

Sustainability of the Islamic finance industry: Overcoming the Challenges

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Abstract

Islamic finance has been around for the past four decades and it has experienced a remarkable growth globally. With this significant growth in a short time span, their concern now should move to ensuring the sustainability of the industry so that it will continue to thrive and not experience any form of major hiccups. This research aims to identify several prominent issues faced by the industry and suggest plausible remedies. This is a qualitative research, where content analysis of relevant articles was made under five identified categories: absence of standardisation, regulatory issues, legal issues, shari'a scholars' shortage and lack of awareness and inefficiency in reaching customer. The result indicates that the Islamic finance industry still has to fulfil the requirements of several niche areas and work its ways to address more pressing issues.

Keywords: sustainability, challenges, Islamic finance

Introduction

The Islamic finance industry has seen a tremendous growth for the past four decades and continues to thrive among other global players. It is a good indicator showing that an infant industry can emerge as a global player given the right time and support. However, the concern now for this particular industry is to uphold its rapid growth and ensure that there will be no halt in its progress.

Sustaining the industry is not an easy undertaking as there are a lot of issues and challenges coming in from all direction. One of the constant criticisms faced is related to the absence of the true philosophy of Islamic finance. This, together with limited or no awareness of Islamic finance, makes the public sceptical towards this particular industry. Hence, the first step in ensuring sustenance is to identify the different issues and challenges present in the current industry and then identify how to overcome them. This research will identify some of the prevalent issues found in the industry today and provide possible recommendations for implementation.

Objective of the Research

The objective of the research is:

- i) To identify and explain some of the prominent issues and challenges present in the Islamic finance industry.
- ii) To recommend ways which could be used to overcome these challenges

Methodology

This is a qualitative research, where content analysis of relevant journal articles was done. The articles were analysed under five categories: absence of standardisation, regulatory issues, legal issues, shari'a scholars' shortage and lack of awareness and inefficiency in reaching customer. From the analysis, possible recommendations were formulated at the end.

Results and Discussion

i) Absence of Standardisation

One of the main issues clouding the industry is the varied methodology in different jurisdictions in deriving a hukm for a contract or a transaction (Khan, 2012). There are four different schools of thought in Islamic jurisprudence: Maliki, Shafi'i, Hanafi and Hanbali. Each has its own mazhab. Each mazhab gives out its own different rulings regarding a particular matter, though at times there might be similarity among them. Each Islamic countries choose to apply one of the four mazhabs in their shari'a rulings. Due to this, there will be difference in the rulings applied. There will be no harmonisation or standardisation within the industry due to difference in Mazhab application.

Islamic jurisprudence or the derivation of fiqh rulings from the different sources (Al-Qur'an, Sunnah, Ijma' and Qiyas) also pose another problem (Venardos, 2006). Different scholars have different interpreting skills and different methodologies in elaborating a ruling. Again, there is absence of harmonisation. With the prevalence of these two issues, more time is wasted in trying to reach an agreement. This is a challenge for the continuous development of the industry since it has to be more innovative than its counterpart, the conventional finance industry.

ii) Regulatory issues

In terms of regulatory challenges faced by the industry, there are quite a few. One of it concerns the issue of who or what should supervise an Islamic financial institution in a country with dual financial system (Warde, 2000). For a conventional system, there are a lot of regulatory bodies which supervise their management and performance. The Basel Accords, International Financial Reporting Standards (IFRS) and International Accounting Standards Board (IASB) are just a few to name. For the Islamic banks, do these standards apply equally or do they need a special set of regulations specifically for Islamic financial institutions which follows the shari'a? There are some shari'a based organisations which are established solely for IFIs. Examples of it are the Accounting and Auditing Organisation for Islamic Financial Institution (AAOIFI) and Islamic Financial Services Board (IFSB). But the problem here is that it is optional for the countries with IFIs to implement the set of regulations imposed by these organisations.

iii) Legal issues

Other than that, in a country with dual legislation (the Common law and shari'a law), the problem for Islamic financial institutions is which legislation to follow if a problem arises. Normally, any legal case of the Islamic financial institution is preceded over by the Common law and not the shari'a law.

iv) Shari'a scholars shortage

Another common issue which crops up is the presence of the shari'a scholars in the industry. One pertinent problem is the inadequate number of shari'a scholars in the industry. They are quite limited in number and tend to sit in multiple shari'a supervisory board of the Islamic financial institution. This can cause conflict of interest.

