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Perceptions Surrounding the Contemporary Practice of Islamic Finance

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Introduction

Islamic finance refers to the industry that structures financial transactions and institutions so that they are compliant with traditional Shari'ah law. Islamic finance has gone through several stages of development beginning with the establishment of the first modern Islamic bank in Dubai in 1975. During the past two decades, the industry has gained unprecedented levels of public attention because of its tremendous growth in size and position as an alternative to conventional banking practices. With the discovery of oil and the subsequent growth of wealth in the Gulf, Islamic banking has spread throughout the Middle East and Asia, garnering the most support in Iran, Saudi Arabia and Malaysia. Today there are over 600 Islamic financial service institutions worldwide with size estimations ranging from $500 billion to almost a trillion dollars.

Its growth, however, has also led to competing claims on the direction Islamic finance should take in the local economy. For instance, in the face of rising income inequality, many claim that Islamic finance needs to play a larger role in alleviating the social ills of economic development. It is believed that the industry may have veered off-track and many accuse the sector of not being substantively different from conventional finance products or of failing to realise its original economic and social ideals.

Islamic Finance and the Perceptions of Non-Muslims

The Islamic finance industry faces a number of external challenges to its reputation and outward perceptions both from consumers and practitioners within the industry and the general public. Especially after the attacks of September 11, 2001, the words 'Islam' and 'Shari'ah' have taken on negative connotations within the media and the Western consciousness. Similarly, after the global economic crisis of 2008, the term 'finance' has come to be viewed more critically, both in the West and the rest of the world. The combination of the two leads to an even higher level of concern, especially as the outside media has often tended to equate Islamic finance or Shari'ah compliant economics to money laundering and terrorism financing. For non Muslims especially, Islamic finance and economics can appear as a black box of unfamiliar terms, non-transparent processes and an unclear purpose and expected outcome. Even the majority of Muslims are not knowledgeable about many of the basic tenets of Islamic economics; the average consumer might often confuse terms or concepts or not even be motivated to open an account or engage in an Islamic investment in the first place.

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Post 9/11 there was a dramatic surge in the percentage of American non-Muslims who viewed Islam and related entities in a negative light. Among these entities was Islamic finance and banking, considered by some to be the source funding terrorist organisations around the world. These claims were fuelled by people in positions of power such as the former National Security Adviser, Sandy Berger, shortly after 9/11, who said that it would be difficult to track down Osama bin Laden's money because it was in 'underground banking, Islamic banking facilities'. These statements, however, have been offset by other equally prominent figures such as former President George W. Bush who in his remarks at the Islamic Centre of Washington shortly following the September 11th attacks stated, 'The face of terror is not the true faith of Islam…Islam is peace."

Unfortunately, this statement was not enough to convince everyone as evidenced by the prevalence of sites and organisations like the Centre for Security Policy, which heads the project Shari'ah Finance Watch. The purpose of this project is to educate governments, policymakers and the general public about what the founders deem as the 'dangers of Shari'ah'. They claim that Shari'ah compliant financial institutions are 'terror financing mechanisms' that impose significant national security, financial and legal risks on Western financial institutions.

This author characterises Islamic finance as a 'black box' for non-Muslims, especially after the 2008 financial crisis. Negative perceptions about Islam lingering from 9/11 combined with new suspicions about finance have raised even more concerns. People are uncertain about investing their money in general, let alone in an industry they do not fully understand.

Several studies suggest, however, that these views may be changing, especially when considering non Western countries such as Malaysia. Since the establishment of Bank Islam Malaysia, the first Malaysian Islamic bank in 1983, Malaysia has emerged as an international Islamic financial centre. The country is now home to the largest Islamic capital market for both sukuk and Islamic equity, the second largest Islamic mutual fund and takaful market and the third largest Islamic banking market. Due to the success of the industry, the International Centre for Education in Islamic Finance (INCEIF) was founded in 2006 by Bank Negara Malaysia, the Malaysian central bank. INCEIF is the only university in the world solely dedicated to the postgraduate study of Islamic finance.

