as *Shariah*-compliant companies (Anuar, Sulaiman and Nik Ahmad, 2009). Otherwise, this study refers the companies whose activities are contravened the *Shariah* principles as *Shariah non*-compliant companies (ShNCC) or conventional companies.

The number of the securities now has reached nearly 90% of total securities traded in Bursa Malaysia.

However, the market did not make full use of the growth of both sectors, until recently, in April 2011 when a *Halal* food index was launched. The world's first *Halal* food index, the Socially Acceptable Market Investments (SAMI) *Halal* Food, is anticipated to grow even faster than the Dow Jones Islamic Index (DJII) in terms of size, branding and spin-off products. This Index contains over 270 stocks from 15 OIC countries from six sectors with a market capitalization of US$114 billion, with 95 of these stocks are from Malaysia. The biggest Malaysian stocks on the SAMI index are Sime Darby Bhd, Nestle (M) Bhd and Genting Plantations Bhd. The champion of the index is Rushdi Siddiqi, who championed the introduction of Dow Jones Islamic Index in 1999 (n.a, 2011).

The summary profile of SAMI *Halal* Food Index is when it was launched as follows:



Source: SAMI Index (Chart by DinarStandard)

The composition of companies producing halal products included in the Index is provided in Table 1. The table shows the latest data as at end of March 2012 on the composition of the companies in the Index according to countries.

Table 1: Composition of the Companies in the Index According to Countries

No.		Number of Companies	%
1	Malaysia	40	27.59
2	Indonesia	16	11.03
3	Saudi Arabia	16	11.03
4	Egypt	15	10.34
5	Turkey	10	6.90
6	Kuwait	9	6.21
7	Oman	9	6.21
8	Nigeria	8	5.52
9	Morocco	7	4.83
10	United Arab Emirates	6	4.14
11	Pakistan	4	2.76
12	Jordan	2	1.38
13	Qatar	2	1.38
14	Syria	1	0.69
Total		**145**	**100**

Source: IdealRatings (March 2012)

The SAMI index is a consumer non-cyclical sector. Investors may include in their portfolios the companies in the index to as a hedge against inflation and also to boost the performance of their portfolios. In term of performance, the SAMI index outperformed several leading global food indexes from March 2010 to March 2011 by 20%, according to IdealRatings, a *Shariah*-screening company, which also collaborated in the introduction of the index.

Quality *Shariah*-compliant asset classes are hard to come by. This is because new issuances of *Shariah*-compliant papers are likely to be held by Islamic funds, creating liquidity problem for the *Shariah*-compliant securities. This leaves investors wanting to invest in *Shariah*-compliant assets are left with limited choice of high quality *Shariah*-compliant papers. The introduction of SAMI *Halal* Index provides investors with more help in term of information search to perform fundamental analysis on these stocks. A

birth of an Index comes with many other perks such as database of securities in the index and many other supports for investors and fund managers.

Having *Halal* food companies as *Shariah*-compliant asset class moves the value proposition of *Halal* food production. Previously consumers provide revenue to the firms producing *Halal* food, but now they are able to invest in these companies directly or through funds. By investing in the sector known to them will make it easier for them to understand the risk and return profiles of these shares.

With the introduction of the Index, investors are able to track and monitor their investment in the companies under the index. If the investment returns from their portfolios in *Halal* food companies beats the Index, it indicates that their investment performance is doing well. Having an Index in an industry helps investors, fund managers and financial planners to benchmark their portfolio returns to that of the index. Having an Index as a benchmark also helps the fund managers to tangibly compare the performance of *Halal* portfolios to the Index. With tangible benchmark, investors and fund managers or financial planners are likely to agree on the baseline (the benchmark). Lacking of such Index will open many opportunities for debate on which investment risk and returns characteristics they should refer to, thus creating some problems for portfolio monitoring and rebalancing.

The SAMI *Halal* Food Index will be the bridge builder for Islamic funds, exchange traded fund investing and *Sukuk* issues as well as for global non-Islamic investors interested in the emerging food sector markets, a non-cyclical and therefore lower risk sector.

For example, split-off effects for the Index introduction will be series of introductions of exchange traded funds for *Halal* food groups of shares which will suit investors with various risk taking profiles. IPOs opportunities are also possible. When this sector becomes more acceptable to the investors, *Halal* food production companies may financial injection from Islamic banks in form of *Mudharabah* participations.

This Index also might kicks off some introductions of *Sukuk* issuance in the future. Shikoh, R. (2011) writes about the how the two areas where *Sukuk* can be utilized by *Halal* food companies. For example, a true asset backed financing, an *Ijarah Sukuk* could be issued to build factories producing *Halal* food. Another interesting opportunity is for the *Halal* food production companies which failed the debt screen test to issue *Sukuk* to refinance conventional and BBA debt to become a *Shariah*-compliant securities.

4. DEFINITION AND ISLAMIC PERSPECTIVE OF SOCIAL REPORTING

There is no specific and universally agreed definition of social responsibility, even though many versions have been offered. Social responsibility can be broadly defined as "including the concern for the impact of all of the corporation's activities on the total welfare of society" (Bowman and Haire, 1976, p. 13). However, in the researcher's view, there are two concepts lie at the heart of corporate social responsibility[7] – the key principles of accountability and responsibility to external stakeholders, including the environment, and a commitment to sustainable business practices. Accordingly, the entity is influenced by and, in turn, has influence upon the society in which it operates (Deegan, 2002; Farook and Lanis, 2005). To that effect, corporate disclosure is seen as a method by which management can interact with broader society to *"influence external perceptions about their organization"* (Deegan, 2002, p. 292).

Coinciding with some major corporate ethical disasters, many companies have been including sections on governance, ethical practice and social responsibility. This led to the increasing of the voluntary disclosures, with changes in the design and content to include graphics, photographs and disclosures relating to human resources, the environment and the community (Marino, 1995; Stanton and Stanton, 2002; Zéghal and Sadrudin, 1990). Such disclosure encompasses the provision of information on human

[7] A comprehensive discussion of the topic of corporate social responsibility also requires a consideration of directors' duties and whether directors are obliged or permitted to consider or take into account the interests of stakeholders other than shareholders. A consideration of these issues is beyond the scope of this paper.

resource aspects, products and services, involvement in community projects/activities and environmental reporting. As Gray *et al.,* (1995) stated:

> *"…it is not restricted necessarily by reference to selected information recipients, and the information deemed to be CSR may, ultimately, embrace any subject…"*

Along this line, corporate social reporting is defined as a method of self-presentation and impression management conducted by companies to insure various stakeholders are satisfied with their public behaviors (see Hooghiemstra, 2000; Patten, 2002). In capturing the understanding of the Islamic social responsibility concept, one needs to know the worldview of Islam. Islam is a complete code of life. There are three fundamental elements of Islam such as *aqidah* (belief and faith), *ibadah* (worship), and *akhlaq* (morality and ethics) (Siwar and Hossain, 2009).

Aqidah is concerned with all forms of faith in Allah and his will that need to be translated into actions. The *Shariah* is the Islamic law governing the actions of human beings, which can be categorized into two main parts, known as *ibadah* (religious worship) and *muamalat* (social relation). The third element is *akhlaq*, which are related to moral behavior, attitude and work ethics (Satkunasingam and Shanmugam, 2004). It serves as code of ethics to be observed by Muslims in all of their conducts of life. According to Billah (2003) *akhlaq* is shaped and developed in the light of a Muslim's belief and conviction in all articles of faith. Thus, *akhlaq* reflects a believer's lifestyle and behavioral pattern in terms of belief, thought and actions (Siwar and Hossain, 2009).

The concept of social responsibility in Islam encompasses a broader meaning embracing the *taqwa* (God consciousness) dimension by which corporation as group of individual, assuming the roles and responsibility as servants and vicegerents in all situations (Dusuki, 2008). Hasan (2002) explain that the relationship with God would be inspired by the values of truthfulness, fairness, kindness, uprightness rather than envy, backbiting,

discrimination. This should naturally manifest in business activities as well as their relationship with their all stakeholder.

Accordingly, social responsibility in Islam stems from the concept of *ukhuwwah* (brotherhood) and social justice (Naqvi and Syed Nawab Haider, 1981) by sharing prosperity for society's progress (Hassan, 2002). Accordingly, in Islam, business activities are considered as religious obligation (al-Shaibani, 1997). Thus, Islamic business activities are not undertaken to satisfy only material needs and wants but more importantly it should be undertaken to fulfill the religious obligation and to achieve other non-material objectives such as to secure social needs (al-Jawziyyah, 1995; Rahman and Goddard, 1998).

The obligation that organization has to protect and contribute to the society in which it functions is defined as social responsibility (Beekun and Rafik Issa, 1997). Therefore, social responsibility is considered crucial for Islamic business organizations[8]. The practice of social justice will prevent Muslims from doing harm. *Allah (subhanahu wa ta'ala)* reveals:

> *"Allah commands justice, the doing of good and liberality to kith and kin, and He forbids all shameful deeds, and injustice and rebellion…" (Qur'an, Surah An-Nahl, chapter 16: verse 90).*

In addition, the concept of brotherhood makes Muslims responsible to each other (Alhabshi, 1994). Both concepts (that is, commitment of Islam to justice and brotherhood) require the Muslim society to take care of the basic needs of the poor (Naqvi, 1981), as the Prophet Muhammad *(sallallahu 'alaihi wa sallam)* says:

[8] Islamic business organizations represent companies that utilize, fully Islamic products in their daily operations and conduct their business in a manner that is consistent with the teachings of Islam.

> *"A Muslim is a brother of another Muslim: he neither wrongs him, nor leaves him without help, nor humiliates him."(Muslim).*

Based on the axiom of *tawhid*, the primary objectives of Islamic social responsibility is to demonstrate responsibility to *Allah (subhanahu wa ta'ala),* human beings, and to the environment as well. *Tawhid*, which signifies the acceptance of unity of *Allah (subhanahu wa ta'ala),* provides one single direction in guaranteeing a unified spirit in adhering to *Shariah* (Moten, 1990). The concept of *tawhid* also signifies man's role as that as *Allah'*s *khalifah* (vicegerent) on earth. *Allah (subhanahu wa ta'ala)* says:

> *"Behold, thy Lord said to the angels: "I will create a vicegerent on earth." (Qur'an, Surah Al-Baqarah, chapter 2: verse 30).*

Allah (subhanahu wa ta'ala) creates man in the best forms (*khaira ummah*) (Nanji, 1991) to worship and serve him and entrusted him a special duty as a *khilafah*[9] (vicegerent) on this earth *(Qur'an, Surah At-Tiin, chapter 95: verse 4).* This illustrates that every man has dual function in their life; as a servant of *Allah (subhanahu wa ta'ala)* and as a *khalifah* on earth (Hassan, 1992). As a servant of *Allah (subhanahu wa ta'ala),* man needs to worship *Allah (subhanahu wa ta'ala),* seeks *Allah's* pleasure, follow *Allah's* laws, be good to all creatures of *Allah (subhanahu wa ta'ala)* and to refrain from doing *al-fasad* (destruction). On the other hand, as a *khalifah* on earth, man needs to enforce the *Shariah* in his life, maintain the harmony and peace, protect the environment, and to fulfill the roles of *al-sifah al-mahmudah* (good manner).