Another problem is that the shari'a scholars are mostly in their heydays who have contributed vastly to the industry as a whole. There are not many scholars from the younger generation. This could be due to several reasons: it takes time to become a true scholar in the industry, the knowledge possessed is not adequate, they might be good only in shari'a knowledge and possess little or no knowledge when it comes to financial reporting. The biggest challenge in grooming the younger generation comes from the ability to perk up their interest and make them care for the industry. Many prefer to work now rather than study as it brings in income for themselves and the family. To combat this way of thinking, it is the responsibility of higher learning institutions to list out the long-term pros of education.

Being literate in the shari'a knowledge alone does not promise a better future for the Islamic finance industry. There is a need to be more knowledgeable in other fields as well such as accounting, finance and the likes of it. This ensures that a future scholar is well-rounded and able to understand the industry better.

v) Lack of awareness and inefficiency in reaching customer

Other issues which needs attention is the ability to differentiate Islamic products from conventional products. Most people are still unaware of the difference between the products offered by Islamic banks and the conventional banks. In their eyes, the Islamic banks have only changed the product name to some Arabic name while everything else is similar to conventional bank.

In the world today, there are sections of the population who choose not to keep their money in bank. This would include those living in the rural areas, the older generation and the likes of it. These groups of people might not even know what a bank is or probably not know that they could actually invest their capital.

Another group of people who are overlooked at times is the poor and needy. It can be risky to provide them with financing and the like but the aim of an Islamic financial institution is to consider everyone equally and be just in their management. Hence, they can always come up with tailored products which best suit the poor.

Islamic financial institutions can be quite reluctant in developing products which could actually be useful for the consumers. They are quite reluctant to promote risk-sharing

financial products such as musyarakah and mudarabah (Askari, Iqbal, & Mirakhor, 2010). These products actually stimulate the industry and keeps it running. Hence, if they cannot offer products based on these contracts, how will they be able to create new innovative products to complement the tremendous growth of the industry?

Conclusion and Recommendation

Sustainability is not as easy as it sounds unless there is an understanding among all the Islamic finance industry players. Human resource together with their skills and knowledge is the main tool to ensure a continuous growth. Other than that, the industry as a whole needs to take a slow and steady approach in ensuring that they can actually maintain their growth rate as well as the overall quality of the industry.

Some recommendations which could be useful in ensuring continuous growth of the industry are explained below:

- i. To tackle the issue of insufficient shari'a scholars, more programmes have to be offered which aims to groom new shari'a scholars. In the programme itself, the higher learning institutions can choose to combine finance modules and shari'a modules. This would ensure their fluency in both and enable them to continuously thrive in the industry and ensure the continuous growth of the industry. Of course, this would take time but it benefits the industry in the long-term.

Similarly, new scholars and to-be scholars should have adequate training to prepare them for any form of instability in the industry. Training institutions or centres would need to come up with training programmes suited for the continuous change in the Islamic finance industry. An effective and efficient training may be achieved if mentorship programmes could be arranged with present shari'a scholars.

- ii. In terms of tackling the regulatory challenges, there are regulatory bodies set in place (example: AAOIFI, IFSB) for the Islamic financial institutions but it has been left open for the countries to either implement it or formulate their own regulations. To tackle this, they need to create some form of harmonisation among the four mazhabs and then, work their way to standardise the Islamic financial industry globally. Time will not be wasted and conflicts could be minimised or avoided at all cost.
- iii. Open more entrepreneurship programmes for the poor and needy. Islamic financial institutions can provide some form of platform for them to start. Providing them with start-up capital as part of their entrepreneurship programmes can actually motivate one to involve in permissible business and enable them to escape poverty in the long-term. They would need to be continuously monitored and provided with proper guidance.
- iv. To educate the public on the difference between conventional banking and Islamic banking, the Islamic financial institutions can conduct road shows and provide the public with explanation. Giving the best possible explanation will ensure that they truly understand what Islamic banking is all about. During the signing of contract between bank and customer, it is best to explain the contents of the contract in a

simple and summarised way. This will save time for both sides and any future misunderstandings could be reduced.

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