More recently, trends have suggested that the European Union may emerge as the latest centre for Islamic finance, possibly due to the mass immigration of Muslims from the Middle East, Asia and North Africa. Britain's Islamic finance sector has nearly $19 billion in Islamic banking assets, exceeding the holdings of several Islamic states including Turkey, Egypt and Pakistan. Perhaps more important is the establishment of Islamic financial education programmes in 55 British colleges and educational institutions. France, with the largest population of Muslims of any European country, has also begun to make progress by passing a series of instructions for facilitating the introduction of Islamic financial products. This legislation was heavily backed by the former French Finance Minister, Christine Lagarde, (now the Managing Director, International Monetary Fund) who characterised it as an 'exciting new beginning for Islamic finance in the Republic.'

Islamic finance has also received support from a number of religious institutions, including Christian organisations, after the 2008 global market crash, which led to criticism of the conventional banking system. The Vatican's official newspaper L'Osservatore Romano published an article stating that the free-market model has 'grown too much and badly in the past two decades.' It concluded, 'The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service.' This trend was continued in February 2008 when, at a lecture on civil and religious law at the Royal Courts of Justice, the then Archbishop of Canterbury Rowan Williams stated that 'giving Islamic law official status in the United Kingdom would help achieve social cohesion because some Muslims do not relate to the British legal system.'

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Observable Global Trends: Perceptions about Islamic Finance

The Islamic finance industry initially began as a means for Muslims to participate in the modern financial world while still adhering to Shari'ah law and, while it has attracted non-Muslims, its main focus is still its Muslims clients. Islamic banking is appealing to pious Muslims who, for many reasons, but particularly the conventional banks' practice of charging interest, are unable to engage in traditional banking. Studies show that many Muslims are in fact willing to pay 'faith premiums' for financial services and products that are Shari'ah compliant.

Post 9/11 Perceptions

Ali and Abdur-Rahman have conducted a study to investigate perceptions of the Islamic finance industry and impacts on the industry following 9/11 by studying representations in mainstream media and by surveying Islamic finance industry and Islamic finance media professionals globally for their perceptions and experiences post-9/11. Study of media articles related to Islamic finance post-9/11 reveals that relatively few articles linked Islamic finance with terrorism, and few (12%) maintained a negative tone. Islamic finance professionals reported that 9/11 brought closer scrutiny of the industry, which increased apprehension, but also led to growth and awareness. The majority of Islamic finance media professionals, however, perceived a negative impact and 70% of them are critical of how the industry handled media attention post 9/11. The study finds that despite some negative media coverage of Islamic finance following 9/11, development of the industry was not significantly impacted and the outlook for future development is overwhelmingly positive.

U.S. Consumer Perception

Shari'ah compliant home financing (mortgages) holds the key to the success of an expanded role for the Islamic finance industry as a whole in the U.S., because it represents, almost literally, a foot in the consumer's door. Unfortunately although some Islamic home finance providers have been quite successful and, in fact, have become competitive with conventional mortgage companies, customers remain sceptical and unconvinced.

Shopping for Scholars

One of the areas receiving the strongest criticism from both inside and outside the industry is the role of the Shari'ah scholars themselves. The main concern of many is the concentration of a few key scholars on a number of Shari'ah advisory boards. A 2010 study conducted by Funds at Work found that three scholars make up 20.9% of total board positions in international organisations while 10 scholars make up over 40% of all positions. It was

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noted that one scholar held 78 board positions at the same time, leading bank managers to question scholars' commitments to their responsibilities. Stemming from this is the view that Shari'ah boards have now turned into a 'brand game'. The so-called 'market for scholars' has become saturated and there is little opportunity for new scholars to enter the industry. Instead, current scholars take on apprentices who later express views on key issues that are nearly identical to their predecessors' views. Lastly, many are concerned with the inherent conflict of interest that stems from having the same Shari'ah scholars on the boards of multiple banks and financial institutions as well as in an advisory capacity to various governments. Some suggest that this might lead to favouritism as well as a failure to properly evaluate documents, products and transactions.

Muddassir Siddiqui, a Shari'ah scholar now based in Dubai and a member of the Shari'ah board of AAOIFI, believes that part of the problem is that the number of banks and financial institutions around the world offering Shari'ah compliant products is growing rapidly and that the industry cannot provide enough scholars to meet the demand. He said, 'There is a big shortage of scholars. Also, some scholars have developed a very deep understanding of how certain aspects of finance works. Wouldn't you want those scholars who have gone through similar challenges?'