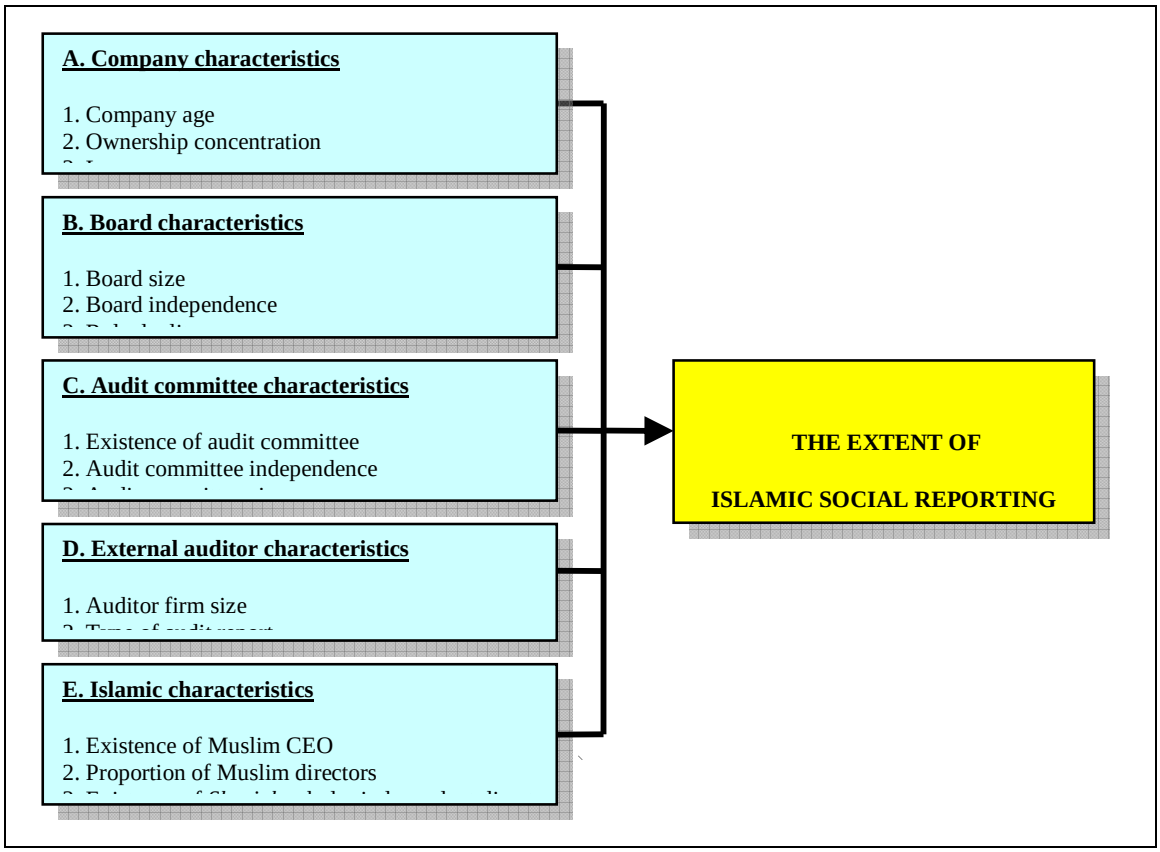
[9] *Khilafah* defines man's status and role and specifies his responsibilities (Bashir, 1998). The concept of *taklif* demonstrates that every individual is responsible for his own deed (*Qur'an*, 2:143).

5. METHODOLOGY

In this context, although there are a number of studies that have examined the factors that may influence a company to provide corporate social reporting, most of these studies examined the conventional social reporting, overlooking examination of Islamic social reporting. One may argue that examining this dimension is equally important since it draws around stakeholders' beliefs, particularly the Muslim stakeholders in fulfilling their spiritual needs. This study, therefore, attempts to examine the factors that may contribute to ISR practices among the top *Shariah*-compliant companies in Malaysia. An examination of this issue provides further understanding on whether the factors found to be influencing a company in the conventional social reporting would appear similar in the Islamic social reporting.

This current study however, classified the possible factors which may influence the practices of ISR in company annual report into five categories, namely: (1) company characteristics; (2) board characteristics; (3) audit committee characteristics; (4) external auditor characteristics; and, (5) Islamic characteristics as shown in Figure 3. This study extends the investigation done by Othman et al (2009) by introducing more possible factors to be discussed. Furthermore, to the best of the researcher knowledge, this is the first study which introduces the Islamic characteristics (factors consisting of: the existence of Muslim CEO, proportion of Muslim directors, and the existence of *Shariah* scholar independent directors) in literature. In discussing these factors, this current study used Sime Darby Berhad as a case of the study. To fulfill the purpose, three years annual report of this company will be used as the samples of study, comprising of the year 2009, 2010 and 2011.

Figure 3: Framework of the Study



Before those possible factors can be further discussed, this current study affords to define each of them together with the definition of the extent of ISR practices in terms of their measurement or operational definition. This is shown in Table 2. Results obtained from the measurement then will be further discussed in the following section.

Table 2: Operationalisation of Variables

ISR Possible Factors	Operational Definitions
Theme A: Company Characteristics	
Company age	**Total years** since it has been incorporated as a legal entity.
Ownership concentration	Percentage **of shares owned by the 10 largest shareholders to total number of shares issued**.
Leverage	The ratio **of total debt to total assets**.
Theme B: Board Characteristics	
Board size	The **number** of board members.
Board independence	Proportion of independent non-executive directors indicates the **percentage of the independent non-executive directors to the total number of the directors on board.**
Role duality	A dummy variable will be used for the presence of dual leadership, where value **"1" is coded if the Chief Executive Officer (CEO) is also the Chairman of the board**, and "0" if otherwise.
Theme C: Audit Committee Characteristics	
Existence of audit committee	A dummy variable will be used for the presence of audit committee, where **"1" is coded if the audit committee is exist** in the company structure, and "0" if otherwise.
Audit committee independence	Proportion of independent audit committee indicates the percentage of the independent non-executive directors who become an audit committee; that is, **the percentage of the independent non-executive directors to the total number of the audit committee.**[10]
Audit committee size	The **number** of audit committee members.
Theme D: External Auditor Characteristics	
Auditor firm size	A dummy variable will be used for the auditor firm size, where **"1" is coded if the firm's auditor is a Big Four[11] auditor,** and "0" if otherwise.
Type of audit report	A dummy variable will be used for the type of audit report, where **"1" is coded if the annual report is clean (so as to give a true and fair view of the financial position),** and "0" if otherwise.
Theme E: Islamic Characteristics	
Existence of Muslim CEO	A dummy variable will be used for the presence of Muslim CEO, where **"1" is coded if the CEO is Muslim,** and "0" if

[10] Malaysian Code of Corporate Governance (2007 revised) stipulates that executive directors are no longer allowed to be members of the audit committee; this bring a mean that all of audit committee members must be independent non-executive directors.

[11] The Big Four includes the four largest audit firms which are: (1) PwC (officially PricewaterhouseCoopers), (2) Deloitte Touche Tohmatsu, (3) Ernst & Young, and (4) KPMG. Global membership for Deloitte Touche Tohmatsu in Malaysia is Deloitte KassimChan.

	otherwise.
Proportion of Muslim directors	Percentage of **the Muslim directors to the total number of the directors** in the board.
Existence of *Shariah* scholar independent directors	A dummy variable will be used for the presence of *Shariah* scholar[12] of independent directors, where "1" is coded if **the *Shariah* scholar is exist among the Muslim independent non-executive directors on board**, and "0" if otherwise.
The Extent of ISR	**Operational Definitions**
Islamic social reporting in companies' annual reports	Total ISR disclosure scores as the sum of the scores awarded for each disclosure item.

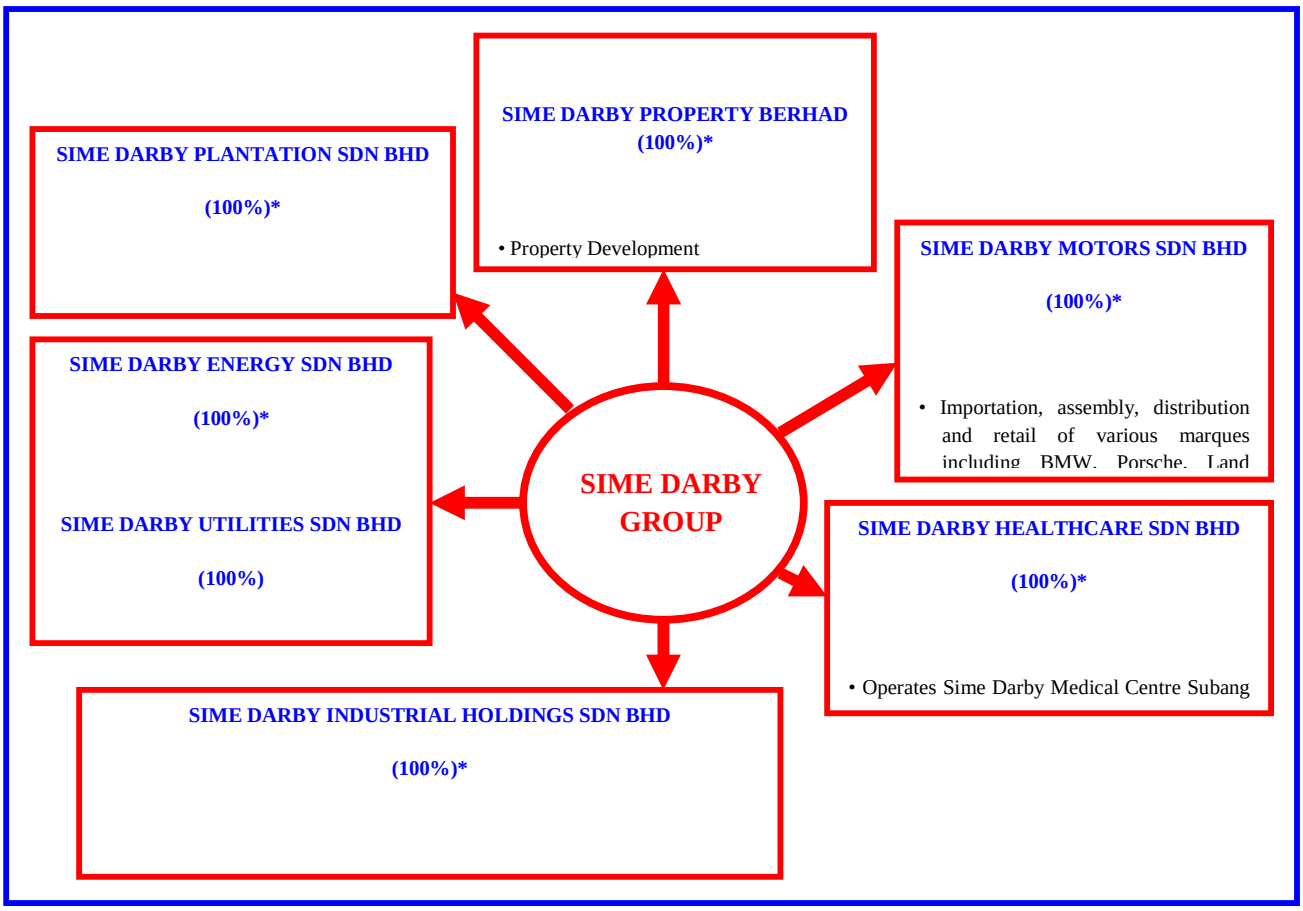
The following section will provide detail information on Sime Darby Berhad as the discussion of its ISR practices throughout their three years annual reports (2009-2011) will be made.

6. ISLAMIC FINANCIAL REPORTING: A CASE STUDY ON SIME DARBY BERHAD

In November 2007, Kumpulan Sime Darby Berhad, Golden Hope Plantations Berhad and Kumpulan Guthrie Berhad merged to become the world's largest listed plantation company as well as a diversified multinational with operations in over 20 countries. The core businesses of the Sime Darby Group are plantation, property, industrial, motors, energy and utilities and healthcare. Sime Darby is one of the largest listed companies on Bursa Malaysia with a market capitalization of RM55.47 billion as at 30 June 2011. It is a global player in the Plantation industry and a leading supplier of Caterpillar equipment and luxury cars such as BMW. The Group's initial trading activities took it beyond Malaysian shores but today, it is a homegrown and diversified multinational with more than 60 percent of revenues derived from overseas operations. Employing over 100,000 people worldwide, Sime Darby is committed to sustainable growth and development in all aspects of its business operations. Sime Darby family in any one of six business sectors, they are: Sime Darby plantation, Sime Darby property, Sime Darby industrial, Sime Darby motors, Sme Darby energy and utilities, and Sime Darby healthcare. The group structure is shown in Figure 4.

