

Full Length Research Paper

# “Islamic banking system: Stake holder’s attitude towards the Islamic banking system objective setting”

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The concept of Islamic banking is not new, but is introduced in the current financial market after very long time. The Islamic banking system is getting a good percentage of the total world financial market. In the financial market there is a strong rivalry, for the Islamic banking industry (IBI) that is conventional banking system. Now the Islamic banking system must have to consider certain important factors while setting its objective, for this it must have to consider its stakeholder perception, means what its stakeholders wants, for the objective setting of the Islamic banking system, we must take the opinion of the stakeholders. For this we have to consider two major objectives of Islamic banking system. On the basis of that we got the respondent attitude. Towards the social and commercial objective and these objectives are consisting of four different variables. To get the relative importance or association of the different variables we used factor analysis. For factor analysis initially we adopted Kaiser-Meyer-Olkin measures. At the end we found the difference in the opinions of the respondent regarding the both objectives; social and commercial objective respectively, that is computed by applying non-parametric statistic Kruskal-Wallis test. Finally we come to the conclusion that the stakeholder of Islamic banking system is mostly concerned, with the social objective of the Islamic banking rather than commercial objective.

**Key words:** Financial market, Islamic banking industry, Kaiser-Meyer-Olkin.

## INTRODUCTION

Islamic financial system is the concept which had been developed 15th centuries ago with the revolution of Islam. But due to many factors, such developments were ignored by the community. Now after the buildup of the new industrial era, a need of Islamic financial institution was felt. The concept of Islamic financial institute provides building of a new banking system known as Islamic banking system. This system is not only recognized as the financial institution for the Muslim community but is also adopted in different regions of the world non Muslim communities. The Islamic financial industry that has taken

practical start about four decades ago is growing exceptionally in this competitive age, where it is competing with the strong competitor known as conventional financial system. In the success and in the introduction of the practical concept of Islamic financial system, Malaysia is considered to be the first Islamic country which has given more consideration for the development of Islamic banking system. The idea of the Islamic banking system is not only appreciated by Muslims it is also adopted by the conventional banking industry as well. They have commenced their independent Islamic windows, which are following the Shari'ah (Islamic regulations) rules. The current growth rate of the Islamic banking industry in the international financial market is about 15 to 20% per annum (Martin and Heiko, 2008).

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Regarding the current progress of the Islamic financial institutions Arekat in 2006 conducted a study it shows that there are about 300 Islamic financial institutions currently working all over the world and their capital investment worth is about US\$700-800 billions, which provides the evidence of the prosperity of the Islamic financial institutions in the world (Arekat, 2006). It has been estimated that Islamic banking will have a market value of US\$4 trillion by 2010 (Cader, 2007). It is expected to capture about 40 – 50% of the total savings of 1.3 billion Muslims worldwide within the next eight to ten years (Alam, 2006). That gives solid evidence of the prosperity of Islamic financial institutions. We can easily get it from statistical evidence provided by the CIBAFI (General Council for Islamic Banks and Financial Institutions), that the growth of Islamic banking is tremendous. Regarding the growth and problems of Islamic banking system survival a study that was conducted in Bangladesh and they come to the conclusion that the Islamic banking can endure with the conventional banking system but it would be much better if the proper platform is provided to the Islamic banking system (Awwal, 2006). Basically the Islamic banking/financial system is the asset based financial system, while the conventional banking/financial system is capital based system (Usmani, 1999). From the fundamental concept of Islamic financial institution we can get that it is build up for the welfare of the society. That concept goes beyond the measures of the concept of conventional financial institutes. The conventional financial institutes are based on the concept of capitalism, and the concept of capitalism is not for the welfare of the society.

In Pakistan the first step regarding Islamic banking system implementation was taken in 1980, when State bank of Pakistan made some changes in the rules and regulations of banking ordinance. With regard to this from 1st July 1985 all commercial banks were notified to start the interest free banking system, by introducing profit and loss sharing system (PLS). That was not a successful experiment. After that in December 2001 the first authority had been issued to Meezan Investment bank as the 1st stand alone Islamic bank in Pakistan. And till the end of 2007 there were six (6) full-fledged Islamic banks. (Meezan Bank, Albarka Islamic Bank, Dubai Islamic Bank, Dawood Islamic Bank, Global Emirate Islamic Bank, Bank Islami Pakistan). The main factor that differentiates Islamic and conventional banking/financial systems is the interest. In conventional banking system the interest is fixed in advance while in the Islamic financial system the profit and the loss is shared between both the borrower and the lender by a specific ratio (Akacem et al., 2002). In Islamic financial system the interest is prohibited by Shari'ah rules and regulation, while the conventional banking system is completely based on

the concept of interest. While Islamic financial system encourages the risk and profit sharing in the globe of financial activities. The basic principle of Islamic financial institutions is to share the profit and loss (Metwally, 1997). Studies Regarding the commercial and economic perspective of the Islamic banking system have been conducted in different regions of the world but regarding the behavioral finance aspect there is small research work been conducted (Gait and Worthington, 2008). And for any organization that has the basic objective to improve the society living standard that must need work to get the response of the society, regarding the objective, goals setting.