Scholars point out however, that no member of any Shari'ah board has been accused or publicly challenged in relation to a conflict of interest situation. They also argue that product providers know what they are getting into. 'If a financial institution knowingly engages the services of a Shari'ah scholar who they know is sitting on the board of a competing financial institution, then really, it is up to them. Do they trust him to keep their secrets? If they don't see it as a problem, then I don't see any conflict there,' says Muddassir Siddiqui. (Siddiqui incidentally does not sit on multiple boards himself, preferring to avoid any potential conflicts.)

Usman Hayat, director of Islamic finance and ESG investing at CFA Institute, says it comes down to transparency. 'You can't always avoid a conflict of interest to ensure independence of judgment. Where you have to manage it, you manage it through strengthening transparency and accountability. The same should apply here to enhance the credibility of the Islamic finance industry.'

Consumer Perceptions

A prominent criticism of the industry is that while it is expanding and making profit, the people whom it was originally designed to help have not benefitted. When looking at the distribution of Islamic finance institutions, the majority of them are concentrated in the oil-rich Gulf States. Shareholders and not the general public benefit from the banking system, where constant pressure to produce profits leads managers to invest imprudently. Even more troubling is that many of these institutions that offer Islamic banking services are either owned by non-Muslims or are located in the West and part of conglomerate groups. In a panel discussion held at Harvard in 2009. Mahmoud El-Gamal presented the findings of his book, Islamic Finance: Law, Economics, and Practice (Cambridge University Press, 2006). He argued that Islamic finance, though based on noble objectives in principle, is reduced to legal arbitrage in practice. The approach historically taken towards Islamic finance, which he terms 'the Arab-Pakistani model,' is concerned with morally regulating the operations of individual businessmen rather than promoting economic growth at the macro level and distributing resources in accordance with Islamic principles of social justice. This has led to the equally troubling concern that products offered by Islamic institutions are simply 'conventional products with an Islamic label.'

Several studies were conducted regarding the perception of the Islamic finance industry. Muslim Amin and Zaidi Isa examined the perceptions of Islamic banking in Malaysia and found that, while the majority of customers were satisfied with the quality of the industry, there was a need for improved customer service and more financial counselling to satisfy customers.

Mohammed Hossain and Shirley Leo's paper on the perception of the service quality within the Islamic banking industry in Qatar found that customers rated Islamic banks highest in terms of the infrastructure of the bank, the convenience of banking and their return on investment. The paper recommended that banks deliver a higher level of customer service in order to increase their market presence and profitability.

A study conducted by Muhammad Hanif and Abdullah Muhammad Iqbal, found that while the majority of respondents in Pakistan understood the theoretical basis of Shari'ah compliant economics, many were sceptical about how Islamic finance operated in Pakistan. Several respondents stated that an interest free economy was not possible and that Islamic banks should exist alongside conventional banks. Proponents of Islamic finance suggested that the industry should launch an awareness campaign to counteract some of the misconceptions about Shari'ah compliant financing. Another suggestion was for the government and other regulatory bodies in Pakistan to play a larger role in mandating the inclusion of Islamic banking within the financial services industry. Others suggested that banks and other financial institutions engage more in the practice of profit and loss sharing (PLS) as a viable Islamic financial product that has to date been underutilised in Pakistan. Finally, some also suggested that other players outside of academia and the industry ought to be involved in the transition to an Islamic economy, including businesspeople, regulators, members of civil society, clerics and well known intellectuals.

Asyraf Wajdi Dusuki and Nurdianawati Irwani Abdullah's study of Islamic bank customers in Malaysia conducted in 2010 seconds these recommendations. The study found that Islamic banks and financial institutions could no longer depend solely on those customers who purchase Islamic financial services motivated by religious or pious considerations. Rather, the industry must strengthen its marketing initiatives to broaden consumer awareness of the Islamic banking sector as well as increase the quality level of its customer service to expand its market share.