[12] For the purpose of this current study, *Shariah* scholar is refers to the Muslim independent non-executive director that has a *Shariah* qualifications or *Shariah* expertise as those with the *Shariah* educational qualification (for example, *Shariah* degree holder in *fiqh muamalah* and Islamic jurisprudence) and/or has experience and/or exposure in *Shariah* corporate governance/Islamic finance (possibly, has a position in the *Shariah* Advisory Council or come from *Shariah* Committee).

Figure 4: Structure of Sime Darby Group



***Note:* * 100%** : wholly owned by Sime Darby Berhad
Source: Sime Darby Annual Report (2011)

7. FINANCIAL HIGHLIGHTS

For the financial year ended 30 June 2011 (Financial Year 2010/2011), the Sime Darby Group posted a record net profit after tax and non-controlling interests of RM3.7 billion. This achievement was 47 percent higher than the Key Performance Indicator (KPI) target of RM2.5 billion. The Group also recorded a Return on Average Shareholders' Funds (ROASF) of 16.5 percent, exceeding the KPI target of 11.5 percent. Table 3 shows the details of the Group results while Table 4 summarizes the divisional results of the Group.

Table 3: Sime Darby Group Results

RM Million	2011	2010	% +/(-)
Revenue	41,858.8	32,506.2	+28.8
Profit before Tax	5,449.2	2,818.6	+93.3
Profit after Tax	3,847.9	854.8	+350.2
Profit after Tax and non-controlling interest	3,664.5	726.8	+404.2

Table 4: Summary of Divisional Results

RM Million	2011	2010	% + /(-)
Plantation Property	3,280.2	2,113.2	+55.2
Industrial	456.0	493.0	-7.5
Motors	1,068.0	758.0	+40.9
Energy & Utilities Healthcare	633.2	386.3	+63.9
Others	312.8	(1,751.7)	+117.9
	26.0	21.9	+18.7
	(42.0)	12.0	-450.0
Total	**5,734.2**	**2,032.7**	**+182.1**

The **Plantation Division** contributed RM3.3 billion to the Group's operating profit, after recovering significantly in the second half of the financial year from the prolonged rainfall and floods in the first half, which had caused lower production and reduced yields. The **Industrial Division** registered a record-breaking performance with an operating profit of RM1.1 billion for Financial Year 2010/2011, driven by exceptional sales of its Caterpillar equipment. Likewise, the **Motors Division** posted a record operating profit of RM633 million on strong and sustained demand for its range of products, especially the BMW marque, in all regions. The **Property Division**, meanwhile, saw a slight decline of 8 percent in its operating profit to RM456 million due to impairment provisions for its overseas properties. The **Energy and Utilities Division** underwent a successful turnaround in Financial Year 2010/2011 and recorded an operating profit of RM313 million, while the **Healthcare Division** registered a 19 percent improvement in its operating profit to RM26 million.

The Company proposed a final dividend of 22 sen per share for Financial Year 2010/2011. Combined with the earlier interim dividend of 8 sen per share, total dividend for the year is 30 sen per share. The Group is in a very strong financial position with shareholders' funds at RM24 billion, cash and bank balances of RM4.9 billion and a low gearing ratio (debt to-equity) of 28 percent. This provides the Group with the flexibility and capacity to seize opportunities in a global economic environment which is increasingly showing signs of volatility.

8. MAJOR CORPORATE ACTIVITIES

During the financial year under review, the Group undertook the following key corporate exercises:

1. Acquisitions

On 18 March 2011, Sime Darby Eastern Investments Private Limited acquired 100 percent of the issued shares of Haynes Mechanical Pty Ltd, AC Haynes Investments Pty Ltd and DG Nominees Pty Ltd for a consideration of up to AUD19.6 million. This acquisition gives the Industrial Division in Australia the additional supply of specialized labor that is required to sustain its growth moving forward, particularly in the parts and services segment.

2. Disposals

On 27 May 2011, Sime Darby Engineering Sdn Bhd entered into Memoranda of Understanding (MOU) with subsidiaries of Petroliam Nasional Berhad and Malaysia Marine And Heavy Engineering Holdings Berhad respectively to dispose of Teluk Ramunia and Pasir Gudang fabrication yards for a total provisional disposal price of RM695 million. On 25 August 2011, the parties entered into conditional sale and purchase agreements for an adjusted disposal consideration of RM689.5 million. Completion of this sale officially marks the exit of Sime Darby from the oil and gas business which is no longer in line with the Group's strategic direction.

9. DISCLOSURE PRACTICES

In analyzing the extent of ISR disclosure in Sime Darby Berhad, this study focused primarily on its 2011 annual report. The annual report has been used to analyze the ISR information disclosure in this study due to several reasons. Basically, this is consistent with previous voluntry disclosure studies (Al Arussi, 2008). Besides the annual report is the only regulated document that is more accessible to researcher (Buhr, 1998). Furthermore, the annual report is considered as a major source of information about an organization's voluntary performance (Deegan and Rankin, 1999) and has been widely recognized as a regulated document which has a high degree of credibility (Tilt, 1994; Neu *et al.*, 1998; Unerman, 2000). Finally, according to the previous studies on voluntary disclosure, the studies on the social reporting in Malaysia are still at the infancy stage and therefore it is expected that very few companies will produce stand-alone social responsibility report separately from the annual report (Al Arussi, 2008).

To fulfill the purpose, this current study adopted the ISR index from Othman *et al.* (2009). This ISR index has identified a total of 43 items of disclosure index which covering the six themes: finance and investment, product/services, employees, society, environment and corporate governance as shown in Table 5. Consistent with most previous disclosure studies (for example, Cooke, 1989; Azhar, 2001; Mohd Shatari *et al.*, 2004), this current study, however, used the dichotomous scoring scheme (the nominal score approach) to record the absence (represented by "0") or the presence (represented by "1") data for the 43 ISR items either in the form of word(s), sentence(s), picture(s) or graphic(s). As long as a minimum of one occurrence of disclosed ISR in any form of disclosure, the item is considered as available (Othman et al., 2009).

Table 5: Summary of Content of ISR Elements According to Individual Items and Themes

Theme		Disclosure Items	
A	**Corporate Governance**	1	*Shariah* compliance status
		2	Ownership structure: Number of muslim shareholders and its shareholdings
		3	BOD structure-muslim vs non-muslim members
		4	Declaration of forbidden activities: monopolistic practice/hoarding necessary goods/price manipulation/fraudulent business practice/gambling
		5	Anti-corruption policies
B	**Products And Services**	6	Green product
		7	*Halal* status of the product
		8	Product safety and quality
		9	Customer complaints/incidents of non-compliance with regulation and voluntary codes (if any)
C	**Finance And Investment**	10	*Riba* activities
		11	*Gharar*
		12	*Zakat*: method used/amount/beneficiaries
		13	Policy on Late Repayments and Insolvent Clients/Bad Debts written-off
		14	Current Value Balance Sheet (CVBS)
		15	Value Added Statement (VAS)
D	**Employees**	16	Nature of work: working hours/holidays/other benefits
		17	Education and Training/Human Capital Development
		18	Equal Opportunities
		19	Employee involvement
		20	Health and Safety
		21	Working environment
		22	Employment of other special-interest-group (i.e. handicapped, ex-convicts, former drug-addicts)
		23	Higher echelons in the company perform the congregational prayers with lower and middle level managers.
		24	Muslim employees are allowed to perform their obligatory prayers during specific times and fasting during *Ramadhan* on their working day.
		25	Proper place of worship for the employees.
E	**Society**	26	*Saddaqa*/Donation
		27	*Waqf* (religious endowment)
		28	*QardHassan*
		29	Employee Volunteerism
		30	Education: School Adoption Scheme/Scholarships
		31	Graduate employment
		32	Youth development
		33	Underprivileged community
		34	Children care
		35	Charities/Gifts/Social activities
		36	Sponsoring public health/recreational project/sports/cultural events
F	**Environment**	37	Conservation of environment
		38	Endangered wildlife
		39	Environmental Pollution
		40	Environmental Education
		41	Environmental Products/Process related
		42	Environmental Audit/Independent Verification Statement
		43	Environmental Management System/Policy

Source: Adapted from Othman *et al.* (2009)

10. ANALYSIS AND DISCUSSION

Table 6 illustrates the operationalisation and the scores for each of the ISR possible factors according to the respective years.

Table 6: The Operationalisation and the Scores of the ISR Possible Factors

ISR Possible Factors	The Operationalization and Scores		
Theme A: Company Characteristics	**2009**	**2010**	**2011**
Company age	**3 years**	**4 years**	**5 years**
Ownership concentration	**= 4421893956 / 6009463831 = 73.58%**	**= 4511817067 / 6009463831 = 75.08%**	**= 4299771637 / 6009463831 = 71.55%**
Leverage	**= 13434.1 / 35439.9 = 0.3791**	**= 16446.7 / 37577.6 = 0.4377**	**= 18048.7 / 42866.2 = 0.4210**
Theme B: Board Characteristics			
Board size	**13 members**	**15 members**	**12 members**
Board independence	**= 5/13 = 38.46%**	**= 9/15 =60.00%**	**= 5/12 = 41.67%**
Role duality	**0**	**0**	**0**
Theme C: Audit Committee Characteristics			
Existence of audit committee	**1**	**1**	**1**
Audit committee independence	**= 3/5 = 60.00%**	**= 4/5 = 80.00%**	**= 5/7 = 71.43%**
Audit committee size	**5 members**	**5 members**	**7 members**
Theme D: External Auditor Characteristics			
Auditor firm size	**1**	**1**	**1**
Type of audit report	**1**	**1**	**1**
Theme E: Islamic Characteristics			
Existence of Muslim CEO	**1**	**1**	**1**
Proportion of Muslim directors	**= 11/13 = 84.62%**	**= 11/15 = 73.33%**	**= 9/12 = 75.00%**
Existence of *Shariah* scholar independent directors	**1**	**1**	**0**

Table 7 shows the result found from the measurement of the extent of ISR practices within those years period annual report (2009, 2010 and 2011) of Sime Darby Berhad. "1" indicates the presence of the information in the particular annual report, while "0" otherwise.

Table 7: Scores on Individual Items and Themes for Six Dimensions of ISR

Theme		Disclosure Items		ISR Score					
				2009		2010		2011	
A	Corporate Governance	1	*Shariah*[13] compliance status	0		0		0	
		2	Ownership structure: Number of muslim shareholders and its shareholdings	0		0		0	
		3	BOD structure-muslim vs non-muslim members	1		1		1	
		4	Declaration of forbidden activities: monopolistic practice/hoarding necessary goods/price manipulation/fraudulent business practice/gambling	0		0		0	
		5	Anti-corruption policies	0	**1**	0	**1**	1	**2**
B	Products And Services	6	Green product[14]	0		0		0	
		7	*Halal* (lawful) status of the product	0		0		0	
		8	Product safety and quality	1		1		1	
		9	Customer complaints/incidents of non-compliance with regulation and voluntary codes (if any)	0	**1**	0	**1**	0	**1**
C	Finance And Investment	10	*Riba*[15] activities	0		0		0	
		11	*Gharar* [16]	0		0		0	
		12	*Zakat* (Islamic tax)[17]: method used/amount/beneficiaries	0		0		0	

[13] The Shariah is "the Islamic law of human conduct, which regulates all matters of the lives of Muslims. It is based on God's (Allah's *subhanahu wa ta'ala*) holy word in the Al-Qur'an, the deeds and sayings of the Prophet Muhammad *(sallallahu 'alaihi wa sallam)*, and the consensus of Islamic religious scholars" (Maali et al., 2006, pp. 1-2).