The researchers perceive that the Islamic banking/financial system in Pakistan is not giving much concentration on educating its customers, at different demographic level. Research findings show that Islamic financial system must have to arrange seminars and workshops in order to educate its customers (Naveed and Kashif, 2010). The customer's perception towards the objective setting of the Islamic financial institutes a study in the Malaysian platform was conducted. They tried to acquire the perception of the customers that what should be the main objective of the Islamic financial institution is such country where dual banking system is operated (Wajdi, 2008). Now following the same concept and research instruments the research is conducted in the plate form of Pakistan, where both banking system are working together. The prime reason of conducting this research is to identify or to answer certain quires like:

- i. What are the main objectives that an Islamic financial institution should consider for its success?
  - ii. How the stakeholders perceive the Islamic financial system, in the sense of social and commercial benefits?
- In order to answer such questions, our study is conducted in Pakistan.

## LITERATURE REVIEW

The Islamic financial system is not only introduced is for the purpose of the profit generation but that is a plate form where it has to fallow the Shari'ah obligation and the rules that are set by the shari'ah (Islamic regulation) for both and employee and an employer. The same philosophy of Islamic financial system has been emphasized by different Islamic researchers, like Chapra (1985); Ahmad (2000); Naqvi (2003).

The success of the Islamic financial concept could be easily understood by considering the fact that the conventional financial system which is purely based on the debt financing concept failed in the financial crises in US in 1929 and 1987 – 1989 (Richard et al., 2008). While if

we consider the economic position of Japan, we can get that Japan has implemented both economical systems debt financing and equity financing, and they got success in the financial system. Regarding the modeling of Islamic financial system there are basically two different opinions. In these the first view is of the Chapra's (1985) which refers the Islamic financial system as a socioeconomic purpose. And that view has been supported by different researcher such as Saddiqui (1985); Ahmad (2000); Haron and Hisham (2003) at different time period. They suggest that the Islamic financial system (IFS), should not be based on the aim to gather only profit from the investors, but IFS should be such a system which promote the basic concept of Shari'ah, and should fulfill the needs of the society. Chapra's model is considered harmonious to the Shari'ah concepts, which makes the Islamic bank as a supporter of the social activities in the society and contributes to the needy people of the society without considering the commercial benefit.

An Islamic scholar Wahbah Al-Zuhayli, has also accentuate the social economic objective of the Islamic financial institutions. He argued in his famous book *Al-Fiqh Al-Islami wa-Adillatu* The primary goal of Islamic financial institutions is not profit-making, but the endorsement of social goals of socio-economic development and the alleviation of poverty" (p. 350). The second view regarding the Islamic banking system model is of the Ismai (Lewis and Algaud, 2001; Satkunasegaran, 2003). He considers Islamic financial institution as a typical commercial entity, which has to conduct business in the light of Islamic law and regulation. And it suggests that the financial institution has the main responsibility to satisfy the shareholders and their clients, and the social objectives should be fulfilled by the other institution like Government etc. and that is the fact that the Islamic financial institution has to pay Zakah at the due time by following the shari'ah rules and regulation. While the usage of share holders/depositor funds for other social activities may expose the validity of Islamic banking system. Ismael's view has the similarities with the view point of Friedman's Concept of firm responsibility. He argues that the society is run by an individual only follow their self-interest. And in this concept the Islamic financial institution has the only objective that is profit maximization.

Khaf (1999) agrees with the views of Ismail models. According to him Islamic banking system is a commercial banking system that should have to fulfill the commercial purpose but within the limitations of the Islamic religious rules. He comes to the conclusion that whatever qualification we give to the Islamic banking system that is basically a financial intermediary and it has to fulfill the obligation of financial intermediary (Khaf, 1999). And the social concept of the Islamic economy has also been

elaborated by Jahangir, 2007; he stated that "the accumulation of social wealth and the establishment of social justice are indeed the two pillars of Islamic economic.