A survey of Malaysian consumers conducted by Mark Loo found that while the majority of Muslims were attracted to Islamic banking for religious reasons, the majority of non-Muslims were mainly attracted towards it for the products and services it offered. In Malaysia in particular, 75% of Muslims saw a strong prospect for Islamic banking in Malaysia, while only 20% of non-Muslims

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agreed. According to the authors, portraying Islamic finance as a religious obligation to Muslims and as a way to save money from non-Muslims gives the industry as a whole a bad reputation. Secondly, the authors recommended that practitioners and providers improve their communication with potential customers by introducing the Islamic financial services they sell in their local language rather than in Arabic. It was recommended that the industry as a whole engage in a concerted effort to improve their human resources divisions and talent recruitment process.

Yussof, Ibrahim Moh Yussof and Mustafa Daud studied the perceptions of the future of Islamic finance in Nigeria among young people. They observed that the perceptions of Nigerian youth studying outside of the country have a strong impact on the development of the Islamic finance industry in their home country. Based on the results of their statistical study, they offered three recommendations to further the development of a Shari'ah compliant economy in Nigeria. The first of these was the need to educate the Nigerian people more on the benefits of Islamic banking for the country's economy as a whole. Secondly, it recommended that the Central Bank of Nigeria (CBN) especially engage in such efforts, as it is optimally placed to encourage research and formulate policy. Lastly, the report encouraged Islamic finance institutions in Nigeria, and the CBN in particular, to focus on improving the quality of training and talent selection within the industry as a whole and provide more opportunities for professional development.

Outside of the negative perceptions, if Islamic finance is to be a legitimate competitor to conventional banking, it must appeal to clients outside the Arab world. A 2005 study by Jorg Bley and Kermit Kuehn found that the use of Arabic terms in Islamic finance served as an obstacle to many in understanding the mechanics of Islamic financial products and services. The study suggested allowing suppliers of Islamic financial services to rename Islamic products as they see fit, after the regulatory bodies have clearly and comprehensively defined the instruments in question. The study recommended that Islamic financial institutions improve their marketing campaigns in order to better appeal to consumers. If the industry does not do this, the study argues that it will no longer be able to compete with conventional finance in growing its market share.

Job Market Perception

A widespread misperception created by a few professionals is that thousands of professionals are needed to run the industry. As a result of that there are hundreds of universities both in the East and the West offering both undergraduate and postgraduate degrees and diplomas as well as certifications in Islamic finance. This view has been contradicted, however, by a recent report from Paul McNamara. He highlighted that highly qualified professionals pouring out of these institutions to be placed in the market are not having any luck in finding the job they envisage. In his analysis of the website, www.efinancialcareers.com, there were only eight jobs listed in the Islamic finance section as compared to a segment on the same website for hedge funds where there were 400 jobs listed. When the industry is claiming to be a trillion dollar industry with 15 20% growth a year, where are the jobs and who is being employed to undertake the work? If these professionals are not being employed, it begs the question whether these institutions are hiring professionals with conventional qualifications? If that is the case, what employment prospects are there for graduates with Islamic finance degrees?

Countering Common Misperceptions

According to Rushdi Siddiqui, former Global Head of Islamic Finance & OIC Countries at Thomson Reuters, many still associate Islamic finance with the funding of terrorism and totally misunderstand the industry as a whole. He placed some of the blame on the industry itself, explaining that Shari'ah compliant financiers have done a poor job of explaining their products and services and how they differ from the tools of conventional finance. According to Siddiqui, there is a great need to educate the 'man on the street' about the workings of Islamic finance in order to dispel the notion that Islamic finance is no more than 'terrorism finance.' Siddiqui identified what he saw as the three main challenges facing the industry as transparency, the search for information and industry connectivity. He specifically pointed to the inability to use the search engine Google to find useful and meaningful information on Islamic finance as a pressing challenge. He also explained that Islamic banks have a presence throughout the Muslim and non Muslim world but that they are not connected in the way that conventional banks are, communicating electronically and engaging in financial transactions together.