[14] The term is used to describe a product that meets one of these criteria: (1) It has qualities that will protect the environment; (2) It has replaced artificial ingredients with natural ingredients. For example, a cleaning product may be considered green for two distinct reasons. It may be manufactured without phosphates in order to reduce a source of pollution in the water supply, which makes it better for the environment than a cleaner that contains phosphates. Or it may contain ingredients derived from natural sources to lower the risk of health problems that can be caused by exposing the skin to artificial dyes or fragrances (Green Retail Decision, 2012).

[15] *Riba* means unlawful advantage by way of excess or deferment (Nabil A. Saleh, 1986).

[16] G*harar* means uncertainty, risk and speculation (ibid).

[17] Zakat "is a levy on Muslims whose wealth exceeds a certain specified minimum" (Sulaiman, 1998, p. 28).

		13	Policy on Late Repayments and Insolvent Clients/Bad Debts written-off	0		0		0	
		14	Current Value Balance Sheet (CVBS)	0		0		0	
		15	Value Added Statement (VAS)	0	**0**	0	**0**	0	**0**
D	**Employees**	16	Nature of work: working hours/holidays/other benefits	0		0		0	
		17	Education and Training/Human Capital Development	1		1		1	
		18	Equal Opportunities	0		0		0	
		19	Employee involvement	1		0		1	
		20	Health and Safety	0		1		1	
		21	Working environment	0		1		1	
		22	Employment of other special-interest-group (i.e. handicapped, ex-convicts, former drug-addicts)	0		0		0	
		23	Higher echelons in the company perform the congregational prayers with lower and middle level managers.	0		0		0	
		24	Muslim employees are allowed to perform their obligatory prayers during specific times and fasting during *Ramadhan* on their working day.	0		0		0	
		25	Proper place of worship for the employees.	0	**2**	0	**3**	0	**4**
E	**Society**	26	*Saddaqa*/Donation	1		1		1	
		27	*Waqf* (religious endowment)	1		1		1	
		28	*QardHassan* ("benevolent or good" loan or No Interest Loan Scheme)[18]	0		0		0	
		29	Employee Volunteerism	0		0		1	
		30	Education: School Adoption Scheme/Scholarships	1		1		1	
		31	Graduate employment	0		1		1	
		32	Youth development	1		1		1	
		33	Underprivileged community	1		1		1	
		34	Children care	1		1		1	
		35	Charities/Gifts/Social activities	1		1		1	
		36	Sponsoring public health/recreational	1	**8**	1	**9**	1	**10**

[18] Qard hasan is a "non-interest-bearing loan made for charitable objectives" (Baydoun and Willett, 2000, p. 77).

			project/sports/cultural events						
F	**Environment**	37	Conservation of environment	1		1		1	
		38	Endangered wildlife	1		1		1	
		39	Environmental Pollution	1		1		1	
		40	Environmental Education	1		1		1	
		41	Environmental Products/Process related	1		1		1	
		42	Environmental Audit/Independent Verification Statement	0		0		0	
		43	Environmental Management System/Policy	1	**6**	1	**6**	1	**6**
	TOTAL SCORES				**18**		**20**		**23**

Source: Othman *et al.* (2009)

From Table 7, it shows that despite of its poor ISR disclosure practices, however, the extent of ISR practices has been positively increased by year. Out of 43 disclosure items, 18 items (42 percent) were disclosed in 2009. This level then increase to 20 items (47 percent) in 2010 and 23 items (53 percent) in 2011. Ironically, it was found that although Sime Darby has been approved as *Shariah*-compliant company in 2011, however, the company did not disclose the information in their annual report. Yet, none information has been disclosed on finance and investment items along those years. This is absolutely inconsistent with what should be practiced by any business organizations which have claimed themselves as "Islamic" and *Shariah*-compliant. On the other hand, the figures illustrated that the company still concentrated more on practicing its conventional disclosure by focusing on disclosing more on its society and environment items.

Figures shown in both tables also illustrates that the older the age of the company, then the higher the level of the disclosure have been made by the company. In addition, with the big size of auditor's firm and clear type audit report, the increasing level of ISR also might be influence by the existence of Muslim CEO in the company which no role duality been practiced, regardless the existence of *Shariah* scholar independent directors in the board structure nor the proportion of Muslim directors as the board members.

More than that, the increasing level of ISR also might be influence by the existence of audit committee. Table 6 shows that with the increasing size of audit committee throughout those years; from 5 members in 2009 to 7 members in 2010. This result also reflects that the independence of audit committee members might influence the level of disclosure. It shows that the higher number of independent non-executive directors in the audit committee, the more disclosure will be made by the company. This scenario support what have been required by Malaysian Code of Corporate Governance (2007 revised) which stipulates that all of audit committee members must be independent non-executive directors; executive directors are no longer allowed to be members of the audit committee.

It was also indicates that disclosure level is not positively related to the size of the audit firm and type of audit report. Similarly, the high percentage of ownership concentration of shares and large board size are not necessarily influence the company to disclose more information on the ISR practices.

11. CONCLUSION

The growing numbers of *Shariah*-compliant securities and the *Halal* Food Index establishment requires a mechanism for investors and other stakeholders to monitor the companies' adherence to *Shariah* and to whether they are socially responsible. This could be done through examining the companies' reporting of Islamic social reporting (ISR). ISR could be used to provide full disclosure in the Islamic context as to increase transparency of business activities in conformance to the spiritual needs, especially of the Muslim decision-makers. The ISR variables identified could be used for future research to learn about the performance of *Shariah*-compliant companies in term of their adherence to *Shariah* and their level of social responsibility practices.

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STUDY THE EFFECTS OF IMPLEMENTATION OF TARGETED SUBSIDIESON THE IRAN PHARMACEUTICAL INDUSTRY (GAHP-TOPSIS METHOD)

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Abstract

The aim of this study is to apply a model for ranking firms according to financial ratios andthe subjective judgments of decision-makers.The proposed approach is based on group analytic hierarchy process (GAHP)andtechnique for order performance by similarity to ideal solution(TOPSIS). The proposed method is used for evaluating the performance of and ranking pharmaceutical companies in Tehran Stock Exchange according to their financial tables and comparing their performance before and after implementation of targeted subsidies. “Spearman correlation test” about amount of ranking was performed and the finding showed that there isn`t significant difference about performance of pharmaceutical companies before and after the implementation of targeted subsidies.

Keywords: AHP, TOPSIS, targeted subsidies, spearman correlation test, pharmaceutical industry

1. INTRODUCTION

Targeted subsidy plan has come to prominence in Iran since 2009. The government has described the subsidy plan as the "biggest surgery" to the nation's economy in half a century and "one of the most important undertakings in Iran's recent economic history". The subsidy reform plan has been the most important part of the broader economic reform program in Iran. As mentioned above, this paper tries to investigate the effects of this plan on the pharmaceutical companies in Tehran Stock Exchange. We evaluate the

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performance of the pharmaceutical companies and rank them according to their financial ratios.

2. LITERATURE REVIEW

Credit evaluation decisions in the banks can be subjective, based on knowledge and experience of the decision-maker, or systematic, based on precise evaluations and application of decision models (Babic and Plazibat, 1998). Application of a decision model requires precise evaluation and analysis of the situation. In other studies, multivariate statistical and econometric analysis techniques such as the linear probability model and the logit probit model are used for credit risk measurement (Altman and Saunders, 1998; Altman et al., 1977). Bryant (2001), Matsatsinis et al. (1997), O'Leary (1995), Sangster (1995), and Smith and McDuffie (1996) developed expert systems for financial analysis of firms. However, since these studies employ financial ratios as abasis for evaluating the firms, the non-financial analysis is limited due to insufficient non-financial measures. Other studies, such as Strischek (1999) and Todd et al. (1998) combine financial and non-financial information, so, they are not limited to using only financial ratios in credit evaluation. Babic and Plazibat (1998) rank the firms with respect to business efficiency using a multi-criteria approach, PROMETHEE. Zhu (2000) uses the DEA approach in the evaluation of thevfinancial performance of the companies of Fortune 500 and assigns the companies into one of the two groups of the financially efficient and non-efficient. Bozdagetal (2003) proposed four different fuzzy multi-attribute group decision making methods to select the best computer integrated manufacturing system. Changetal. (2003) adopted fuzzy synthetic and TOPSIS approach for ranking of airport performance. Kahraman et al. (2003) used FAHP to select the best supplier firm providing the most satisfaction for the criteria determined. Kahraman, Cebeci, and Ruan (2004) used the FAHP for comparing catering firms in Turkey.

Using AHP and desirability theory, Stwart (2001) offered a BSC framework for evaluating IT units (Clinton et al, 2002). Chiang (2005) offered a dynamic approach based on AHP and BSC for purpose of choosing the sellers (Leung, 2006). Sekreter, et

al.(2004) developed a model for determining the credibility of the Turkish firms in the food industry. Wang (2007) evaluated financial performance of domestic airlines in Taiwan with fuzzy TOPSIS method. Leung et al (2006) proposed an approach integrating AHP and Analytic Network Process (ANP) with BSC (Sharma and Rajab, 2007).Sharma et al (2007) used a model integrating AHP with Score Card in order to evaluate IT unitin a manufacturing factory in Taiwan.

In quantity discount factor and minimizing the total cost of purchasing an integral model of AHP and nonlinear integer program was to determine the best supplier and optimal order quantity (Kokangul et al., 2009). Cebeci (2009) drew on an approach integrating fuzzyanalytic hierarchy process and score card in order to select the most appropriate ERP system intextile industry (Cebeci, 2009). Mehregan, at al. 2010 introduced a new approach to e-learning system assessment by identifying and prioritizing the preliminary e-learning critical success factors (CSFs) or enablers that need to be concentrated by universities and educational institutes with fuzzy AHP. The result of such performance evaluation subsequently acts as an informative tool for developing e-learning system plan.A fresh approach for decision support enabling effective supplier selection processes in electronic marketplaces was introduced by Chamodrakas et al. (2010). It involves an evaluation method in two stages: I) initial screening of the supplier through the enforcement of hard constraints on the selection criteria; II) final supplier evaluation through the application of a modified variant of the Fuzzy Preference Programming (FPP).

3. METHODOLOGY

Before describe the research process, explanations on methods used in this paper are presented, which following sections will see:

AHP

AHP is a widely used multiple criteria decision making tool first proposed by Saaty (1980). Since its invention, it has been a tool at the hands of decision makers and

researchers and it is one of the most widely used multiple criteria decision-making tools (Vaidya& Kumar, 2006). Forman and Selly (2001) argue that the elements used in the naming of the AHP method explain its application logic:

- *Analytic:* The AHP should be called Hierarchic SynthesisProcess, since in its essence the AHP assists in the measurement and synthesization of aseries of factors involved in complex decisions.
- *Hierarchy:* Subdivision in hierarchy is a known characteristic to organizations. Hierarchyis the adaptable way of finite intelligence to assume a complex situation. Greatorganizations possess hierarchic structures as they are divided in units that are subdividedinto smaller and smaller units.
- *Process:* A process is a series of actions, alterations or functions that lead to an end orresult. The process of the AHP is not a model in which the correct answer is found, but aprocess that helps decision makers find the best answer.

AHP provides an extensive context in which all problems can be solved. Though these problemsinvolve senses, rationality and irrationality are multipurpose,multi-criteria,and multidecisionmakerin certain and uncertain situations (Stwart and Mohamad, 2001).In this paper we have proposed the use of AHP for determining the weights of the main and sub-criteria.

TOPSIS

The TOPSIS model was introduced by Hwang and Yoon in 1981. It is one of the best and widely used models for multi-criteriadecision-making (Wang, 2008,Opricovicetal., 2004). To applythis method, the following stages should be followed:

1. Selecting normalized function matrix;

   Matrix normalization is intended to unify matrixes, which is done as below,

   $X = (Xij) \forall i , j$

   whereXijis the function of the ith option for the jth criterion.
2. Creating normalized function matrix's weight;

   In the TOPSIS, normalized function matrix's weight is defined as:

   $V = (X ij) \forall i, j$

$Vij = (Xij)Wj \times rij \; \forall i, j$

In which Wj is the weight of each criterion.