A study was conducted in 2002 in order to know about the effectiveness of the Islamic, conventional banks and the combination of these two models. Three models were tested and the authors concluded that the debt and the equity combination is the most effective financial model for any institution (Akacem et al., 2002). A study was conducted in 2008 in order to know how an organization can develop the customer's loyalty. The study concluded that the organization must get the basic driver of the customer's values and its norms. When an organization gets these drivers then it is easy for the organization to get its customers attraction and different customers have their own set of mind. So it is important for the organization to be familiar with its customer set of mind. (Gee et al., 2008).

A survey that was conducted in 2008 where researcher has got to the point regarding Islamic banking system that it is an institution that should consider the social objective of the society and should promote the values and norms of Islamic thoughts. That the survey was conducted in the plate form of Malaysia where there are different states and there are people of different religions (Wajdi, 2008). Now in order to get information regarding the customers of Pakistani market, we conducted a survey in order to know about the Pakistani customers, because Pakistani market is considered to have mush potential of investment. Here the investor has the opportunity to generate more.

## **METHODS**

### **Sample**

In the study we collected data from different Islamic banks in all major cities of Pakistan. The sample of the study is selected randomly from all the Islamic banking system that are working in Pakistan, the sample size was 322. In this we have 80 different deposit holders of the Islamic banking system, 76 customers, 79 local community, 39 religious scholars and 48 different employees of the Islamic banking system of its different banks.

### **Measure**

That was survey based research. For this we have adopted different factors from the research study of Wajdi (2009) he conducted that research in 2008 at the platform of Malaysia. The research question has basically eight variables. These eight variables are the combination of social and commercial factors. These factors are consisting of the following variables:

1. Maximizing profits;
2. Contributing to social welfare;

3. Alleviating poverty;
4. Promoting sustainable development projects
5. Minimizing costs of operations;
6. Enhancing product and service quality;
7. Offering viable and competitive financial products
8. Promoting Islamic values and way of life towards staff, clients and the general public.

Actually what we want to elaborate is to get the opinions of the stakeholders of Islamic financial system in a Muslim country like Pakistan which was considered to be an emerging market for the investors regarding the objective setting of the Islamic financial institution. Either the Islamic financial institution should consider only social purpose of the institute or it should consider both social and commercial purposes. The questionnaire for the study has been adopted by the study of Wajdi in 2008, but is modified; we also get the impact of education qualification on the objective settlement of the Islamic financial institution. The questionnaire is structured in English and Urdu.

### Data collection

For the research purpose the data is gathered from different respondents. We have responded for the research are customers of the Islamic financial institution (IFI), depositors of the IFI, employees of the IFI, customers of the conventional financial institution, general public, Islamic scholars. Customers and depositors are differentiated from each other because the customers were actually the individuals who are not enrolled in the deposit account actually but are enrolled with Islamic bank on the way like car financing, home financing etc., and the depositors are the individuals who are having accounts like PLS, investment account etc.

In the employees category we have targeted both the managerial level and the clerical level employees. In the general public category the targeted respondents were students of universities, employee from different sectors of Governmental and non-Government organizations, religious scholars from different sects of Islam. The questionnaires were distributed and filled from different branches of full-fledged Islamic banks and Islamic windows of the conventional banking system in different cities of the country.

## RESULTS AND DISCUSSION

For the research analyses we have adopted SPSS 14 version, we initially have adopted Cronbach's alpha, in order to get the reliability of the data. And for testing the reliability of the data we apply Cronbach's alpha. And the result shows that it is about 70.2%. That indicates that the data is reliable for the analysis. Now before performing other statistical tool we exercise the Kaiser-Meyer-Olkin measures for the Islamic banking objective setting, the total combined value for the KMO is (0.72) which is acceptable. It shows that we can proceed for further analysis. The KMO value should be greater than 0.50, which shows the suitability of the factor analysis. If the KMO value is less than that the factor analysis is not as much suitable as we predict. And for further confirmation for the factor analysis we applied Bartlett's test for Sphericity. The Bartlett's test for sphericity also reached (0.000) significance level, that

supports the factorability of correlation matrix. Results are shown in Table 1 this shows our factor analyses.

### Factor analyses

Now from Table 2, we can easily interpret that the different eight variables are highly correlated to each other. It is interpreted from the factors community values. The higher the value the higher the relationship among the variables. Just as in the social factor we have four variables. "Promoting Islamic values and norms objective", "contributing social welfare objective", "elevating poverty objective", "promoting sustainable development project objective" Now the communality values among these variables are ranged from 0.664 to 0.581, which indicates that these variables are highly correlated with each other. If the values are very low, it suggests that the variables are not associated with each other in order to explain the factor. Such like that in the other group we have four variables that are associated with each other in order to explain the factor. These variables are "maximizing cost operational objective", "enhancing product service quality objective", "maximizing profit objective", "offering viable and competitive financial product objective" And the values are ranged from 0.672 to 0.555, which also shows that the variables are highly associated with each other in order to explain the commercial objective of the Islamic banking system.