Redefining and Reappraising the Islamic Finance Industry

Over the last 25 years, as the industry has grown to be a global force, a process of self-criticism has begun. There are competing views about the direction the Islamic finance industry should take both locally and globally. For instance, in the face of rising income inequality, many observers claim that Islamic finance needs to play a larger role in alleviating the social ills of economic development. Others claim that this responsibility falls beyond the imperatives of Islamic finance, which they see as simply a Shari'ah compliant version of conventional finance.

In the past 10 years Harvard forums discussions have focused on the challenges faced by Islamic finance practitioners in structuring

Shari’ah compliant financial products. It was recognised, however, that the meteoric rise of Islamic finance in recent years has caused a gap to emerge between two professional groups required for its success the Shari’ah scholars and the Islamic economists. With this in mind Harvard and the London School of Economics (LSE) created a new platform in 2006 to bring together these two groups, the scholars and the economists. Both professions have seen significant developments in their respective fields and it was felt that there was a need for further understanding and cooperation between the two. At an annual meeting participants share their thoughts and opinions and discuss some of the most pressing issues facing the Islamic finance sector today. The aim is for the participants to engage in open dialogue and develop further insight in the field, rather than prescribe a particular course of action or conclusion.

Looking Ahead

There are institutional and strategic changes that the Islamic finance industry can adopt to address the negative perceptions it faces. In order to improve the current perception, greater dialogue is needed among all those involved in the industry, including Islamic economists, Shari’ah scholars, practitioners, regulators and legal professionals. Public lectures are needed to educate the media and general public, including both Muslims and non-Muslims. The role of academia is critical in engaging Islamic finance stakeholders in a healthy discourse on the subject of Islamic finance. Academic institutions such as Harvard University can engage in efforts to bring together all the actors to develop a better understanding and resolve the issues facing the industry. In particular, initiatives should focus on improving transparency and organisation at a national and international level, so that Islamic financial institutions can better communicate with each other and become more involved with one another. Islamic finance industry leaders should make themselves available to discuss the issues openly and provide clear directions for the industry, removing any misunderstandings being created by Islamophobia or other issues. Issues of ethics and governance as well as social relevance must be addressed to bring about greater community participation. As evidenced by the views of Islamic finance practitioners and media professionals, increasing coverage in the global media, and the sustained growth of the industry worldwide, the outlook for future development of the industry is overwhelmingly positive.

Summary

This article has identified some of the most pressing issues confronting Islamic finance today and particularly the perceptions of the industry among both Muslims and non Muslims. Studies have shown that the primary motivating factors for most Muslim customers in deciding between a conventional and an Islamic bank have been a combination of religious and economic reasons. On the other hand, non Muslim customers tend to value the speed and efficiency of service, the reputation and the image of the institution, confidentiality and convenience when choosing a bank or a financial institution. The Islamic finance industry has fallen short in meeting many of these expectations, for both Muslims and non Muslims because of ineffective marketing efforts on the part of Islamic banks and financial institutions.

A few remedies have been suggested by past studies to address these negative perceptions. These include awareness campaigns to counteract some of the misconceptions about Shari’ah compliant financing; a need for regulators to develop a tailored structure for Islamic financial institutions; better marketing campaigns and products to attract new customers, both Muslim and non-Muslim; allowing providers to rename Islamic products as they see fit in order to better appeal to customers and a focus on improving the quality of training and talent selection within in the industry as a whole and providing greater opportunities for professional development.

Looking beyond the industry itself, academics and professionals should look to other fields, including faith based financing and social corporate responsibility as a model for future development. Economists should be appointed to Shari’ah boards, as many Shari’ah scholars lack an understanding of the macroeconomic forces impacting the industry. Additionally, more specialists from other industries, as well as more non-Muslims, should be involved in the academic and professional sides of the industry as their perspectives can be crucial in moving forward.

S. Nazim Ali has been the Director of the Islamic Finance Project (IFP) at Harvard Law School, Harvard University since 1995. For the last thirty years, he has focused his research efforts exclusively on the field of Islamic finance. He has played a lead role in organising several conferences, workshops and symposia, including the Harvard University Forum on Islamic Finance and the annual workshop at the London School of Economics. He also led the effort that resulted in the publication of the world’s first academic software database covering the Islamic finance sector, the IFP DataBank (http://ifp.law.harvard.edu).