3. Determining ideal positive and negative solutions;

   Ideal positive and negative solutions are calculated as follows:

   $A+ = \{(\max Vij | j \in J), (\min Vij | j \in J'), i = 1, 2, \ldots, m\}$

   $A = \{(\min Vij | j \in J), (\min Vij | j \in J'), i = 1, 2, \ldots, m\}$

4. Calculating the distance between positive ideal and negativeieal solutions for each option;

$$s_i^* = \sqrt{\sum_{j=1}^{n} (v_{ij} - v_j^*)^2} \qquad i=1,2,\ldots, m$$

$$s_i^- = \sqrt{\sum_{j=1}^{n} (v_{ij} - v_j^-)^2} \qquad i=1,2,\ldots, m$$

5. Defining relative nearness of each option to ideal solution;

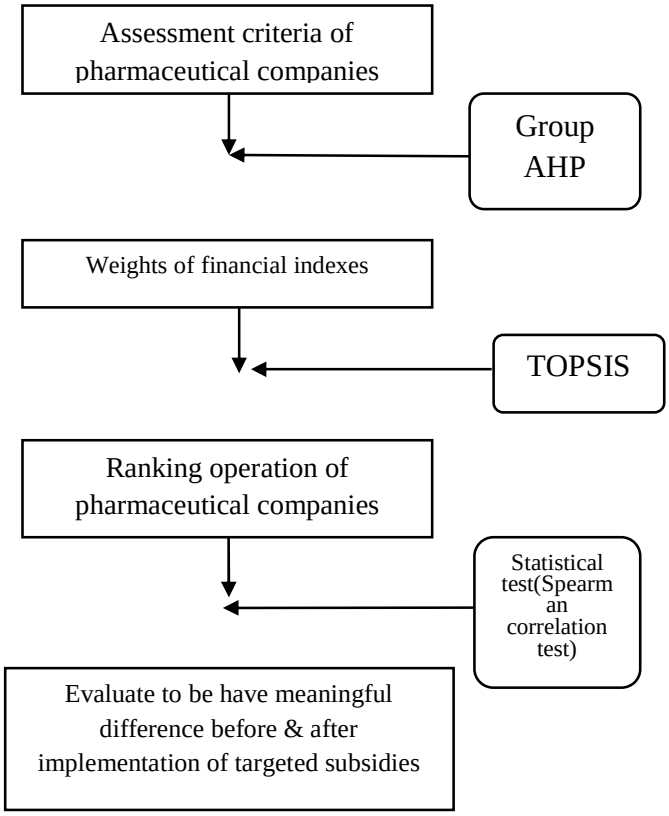
$$C_i^* = \frac{s_i^-}{s_i^+ + s_i^-} \quad i=1,2,\ldots, m$$

   ✓ The option with greater C_i^* is better.

Framework and used methods

The assessment method of the study involves the several stages shown in the Figure 1.

Figure 1: Framework of study

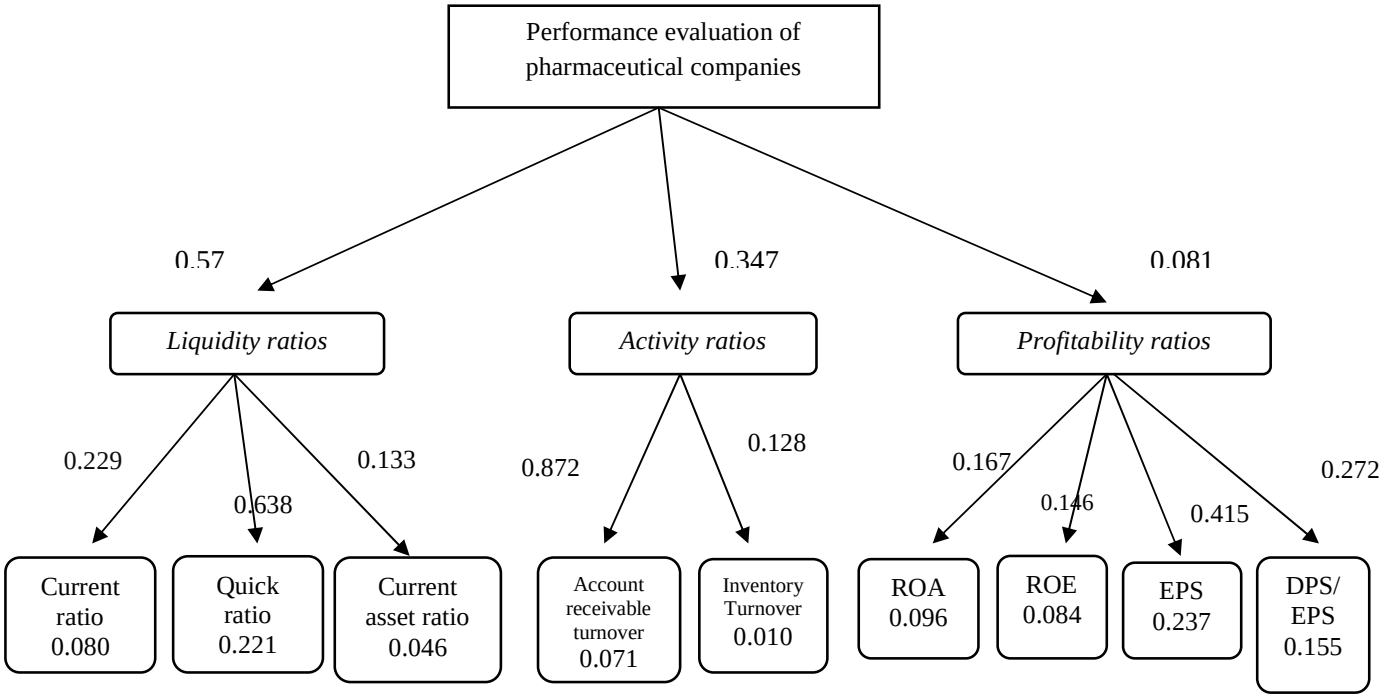


First, we should identify those aspects and specifications of quality which are important in pharmaceutical companies. After carrying out assessment of criteria hierarchy, weights of the criteria are measured via group analytical hierarchy process (GAHP). Then, the TOPSIS method is used to attain the final results of ranking. Finally, statistical test is performed to determine if there is a meaningful difference in the companies' performance before and after implementation of targeted subsidies.

4. DATA ANALYSIS

To conduct the study, first we collected several experts' opinions about the financial ratios and used their opinions to find the weights of indexes studied in this paper.

Figure 2: Weights of financial ratios



Using surveys conducted and do group AHP, weights of financial indicators were calculated. Also, the findings of this stage were tested about rate of inconsistency which showed that there was no inconsistency in combination findings of group AHP method. The above chart shows the weight of financial indexes studied.

In the next stage, we collected primary data that includes figures of financial ratios before and after the implementation of targeted subsidies for companies in the pharmaceuticals industry. These figures are calculated according to financial reports for 2 years before and 2 years after implementation of targeted subsidies in Iran.

Table 1: Ranking of companies via TOPSIS method

Name of companies	Ranking before the implementation of targeted subsidies	Ranking after the implementation of targeted subsidies
Abidi	9	6
abooreyhan	18	15
Alborzdaroo	3	4
Amin	20	12
Damloran	16	13
exir	13	17
farabi	7	5
Iran daroo	11	9
Jaberebnehayan	8	10
kimidaroo	6	16
kosar	12	19
loghman	19	20
osve	5	7
Pars daroo	14	14
razak	2	2
Shimidarooyee-daroopakhsh	17	18
Sinadaroo	1	1
sobhan	10	8
Faravardehayetazrighi	15	11
Tehran daroo	21	22
Tehran shimi	22	21
zahravi	4	3

In this section, TOPSIS method was applied to the data collected in the previous step was. With proper implementation of the TOPSIS method, we ranked the companies by the amount of relative nearness to ideal solution before and after the implementation of targeted subsidies as shown in Table 1.

In the final step, “spearman correlation test” as statistical test of this study of the figures of ranking before and after the implementation of targeted subsidies was performed. A finding showed that the P value amount is approximately zero and the amount of spearson`s correlation coefficient is 0.832, which indicates that there is a significant correlation in the ranking of pharmaceutical companies before and after the

implementation of targeted subsidies with 95% confidence level. This means that there is notsignificant difference inrankings before and after the implementation of targeted subsidies.

5. CONCLUSION

In this article, the following operations were performed to check the status of pharmaceutical companies before and after the implementation of targeted subsidies:

- Recognizing key financial indicators for pharmaceutical companies in Iran.
- Studying average importance level of each index via Group Analytic Hierarchical Process for all responders.
- Finding the amount of financial indicators for pharmaceutical companies before and after the implementation of targeted subsidies.
- Using TOPSIS as a principle in ranking pharmaceutical companies before and after the implementation of targeted subsidies.
- Performing “spearman correlation test” as statistical test of the figures of ranking before and after the implementation of targeted subsidies.

The final ranking shows that Sina Daroo Company is the best in terms of performance, and this condition is true both for the periods before and the period after the implementation of targeted subsidies.

By comparing the rankings of companies, significant difference wasn’t observed in rankings before and after the implementation of targeted subsidies, which indicates that the implementation of targeted subsidies was not yet effective on the companies’ performance. As the result of the enforcement of this law in Iran, some pharmaceutical companies have risen to prominence and some have declined. Of the new parts of implementation of this law in the coming years maybe be seen many changes in this industry.

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THE MARKOWITZ'S MEAN VARIANCE ANALYSIS: A REVIEW FROM SHARIAH PERSPECTIVE

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Abstract

The analysis on the portfolio theory doubtfully complies with *shariah*. Therefore, this paper presented a review to the Markowitz's Mean Variance Model (Portfolio Theory) and discussed the fundamentals underlying the model in term of *shariah* compliances. First, the assumptions of Markowitz's model were revised in term of compliances with *shariah* and the appropriate modifications were discussed that lead to the variation of efficient frontier and the characteristic of return and risk. Intriguingly, the principles of Islamic finance do agree with many conventions underlying the model. However, it was uncovered that Islamic variables such as prohibition of short selling, purification and *zakat*, should be integrated in the model. Lastly, the paper presented empirical results on the new Islamic mean variance analysis in term of the resulting efficient frontier. In conclusion, a new revised mean-variance analysis should overcome the gap in conventional tools in measuring risk and returns and making decision on the choice of investments according to *shariah*.

Keywords: Markowitz's Mean Variance Model; *shariah*

1. INTRODUCTION

In 1952, Harry Markowitz set up a portfolio selection model that became the foundation in modern investment and theorized that a properly diversified portfolio would provide maximum return for a given level of volatility, vice versa. By combining different assets whose returns are not perfectly positively correlated, Markowitz (1952) seeks to reduce the total variance of the portfolio return. In addition, Bernstein (1992) distinguished Markowitz's model as a prominent insight in the history of modern finance and the model ultimately transformed the practice of investment management beyond recognition.

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Islamic finance is now emerging as a rapidly growing part of the market worldwide, and not only restricted to Islamic countries; it is spreading to wherever there is a sizable Muslim community. More fascinatingly, the world, even non-Muslim, community has also accepted Islamic finance and the recognition of Islamic finance is rising in mitigating market failures. Statistically, the global market of Islamic finance has been projected to be growing at a rate of 15-20% per annum. The estimates of the size of Islamic finance are as high as $1,020 billion for 2007 and the estimates of all, retail and corporate, global Islamic banking range from $420 billion to $500 billion (Silva, 2007). The advancement of Islamic finance leads to the question whether or not the theory and analysis of Islamic financial asset are truly in accordance to Islamic principles i.e. Markowitz's Mean Variance Analysis.Usmani(2007) argued that using conventional benchmark for halal business is not desirable.Therefore, the purpose of this paper is to revise the mean-variance analysis (portfolio selection and optimization) in term of their compliances to *shariah* (principles of Islamic finance). Particularly, the set of assumptions underlying the model will be reviewed and the characteristics of desired Islamic model will be ascertained.