From Table 2 also, we can get that there are three components showing more importance from the stakeholders in order to set the objective of the Islamic banking system and they are: 1) Promoting Islamic Values and Norms Objective; 2) Contributing Social Welfare Objective; 3) Elevating Poverty Objective. These 3 components as a whole explain about 62.00% variance of the overall targeted component or targeted factors.

### Kruskal-Wallis test

As the entire respondents have not the same attitude the same interest. Every respondent has its own value of interest with respect to the response to the Islamic banking objective setting. So in order to know the perception difference among the stakeholder, a non-parametric Kruskal-Wallis test was applied. For this purpose the null hypothesis is:

$H_0$ : There is no difference in the responses of the respondent regarding the importance of social and commercial objective.

The result shows that the mean degrees of importance for the five different stakeholders are not same for both

**Table 1.** Bartlett's test for sphericity that supports the factorability of correlation matrix.

<b>KMO measure of sampling adequacy</b>		<b>0.721</b>
	App. Chi square	450.103
Bartlett's test of sphericity	df	28
	Sig.	0.000

**Table 2.** Interpretation from the factors community values.

Variable	Factor							
	1. Social objective				2. Commercial objective			
	1	2	3	4	5	6	7	8
1.Promoting Islamic values and norms objective	0.653							
2.Contributing social welfare objective		0.664						
3.Elevating poverty objective			0.581					
4.Promoting sustainable developing project objective				0.603				
5.Maximize cost operational objective					0.555			
6.Enhancing product service quality objective						0.672		
7.Maximize profit objective							0.593	
8.Offering viable and competitive financial product objective								0.639
Egeinvalue	2.636	1.188	1.136					
Percentage of variance	28.499	17.999	15.505					
Cumulative percentage	28.499	46.498	62.003					

factors that measure the social and commercial objectives of the Islamic banking system. The  $X^2$  values for both factors are much greater than the tabulated values. That suggests that the respondent has the difference in giving importance for both factors social and commercial objectives. And further to know the respondents strength of their response towards the social and commercial objective. The mean rank values are provided that shows that which respondent is giving priority to which factor and how much. This shows that the Islamic scholars are giving more priority to the social objectives of the Islamic banking system and the bank employees are giving more priority to the commercial objective of the Islamic banking system (Table 3).

## CONCLUSION AND SUGGESTION

The research survey has been conducted in order to get the objective setting of the Islamic banking system and for this the stakeholder of the Islamic banking were consider to be the respondents. During the survey initially what we have conclude is that the stakeholder of the

Islamic banking system are more conscious about the social factor for the objective setting of the Islamic banking system. The analysis indicates that the more important object that is perceived by the stack holders for the objective setting is "Promoting Islamic Values and Norms Objective". So if the Islamic banking system wants to survive in the financial market of Pakistan then they must have to consider about this factor. We got from the analysis that the different stakeholders have difference in their opinion. Regarding this, the Islamic scholars are more concerned about the social objective of the Islamic banking system and the bank employees are with the opinion of the commercial objective. Not only bank but any organization cannot exist in the market if they only consider the materialistic object. For any organization to get popular they must have to get the opinions of its customers, its different stakeholders. With their opinion they can easily and successfully survive in the market. So, for the Islamic banking system in Pakistan, not only in Pakistan but all over the Islamic and non Islamic countries, must have to consider these few important factors in setting the objective. For further re-search work researchers should concentrate on the cross

**Table 3.** The Islamic scholars are giving more priority to the social objectives of the Islamic banking system and the bank employees are giving more priority to the commercial objective of the Islamic banking system.

Factor	Respondent	N	Mean rank	X <sup>2</sup>	Asymp. Sig.
Social objective	Depositor	80	88.81	127.814	0.000
	Customer	76	118.4		
	Local community	79	215.09		
	Islamic scholars	39	234.73		
	Employees	48	203.18		
	Total	322			
Commercial objective	Depositor	80	72.94	138.656	0.000
	Customer	76	150.94		
	Local community	79	217.54		
	Islamic scholars	39	155.87		
	Employees	48	238.16		
	Total	322			

cross border research studies. Because the current world is considered as global village, so to exist in a global village what we have to do we have to consider the complete glob not have to become limited too our state or country. That's why there is need of research studies that compares cross cultural customers views.

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