2. LITERATURE REVIEW

2.1 Principles Of Islamic Finance

Principles of Islamic finance will be largely based on Al-Quran and *Hadith*. The principles will be the major guideline to revise the Markowitz's Model. There are seven key principles of Islamic finance (Lewis and Algoud(2001), Iqbal(1997)), (1) the prohibition of *riba*, (2) the basis of *halal* activities, (3) the prohibition of speculative behaviour (*maysir*) and extreme uncertainties (*gharar*), (4) the obligation of *zakat* payment, (5) *shariah* board as the ruling body of Islamic finance, (6) profit risk sharing and (7) sanctity of contracts. In addition, Selim(2008) has provided more generalised features of the principles that govern Islamic finance as it relates to Islamic economic fundamentals. In fact, all the seven features listed above are the subsets of the features given by Selim (2008), the features are the *Principles of Universal Complementary*, the *Principles of the Abolition of Usury* and the *Principle of Justice in Al-Hisba*.

2.2 Markowitz's Assumptions: Shariah Perspective

A. Non-satiation and risk averse

Markowitz (1952) made certain implicit assumptions in developing the Mean-Variance Model. The first two assumptions are investors prefer more to less (non-satiated) and risk averse. In fact, Islam recognizes that human desires are not limited, human will always prefer more to less. This is further attested by the Quran and *Hadith* that (as cited from Rosly, 2005)

> *'Surely man is created greedy and impatient' (Al Ma'arij; 19)*
> *'And you love wealth with exceeding love' (Al Fajr; 20)*
>
> *'If man is given a valley of gold, certainly, he wants the second and third one' (Sahih Hadiths)*

This desire is essentially natural in human being and the desire will oblige them to maximise the return in trading or financial transaction. Fascinatingly, Amin and Yusof(2003) advocated that the principle of profit maximization is valid for Islamic economic framework even though it has been heavily criticised as inconsistent with Islamic behaviour. Quran itself has discouraged any trading without profit.

> *'These are they who purchase error at the price of guidance, so their commerce doth not prosper, neither are they guided' (Al Baqarah: 16)*

However, there is one condition that must be met; Islamic values are explicitly incorporated particularly in the measurement of the cost of production of an Islamic firm. Allah also emphasized that Muslim can seek for the wealth as long as they adhere to the Islamic principles and not to forget their portion in the life hereafter.

> *'But seek, with that [wealth] which Allah has bestowed on you, the home of the hereafter, nor forget your portion in this world: but do good as Allah has been good to you, and do not seek mischief in the land: for Allah loves not those who do mischief'(Al Qasas:77)*

Indeed, there is no evidence from Quran and *Hadith* that mentions limitation of return to one-third, one-fourth or one-fifth (Al-Qaradawi, 2003). Furthermore, Prophet (SAW) allowed, as narrated by al-Bukhari and ZubairibnAwwam, the profits to be up to 100 per cent and some companions earned more than 100 percent in trading (Al-Bukhari, n.d.). There are two plausible explanations on why excessive profit can be generated: (1) excess demand and (2) a flagrant misinterpretation of value (*ghaban al-fahish*). However, *ghaban al-fahish* is not at all condoned unless it is caused by fraud (*taghrir*). Excessive profit created from sales when demand is rising is allowed in Islam and deemed as a bounty (*rizk*) from God (Rosly, 2005). Therefore, al-Zuhaily(2002) suggested that the authority should fix the net profit margin to promote market justice and to obtain blessings. Besides, there have been many Islamic scholars that are of the view that excessive profit making is not encouraged and it will deprive the blessings of Allah (Omar et al., 2011). Nevertheless, it is still permitted according to *shariah*. Hence, investors can take any profits available in market as long as it does not conflict with any Islamic principle, i.e. *halal* profit and not oppressive to other investors. On the other hand, for the case of risk aversion, IbnTaimiyah illustrated a context that concurred Islamic finance does support risk minimization. He stated that it is permissible for a man to repay a loan in another country to mitigate any risks that might exist (cited from Islahi, 1988). In fact, one of the key elements in Islamic finance is risk sharing and risk sharing pilots to minimization of risk exposure. *Shariah* obviously encourages risk avoidance. In conclusion, the objective is to maximize the yield (return) and simultaneously minimize the risk has no any conflict with *shariah* principle.

B. Concave and non-decreasing utility function

This is essentially consistent with the first two assumption and the arguments for it have been discussed. Concave and increasing utility function means the first derivative is greater than zero which implies non-satiation. Also, the second derivative is lower than zero that implies risk aversion.

C. Return, variance and covariance are known

All expected returns, variance and covariance should be known so that investors can make decision purely on the basis of expected return and variance (risk). According to Rosly(2005), this is, in fact, in line with the Islamic principles of *al-ghormbilghnom*(with risk comes profit) and *al-kharajbildamam* (profit is accompanied with responsibility). In fact, the Islamic legal maxim of *al-ghormbilghnom* is invoke to invite investors to participate in ventures involving both risk and reward such as *al-bay'*, *al-ijarah*, *salam*, *mudarabah* and *musyarakah*. Trade-off between profit and risk has also been discussed by Usmani(2007) and he pointed out portfolio diversification and expertise as the mean of risk minimization. Therefore, it is reasonable if the Islamic investors make decisions based on return and risk.

D. Fixed single-step time period and transaction cost

Fixed single-step of time period and no transaction cost are assumed to reduce a great deal of complexity in the model (Elton, Gruber, Brown, & Goetzmann, 2010) and the omission of transaction cost from the model does not conflict with any *shariah* principles that already be presented before. Nevertheless, Steinbach (2001) presented that multi-period mean-variance problems behave similar to the single-period counterparts in many respects. Furthermore, Fama (1970) and Elton and Gruber (1974a, 1974b) have explored the conditions under which the multi-period investment consumption period can, in fact, be reduced to the problem of maximizing a one-period utility function. Therefore, it is reasonable to concentrate with only fixed single-step time period in developing Islamic analysis. In term of transaction cost, it is sensible to point out that the exclusion causes serious errors when many transactions are performed (Steinbach, 2001). The inclusion of transaction cost is an essential element of a realistic portfolio optimization that leads to more intuitive and sensible allocation (Mitchell and Braun, 2004). Essentially, the inclusion of transaction cost can be done after an Islamic mean variance analysis (without transaction cost) is ascertained. Therefore, the research will only focus on the exclusion of transaction costs and the inclusion of transaction cost into the model would be a subject that requires future research.

E. Asset may be held in any amount

The next assumption is asset may be held in any amounts. This provision means that short selling or negative amount of asset holding is allowed in the construction of the model. Dusuki and Abozaid(2008) highlighted and discussed, namely the issue of *bay`ma`dum* (selling what the seller does not own), the eligibility of stock as object of a loan contract and benefiting from loan contract. Although they could find solutions to the problem of ownership of stocks in short selling by adopting and applying some jurist opinion, the issue on benefiting from loan contract is still undefended. As thoroughly discussed, any gain stipulated by the lender is deemed *riba*. Hence, the issue of stockowner benefiting from the charges imposed on the lending stocks in short selling is apparently against the *shariah* principles and hence a clear-cut *riba* and thus forbidden. Furthermore, another one Prophetic *hadith*(as cited from Rosly, 2005) that emphasizes Islamic finance forbids short selling practise is given by

> *"Ja'far b. AbiWahshiyah reported from Yusuf b. Mahak from Hakim b. Hizan (who said): I asked the Prophet PBUH: O Messenger of Allah! A man comes to me and asks me to sell him what is not with me, so I tell him (what he wants) and then buy the goods for him in the market (and deliver).* And the Prophet said: *sell not what is not with you."*

Besides, Elton et al. (2010) suggested that when short sales are allowed, the efficient frontier will have no upper bound and the efficient frontier set still starts with the minimum variance portfolio. Furthermore, Merton (1972) displayed that the efficient set is the upper half of a hyperbola. Lastly, it is decisive to include the provision of tax in the model and we can relate the provision of tax to the notion of the inclusion of *zakat* factor into our model. We already discussed the obligation of *zakat* and this assumption will be, later, discussed under '*Zakat* and Purification of Return'.

In conclusion, most of the assumptions prevailed in the Markowitz's Mean Variance Model are admitted in the construction of our Islamic Mean Variance Model because they have no conflicts with *shariah* principles and some of the assumptions do exist

for simplification of the model. It remains an open debate for further study to incorporate multi period models and transaction cost into the Islamic capital asset pricing model. However, the developed model must be proficient to represent the reality of financial market. Therefore, the modification of the model must not only consider the compliance of each assumption to *shariah*, but the competence of the model as an analysis tool should be taken into consideration too. The application of the model as an analysis tool must be free from the element of *maysir* (gambling) and *gharar* (extreme uncertainty). Therefore, we need to ensure the model has a considerably minimum error in making analysis besides ensuring the imbedded elements (assumptions) in constituting the model are compliance to *shariah.*

2.3 *Zakat* And Purification Of Return

Zakat is an obligation in Islamic finance (Lewis & Algaoud, 2001). According to DeLorenzo(2000), it should not be necessary to explain that *zakat* and purification are two entirely different, though not unrelated, matters.Noor (2009) asserted purification of returns is basically the act of deducting the non-*halal* "tainted income" which is not acceptable from the *shariah* point of view, from the total returns on investment.The non-*halal* elements should be removed by donating to charities IbnTaymiyyah and al-Halim(1991). IbnTaimiyyah and al-Halim(1991) concurred that, if *halal* mixes up with *haram*, provided that the *haram* portion is cleansed, the rest is *halal*.Due to the complexity of and the generally non-Islamic nature of the current capital market, returns obtained from portfolios or individual assets has to be cleansed through post-investment purification practices (Elgari, 2000).According to Khan (2010), there are two main approaches for purification of equity stocks that are dividend purification and *haram* income purification. However, Khan (2010) affirmed that the second approach is preferable by *shariah* scholars and this is actually the same method employed by Rosly(2005). DeLorenzo(2000) classified accounting items that might contribute to prohibited income; non-operating income from interest bearing investment, or earnings from prohibited business activities that are beyond the scope of a company's primary business.

3. MODELLING ISLAMIC MEAN AND VARIANCE MODEL

In this section, we outline how Mean and Variance Analysis (including portfolio optimization) can be modelled within the framework of Islamic finance. We consider the situation where these are the set of assumptions under Islamic model

a) The return of asset are normally distributed, the expected return and risk can be represented by mean and volatility (variance).
b) All expected return, variance and covariance of pairs of assets are known.
c) Investors make their decisions purely on the basis of expected return and variance.
d) Investors are risk-averse and non-satiation (prefer more to less).
e) There is a single-step time period.
f) There is no transaction cost.
g) There is *zakat* and purification possibly deducted from the expected return
h) Assets may be held in any amount but short selling is prohibited.

A. Mean and Variance under Islamic Framework

From Elton et al. (2010) and Markowitz (1952), the expected return and variance of the portfolio is given by

$$\bar{R}_p = \sum_{i=1}^{N} (X_i \bar{R}_i)$$

$$\sigma_p^2 = \sum_{i=1}^{N} X_i^2 \sigma_i^2 + \sum_{i=1}^{N} \sum_{j \neq i}^{N} X_i X_j \sigma_i \sigma_j \rho_{ij}$$

Therefore, given that $(1-z)(1-\partial_i)R_i$ is the return of individual asset i where z is the zakat rate and ∂_i is the individual purification rate for asset i, the expected return and variance of individual asset i is given by

$$E[(1-z)(1-\partial_i)R_i] = (1-z)(1-\partial_i)\bar{R}_i$$

$$Var[(1-z)(1-\partial_i)R_i] = (1-z)^2(1-\partial_i)^2\sigma_i^2$$

Therefore, the expected return and variance on the portfolio is given by

$$\bar{R}_p = \sum_{i=1}^{N} [X_i(1-z)(1-\partial_i)\bar{R}_i]$$

$$\sigma_p^2 = \sum_{i=1}^{N} X_i^2(1-z)^2(1-\partial_i)^2\sigma_i^2 + \sum_{i=1}^{N}\sum_{j\neq i}^{N} X_i X_j(1-z)^2(1-\partial_i)(1-\partial_k)\sigma_i\sigma_j\rho_{ij}$$

B. Zakat and Purification

Zakat rate is constantly 2.5% since it is the rate on most forms of monetary wealth and earned income (Al-Qaradawi, 1999).According to Rosly(2005), the non-*halal* debt (liability) financing can represent the total prohibited income and the equity financing can represent the total income. The formula for purification factor then becomes

$$\partial_i = \frac{Total(nonhalal)Debt}{TotalEquity}$$

C. Portfolio Optimization

Single period optimization was developed in the pioneering work of Markowitz (1952). The inputs in the single period problem are not only the expected return and the standard deviation of each asset, but also the correlation matrix for each and every pair of assets. These inputs are usually derived from historical data on asset class returns and current market conditions (Kaplan, 1998). On the other hand, Bernstein and Wilkinson (1997) provided a thorough discussion on the multi-period optimization strategy.

There are many computer programs (optimizers) that can delineate efficient frontier;VisualMvo, MvoPlus, VBA, Mathematica, R. But, other optimizers do solve for the entire efficient frontier. Once the efficient frontier has been found, objective functions with any number of parameter values can be optimized without having to return the algorithm (Kaplan, 1998). Markowitz (1959) showed that the number of

efficient portfolios is infinite. Therefore, we require a limited number of 'corner portfolios' in order to identify all efficient portfolios. By locating all 'corner portfolios' the critical line algorithm can generate the entire efficient frontier as every efficient portfolios is linear combination of the two corner portfolios.

Once the efficient frontier has been generated, investors will choose one efficient portfolio. There are various techniques that have been proposed for selecting the optimum portfolio (Elton et al., 2010). This includes; choosing directly, utility (preference) function, safety first, risk tolerance function, maximizing the geometric mean return and value at risk (VaR)

4. IMPLEMENTATION – EMPERICAL RESULT

In the following empirical analysis, we report results concerning the impact of the different models of Mean-Variance Analysis on the efficient frontier. The main purpose of this analysis is to evaluate the efficient frontier resulted from adjusted (Islamic) Mean Variance Analysis to the conventional counterpart. The analysis is based on the data of 5 *shariah*-compliant public listed companies in Bursa Malaysia; HupSeng Industries, IJM Plantations Bhd, IOI Corporation Bhd, Petronas Gas Bhd and Sime Darby Bhd. Some backgrounds of the companies; HupSeng Industries, through its subsidiaries, engages in the manufacture and sale of biscuits and coffee mix in Malaysia,IJM Plantations Bhd, together with its subsidiaries, engages in the cultivation, milling, and trading of oil palm primarily in Malaysia and Indonesia, IOI Corporation Bhd, an investment holding company, engages in the cultivation of oil palm and rubber, as well as processing of palm oil in Malaysia and internationally, Petronas Gas Bhd engages in the processing and transmission of natural gas in Malaysia, Sime Darby Bhd, an investment holding company, engages in plantation, property, industrial, motors, energy and utilities, and healthcare and other businesses worldwide.

The daily closing prices of all 5 companies are obtained from 1 January 2006 to 31 December 2011. The return on the companies can be calculated as follows

$$R_{it} = \frac{P_t - P_{t-1}}{P_{t-1}}$$

Where, R_{it} is actual return of company (stock) i at day t, P_t is daily closing price of stock i on day t and P_{t-1} is daily closing price of stock i on day $t-1$. Then, determine the expected return, variance and covariance matrix (IBM SPSS can be employed). To delineate the Islamic efficient frontier using 'VisualMvo', we should remove purification and *zakat* factor (2.5%) from expected return and variance. For purification, the data can be obtained from the accounting statement companies (in their annual reports). This can be found under liability segment in 'profit & loss' and 'balance sheet' statement. The accounting items that we should view are non-operating income from interest-bearing investments and earnings from prohibited business activities that are beyond the scope of company's primary business, i.e. from acquisition and corporate diversification. The period under observation is from 2000 to 2011. Lastly, there are two restrictions that must be placed to prevent short-selling practices, (1) $\sum_{i=1}^{N} X_i = 1$, (2) $X_i \geq 0$ for all i.

A. Inputs for Optimizer

TABLE I. EXPECTED RETURN AND STANDARD DEVIATION

Company	Conventional		Islamic		Purification Rate
	Expected Return	***Standard Deviation***	***Expected Return***	***Standard Deviation***	
Hup Seng Industries	10.404%	0.016428854	9.920%	0.014429095	2.207%
IJM Plantations Bhd	22.400%	0.016430321	21.584%	0.012561851	1.172%
IOI Corporation Bhd	36.828%	0.020268451	35.327%	0.01278051	1.617%
Petronas Gas Bhd	9.734%	0.013836375	9.277%	0.012238968	2.254%
Sime Darby Bhd	14.943%	0.016528593	14.215%	0.013824542	2.429%

The correlation matrix is given by {HupSeng Industries, IJM Plantations Bhd, IOI Corporation Bhd, Petronas Gas Bhd, Sime Darby Bhd)

$$\begin{pmatrix} 1 & 0.08 & 0.113 & 0.022 & 0.118 \\ 0.08 & 1 & 0.345 & 0.085 & 0.222 \\ 0.113 & 0.345 & 1 & 0.14 & 0.307 \\ 0.022 & 0.085 & 0.14 & 1 & 0.178 \\ 0.118 & 0.222 & 0.307 & 0.178 & 1 \end{pmatrix}$$

B. Efficient Frontier

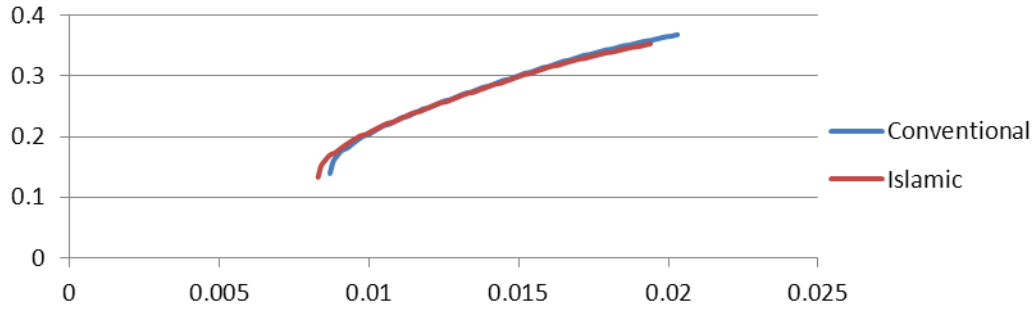


Figure 1. Islamic and conventional efficient frontier

TABLE II. MINIMUM VARIANCE PORTFOLIO

Analysis	Expected Return	Standard Deviation
Conventional	13.92%	0.0087
Islamic	13.29%	0.0083

Both expected return and standard deviation of minimum variance portfolio (MVP) for Islamic analysis are lower than the conventional counterpart. The difference is due to the term $(1-z)(1-\partial_i)$ in Islamic analysis. In general, Islamic efficient frontier looks similar as compared to conventional efficient frontier. However, Islamic efficient frontier outperform conventional efficient frontier for the low risk (standard deviation) and subsequently underperform for the high risk (standard deviation). Both efficient frontiers intersect at one point (expected return 25.4% and standard deviation 0.0123). The restriction of short selling causes the efficient frontiers to have limited upper and lower bound.

5. CONCLUSION

The term $(1-z)(1-\partial_i)$ does not proffer much impact on the shape and position of Islamic efficient frontier in contrast to conventional efficient frontier. This is largely due to the term $(1-z)(1-\partial_i)$ does affect both expected return and standard

deviation, not only expected return. Therefore, Islamic efficient frontier is like being "shifted down" to the left. As a result, both lower bound (minimum variance portfolio) and upper bound for Islamic efficient frontier is lower than conventional efficient frontier. It is worth to highlight that Islamic efficient frontier and conventional efficient frontier will intersect at one point. Furthermore, before the intersection point, Islamic efficient frontier outperforms conventional efficient frontier and after the intersection point, Islamic efficient frontier underperforms conventional efficient frontier.

In conclusion, most of the assumptions prevailed in the Markowitz's Mean Variance Portfolio Theory has no conflicts with *shariah* principles and Islamic variables like prohibition of short selling, *zakat* and purification are crucial in the development of Islamic portfolio analysis based on Markowitz's model. Nonetheless, some of the assumptions do exist for simplification of the model. It remains an open debate for further study to incorporate multi period models and transaction cost into the Islamic model. However, the developed model must be proficient to represent the reality of financial market. Therefore, the modification of the model must not only consider the compliance of each assumption to *shariah*, but the competence of the model as an analysis tool should be taken into consideration too. The application of the model as an analysis tool must be free from the element of *maysir* (gambling) and *gharar* (extreme uncertainty). Therefore, we need to ensure the model has a considerably minimum error as an analysis tool besides ensuring the imbedded elements (assumptions) in constituting the model are compliance to *shariah.*

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AWARENESS OF ISLAMIC BANKING SYSTEM AMONG THE BANKING CUSTOMERS OF PAKISTAN

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Abstract

Islamic banking is a growing concept in Pakistan, but the awareness about its working, products and services is less as compared to conventional banking. Therefore, this research was conducted to find out the reasons behind lack of awareness of Islamic banking system among banking customers. The tool used for data collection was personal interview consisting of 10-14 items developed by Waseem Ahmad (2008). Results showed that customers do not have enough knowledge to understand the working of Islamic banking system and its terminologies. Only 20% (12 out of 60) respondents showed positive response and said that they are well aware of Islamic banking system, but 80% respondents showed negative response and said that Islamic banking system is not easy to understandable because people do not have enough knowledge about Arabic terminologies and people are not fully aware of different Islamic banking products. Results showed that 80% respondents have 30-40 percent awareness of Islamic banking system while 20% respondents have 60-90 percent awareness of Islamic banking system.

Keywords: Islamic Banking System, Awareness, Interest Free, Customer Satisfaction, Quality Services.

1. INTRODUCTION

We know that Islam is a comprehensive religion and provides the instructions for all aspect of life. The whole system is based on knowledge, faith, wisdom and goodness. Islam prohibits all those things which are harmful for human being and society. Islamic banking is based on Islamic law and follows the shariah, called fiqh muamalat (Islamic

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rules on transaction). The concept of that rules and practices of muamalat came from holy Quran, Sunnah and other sources of Islamic law.

As we know that the main purpose of conventional banking is to make profit whether in the form interest or something else. If somebody wants loan for his or her business, they give the loan without knowing that what kind business he or she is involved and what kind of products or services that business is providing, whether the products and services of that business are good for the society or not. But Islam forbids this concept and says that you have to know the type of business and also the products and services that business is providing.

Islamic banking is best known for interest free banking. Charging interest on loan is prohibited by the Holy Quran. Gard-el-hassan (literally good loan) is the only kind of loan which is allowed by Islam. In this loan lender does not charge any additional amount over the lending money. Currently Islamic banking system exist in many Muslims and non Muslims countries. Stockholders equity, deposits and advances in these banks have risen significantly (Saeed, 1999).

The concept of Islamic banking is getting momentum all over the globe especially in Pakistan, where as interest based banking is declining unexpectedly in those countries which are the founder of interest based financial system and champion of capitalism (Awan, 2009). According Khan (2009), the re-launch of Islamic banking in Pakistan by the SBP is become successful due to the hard work and careful planning. The results proved that the idea for introducing the Islamic banking system in Pakistan has succeeded.

Iqbal (2001) defines that generally Islamic banks are well advanced, well established and profitable. The concept of Islamic banking in Pakistan appeared by the response of both economic and religious needs. Pakistan was in the list of those three countries that had been trying to implement the riba free banking at national level.

The result showed that the people of Jordan have information about most of Islamic financial products such as Mudaraba, Musharaka and Murabaha and they also showed certain degree of satisfaction towards Islamic products and facilities, but also uttered their

dissatisfaction towards some islamic bank services (Khatib et al, 1999). According to Jusoff et al, (2009) to get competitive advantage they need to provide quality products and service and not just only rely on their "Islamic" image and reputation to draw customers (Muslims and non-Muslims).

The concept of Islamic banking is getting momentum day by day in Pakistan. Most of work has been done on Islamic banking system and customers' satisfaction towards Islamic banking system in Pakistan, but less work has been done on awareness of Islamic banking system. Therefore, this research was started to find out those factors which are important to create awareness of Islamic banking system among banking customers of Pakistan.

Today Islamic banking has established its identity. But the awareness of Islamic banking system is less as compared to conventional banking system in Pakistan. So our main objective or goal is to find out the awareness of Islamic banking system among the banking customers of Pakistan. The paper is organized as follows. Section 1 set outs the introduction of the Islamic banking system. Section 2 provides a basic understanding of the fundamental features of Islamic banking with the help of literature review. Section 3 discusses how the performance evaluation framework should be designed and consists of methodology to be. Section 4 offers analysis of data and findings. Section 5 provides concluding remarks and Section 6 consists of suggestions for improvement.

2. LITERATURE REVIEW

Harran (1999), defined that it is very necessary for Islamic finance to bring new type of creative and innovative entrepreneurs and investment managers that are more focusing on managing risk effectively rather than avoiding it. Customers' satisfaction is very important for any kind of business, if they are satisfied business will be successful and if they are not, business will not compete in the market. As Taap et al, (2011) concluded that it is very important for banks to focus on the customers' viewpoint in current competitive environment. If the customers are satisfied by the service quality of the

banks, the word of mouth will be positive, switching and complaints will be reduced. As Yavas et al, (2004) defined that quality service is one of the elements which brings customer satisfaction and linked it to such behavioral outcomes as switching, recommending, complaint and word of mouth. Eriņa and Lāce (2011) argued that the most important purpose of bank management is to increase competitive advantages which are able to create good association between bank and customer and also provide more improvement of the quality of relationship.

Hamid and Nordin (2001) suggested that awareness will come through education; better education will help people to understand the Islamic banking products. They found out that more awareness of Islamic banking system but poor knowledge of specific products of Islamic banking, as well as lack of understanding between conventional and Islamic banking system. The level of customer's awareness towards the products of Islamic banking is good in some common products like time deposit, current deposit. But mostly have no idea about different Islamic financial products like Ijara, Murabah (Khattak and Rehman, 2010). According to Rammal and Zurbrugg (2007), the results show that most of the Muslims in Australia would be interested to buy the products of Islamic banking, but they have no proper information about profit and loss sharing instruments. Gerrard and Cunningham (1997) concluded that few Muslims of Singapore have knowledge of Islamic banking system but non Muslims have no awareness.
It is vital for Islamic banks to develop service products that meet or exceed customers perception after determine what they expect (Abedniya and Zaeim, 2011).

Parasuraman et al, (1988) defined that in current competitive environment customers become more demanding and having high expectations regarding the quality of products and services. This shows the continuous increase in customer expectations and demands within the improvement of the quality of service. It should be effective for the banks' management to improve their ATM systems so as to reduce the waiting time in the line. This will help to improve efficiency in the delivery service and also increase customer confident (Ombati et al, 2010). DICK (2007) suggested that banks exercise fixed cost quality investment to capture the extra demand when the size of market grows, in this way they raise the entry barriers. Chaoprasert and Elsey (2004) concluded that in order to

increase customer satisfaction banks still need to adapt and correct their operations, which will lead to business survival, profit and greater market share. Study of Indian commercial banks showed that better technical, human and physical aspects of service quality of the bank branches enhance customer satisfaction (Lenka et al, 2009).

Awareness is very important to understand the system of Islamic banking. Literature showed that lot of work has been done on that topic in Malaysia but in Pakistan less work has been done.

3. METHODOLOGY

3.1 Population and Sample

Population of this study includes the banking customers of twin cities (Rawalpindi, Islamabad) of Pakistan. Overall 60 customers were selected for interviews with equal representation of both conventional and Islamic banks.

3.2 Procedure

Since interviews had to be conducted to solicit responses therefore, all the prospects were briefed about the purpose and significance of the study. Interviews were recorded through tape recorder to reach at certain conclusion. The tool used for data collection was personal interview consisting of 10-14 items developed by Waseem Ahmad (2008). Convenience sampling method was used for data collection and ratio scaling was used for data analysis. Ratio scaling starts with absolute zero and indicates proportion. Ratio scale overcomes the disadvantage of the arbitrary origin point of the interval scale, in that it has an absolute zero point. Interviews were started with introduction of the researcher and then customer and then it moved to the real objective of the research. Each interview was consisting of 15-20 minutes in duration.

3.3 Reason for Chosen Qualitative Research

In qualitative research methods it is easy to get detailed, conceptual and rich ideas because these methods provide the results that how people feel and what they think because they feel relax to comments on any specific topic.

4. ANALYSIS AND FINDINGS

In this research, awareness of banking customers towards Islamic banking system is checked. Interviews conducted of both (Islamic& Conventional) banking customers of twin cities (Rawalpindi, Islamabad). Data was analyzed by ratio scaling. Results show that the awareness of banking customers towards Islamic banking system is less as compared to conventional banking system. There are detailed analyses of questions which we asked to the banking customers of Pakistan

4.1 Banking Customers of Pakistan

4.1.1 What is the difference between Islamic and conventional banking?

80% respondents said that Islamic banking is based on interest free and conventional banking is based on interest. It shows that they do not have enough idea about the concept of Islamic banking. 20% respondents gave the detailed answer of that question and said that working of Islamic banking is different from conventional banking, Islamic banking system follows the Islamic rules and regulation and based on interest free banking but conventional banking is based on interest. Gharar and speculation both are involve in conventional banking but Islamic banking system is against speculation and gharar. The focus of conventional banking is to make profit but the main purpose if Islamic banking is to work for the betterment of human being. So we can say in the light of those answers that mostly respondents have 10-20 percent knowledge about that question but 20% respondents have more than 80% knowledge about that question.

4.1.2 Do you agree that interest is prohibited in Islam and why?

Majority have 20-30 percent idea about that question so that's why they said yes it is prohibited in Islam but they gave only two reasons which explain that why it is prohibited in Islam. They said that it is effortless money and any amount which is generated without making any effort is not allowed in Islam. Rich become richer and poor become poorer. But there were few respondents who have detailed information about this question and said that profit and loss on investment is not predetermined and interest is fixed payment which has to be paid in both profit and loss situation. Any amount which is generated without making any effort is not allowed in Islam. The borrower is charged excessive of the principal amount, the repayment of loan becomes difficult and the lender can do exploitation. Rich become richer and poor become poorer. Those answers showed that they have 80-90 percent knowledge about that question.

4.1.3 Do you think that the customers have full awareness of Islamic banking system?

20% respondents said yes, the customers have full awareness of Islamic banking system but 80% respondents said Islamic banking system is not easy to understandable because of Arabic terminologies and people are not fully aware of different Islamic banking products. It shows that there are few respondents who have more than 60% awareness of Islamic banking system.

4.1.4 Do you think Islamic banking is on religious basis or ethical basis?

All respondents said that Islamic banking is on religious and ethical basis; it is working according to Islamic laws and also works for the betterment of human being.

4.1.5 Do you think Islamic banking in current situation is totally according to Islamic Sha'riah?

Only 12 respondents said that practically its working is not totally according to Islamic sha'riah but mostly said that it is working according to sha'riah. As we know that

practically Islamic banking system is not working according to sha'riah, so we can say that 20% respondents have good knowledge about Islamic banking system.

Mostly respondents have basic idea of Islamic banking system, but they said that they do not have enough knowledge to understand the Islamic banking terminologies because all the terminologies are in Arabic and people are not fully aware of different Islamic banking products.

Only 20% (12 out of 60) respondents showed positive response and said that they are well aware of Islamic banking system, but 80% respondents showed negative response and said that Islamic banking system is not easy to understandable because people do not have enough knowledge about Arabic terminologies and people are not fully aware of different Islamic banking products. So in the light of those results we can say that 80% respondents have 30-40 percent awareness of Islamic banking system while 20% respondents have 60-90 percent awareness of Islamic banking system.

5. DISCUSSION AND CONCLUSION

This study discussed the awareness of banking customers towards the Islamic banking system. Overall results show that customers are not fully aware with working of Islamic banking, most importantly the terminologies are difficult to understand. It is very important for Islamic banking industry in Pakistan to create the awareness about the working of Islamic banking system among the banking customers, so that it can achieve its goals and easily meet the expectations of the customers.

The concept of Islamic banking is getting momentum day by day in Pakistan, but the awareness of the working of Islamic banking system is less as compared to conventional banking system. According to the results it is concluded that more and more awareness about the working of Islamic banking system and its products can make the customers loyal and satisfied. A well defined system can make the Islamic banking industry more competitive, efficient and profitable and allow the industry to better service its customers and to raise their satisfaction level.

6. SUGGESTIONS

There are some suggestions through which people can get the knowledge about Islamic banking system:

1). Education is one of the most important factors to create the awareness of Islamic banking system among the banking customers of Pakistan. As *Tahir* (2003), said that public awareness is very important and it can be achieved by making Islamic banking course as part of business administration program, offering degree program in Islamic banking, include Islamic banking concept in school curriculum or starting public educational campaign. Currently Riphah international university is offering MS degree in Islamic banking.

2). Media is one of the best source which provide authentic information, so Pakistani media can play very vital role in this regard by providing the information about the working of Islamic banking system and terminologies using in Islamic banking.

3). Third and final suggestion is that the government of Pakistan can create the awareness of banking customers towards Islamic banking system, by conducting different seminars and workshops on Islamic banking concept. This is one of the best methods to understand the things practically.

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APPENDIX

"Awareness of Islamic banking system among the banking customers of Pakistan"

Interviews from Islamic Banking customers and Non- Customers of Islamic banking

Customers of Islamic banking

- What is the difference between Islamic and conventional banking?
- Do you agree that interest is prohibited in Islam and Why?
- Do you think that the customers have full awareness of Islamic banking system?
- Do you think Islamic banking is on religious basis or ethical basis?
- Do you think Islamic banking in current situation is totally according to Islamic Sha'riah?
- Why did you move to Islamic banking?
- Which products of Islamic banking you are currently using?
- Are you receiving any profit or other benefits from your Islamic banking accounts?
- Do you think that customers are fully satisfied with the products offered by Islamic banks or they want more flexible and suitable products?

Non- Customers of Islamic banking

- What is the difference between Islamic and conventional banking?
- Do you agree that interest is prohibited in Islam and Why?
- Do you think that the customers have full awareness of Islamic banking system?
- Do you think Islamic banking is on religious basis or ethical basis?
- Do you think Islamic banking in current situation is totally according to Islamic Sha'riah?

[i] The specification of gross domestic products (GDP) in purchasing power parity terms enables one to compare the cost of purchasing a comparable basket of goods and services, and this removes the influence of macroeconomic and policy factors that may only influence exchange rate markets and which are not meaningful for international comparisons. (Hirschberg et.al, 1994).

[ii] SITC 5 include chemical and chemical products, SITC 6&8 include other manufactured goods, and SITC 7 include machinery, appliances and parts.

[iii] Null hypothesis under White's test indicates that the constant variance (homoskedasticity) and the null hypothesis under Wooldridge's test indicate no first-order autocorrelation.