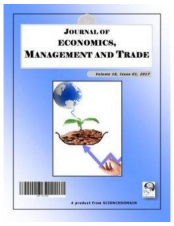

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Perspectives of Islamic Banking and Its Place in Economic Theory: Empirical Evidence from Saudi Arabia

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Author's contribution

The sole author designed, analysed, interpreted and prepared the manuscript.

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ABSTRACT

The study investigateswhether Islamic banks have unique modes and principles of their own, different from those of conventional banks and to find out the salient perspectives of Islamic banking in Saudi Arabia. The study concludes that Islamic Banking is based on *Shariah* (Islamic law) which prohibits dealing with *riba* (usury interest), *gharar* (uncertainty and speculation), debt-financing, gambling, alcohols, adultery and pork. Consequently, Islamic banking has its unique financial principles and modes which make them distinguished from those of conventional banking. Such modes include *Murabaha* (cost plus), *Mudaraba* (trading at agreed prices), *Ijarah* (leasing), *Musharakah* (equity participation) and *Sukuk* (Islamic bonds based on assets). The Saudi banking system is dual where Islamic and conventional banking may work side by side. In view of the foregoing findings from this study, it is hereby recommended that the use of Islamic banking in western countries as a complementary to conventional banking to serve their clients, having new innovative Islamic financial products and hedging instruments besides developing the Islamic banks to be cost-effective providers of high quality financial services.

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1. INTRODUCTION

In the last three decades, Islamic banking has spread in Arab, Muslim and Non- Muslim countries with assets exceeding 1.5 trillion dollar. However, concept, principles and appliance of Islamic banking are still a important hot issue among economists and *Shariah* (Islamic law) scholars.

The research problem is whether Islamic banking has a unique economic and finance system to follow or it is a part of the conventional economic and finance theory. This study is an attempt to shed light on this important issue and to find out answers to the following research questions: Is there a unique Islamic economic and finance system that covers Islamic banking? If so, what are the main characteristics of such a system particularly in Saudi Arabia? What are the major differences between Islamic and conventional banking?

This study aims at:

(1) Investigating whether there is an Islamic economic principles and modes that govern the Islamic banking operations.
(2) Identifying the main characteristics of Islamic banking in Saudi Arabia.
(3) Conducting a comparison between Islamic and conventional banking.

The importance of the study stems from the fact that very little is known about the Islamic banking principles that are derived from *Shariah* Law that governs the operations of Islamic banks. Moreover, there is a scarcity in studies on the Islamic banking model of operations. The conclusions and recommendations of this study will be of great benefits to the financial managers and officers working in the banking institutions.

Concerning the research methodology, the researcher adopted a descriptive and analytical approach in collection and analysis of the primary data from a questionnaire which was distributed equally to a purposive convenient sample of 30 academic staff at faculties of administration & financial sciences in 3 public Saudi universities of Taif, King Abdul-Aziz and Umm Al-Qura. The questionnaire included two parts. Part 1 consists of paragraphs relating to personal information of respondents, while part 2 includes 49 paragraphs relating to Islamic banking (see the questionnaire in Appendix 3). The questionnaire was distributed to several referees to check its soundness and accuracy then its reliability was tested by Cronbach Alpha Coefficient which was (0.801). Respondents returned all distributed questionnaires fully filled. The statistical tools of analysis in this study are: frequency distributions, percentages, mean standard deviation and t-test using SPSS.

The limitation of this research is the small size of the sample due to difficulties in conducting personal interviews with academic staff of far away universities in a very large country such as Saudi Arabia. Hence, generalization of the research results is limited by the small size of the sample. The scope of the research is limited to surveying the points of view of academic staff of faculties of administration & financial studies in public universities of Taif, King Abdel-Aziz and Umm Al-Qura. The study does not cover other public and private universities in the Kingdom due to the limited time and resources.

The organization of this research consists of the following sections: (I) Introduction. (II) Theoretical Framework of Islamic Banking and Previous Studies. (III) Comparative Overview of Islamic and Conventional banking. (IV) Analysis and Discussion of the Empirical Results. (V) Conclusions & Recommendation, besides references and appendices.

2. THEORETICAL FRAMEWORK OF ISLAMIC BANKING AND PREVIOUS STUDIES

Islamic banking is defined as banking activities that are consistent with the principles of *Shariah* (Islamic Law) which prohibits the fixed or floating payment of interest known as *Riba*or *Usury* in money lending [1]. Islamic banking is based on Islamic law or *Shariah* which deals with *FiqhMuamalat* (Islamic rules on transactions) which came from the *Quran* and the *Sunnah* and other secondary sources of Islamic law such as collective opinion among Shariah scholars (*ijma)* analogy (*qiyas)* and personal reasoning (*Ijtihad)* [2].

The first Islamic bank was established in Egypt in 1963 followed by Islamic banks in more than 57 countries particularly in Malaysia, Indonesia, Pakistan, Iran, Afghanistan, United Arab Emirate, Bahrain, Saudi Arabia, Kuwait, Oman, United

Arab Emirates, Bahrain, Jordan, Lebanon, Iraq, Sudan, Tunisia, Algiers, Morocco, Yemen, Palestine, Mauritania and Somalia. In 1975, the Islamic Development Bank was established, in Jeddah-Saudi Arabia, with membership of more than fifty Islamic countries. Moreover, several local, regional and international conferences were held on Islamic banking, besides hundreds of books and dissertations were published concerning Islamic banking. Furthermore, Switzerland, UK, France, USA, and other countries in the western hemisphere have established windows for Islamic banking in their financial institutions such as Citibank, UBS, HSBC, Barkleys, Grindlays, Dutch banks, French BNP, Society General and other banks to attract more liquidity and investments [3]. Details of the main Islamic banks world-wide are shown in Appendix 1.

The spread of Islamic banking and finance has impacts on academia, research centers, academic journals, seminars, conferences, establishing departments for Islamic economics, writing doctoral dissertations on Islamic banking. During the *Shura* (parliament) Conference on Islamic banking in Kuwait on December 16, 2013 Ajeal Alnashmi, Head of *ShariahFiqh Association* at Gulf Corporate Council (GCC), announced that the number of Islamic Banks world-wide reached 350 including 50 in Western countries and there are more than 40 products of Islamic banking with investment more than US$1.3 trillion expecting it to reach US$2 trillion in the coming few years and Islamic banks work according to 50 criteria decided by *Fiqh Shariah Council* [4]. Recently, a new Islamic Banking Research Center in Dubai was established to make Dubai the Center for Islamic Banking in the Middle East.

According to the Ernest & Young report on Islamic banking competitiveness in 2013, the size of assets of Islamic banking reached $1.8 trillion with the top 20 Islamic banks hold 57% of total assets of Islamic banking. Saudi Arabia was ranked first with $207 billion assets followed by Malaysia with total assets of $106 billion, then United Arab Emirate with $75 billion assets. The report noted that the average return on equity (ROE) of Islamic banks was 11.6% in 2011 against 15.3% for conventional banks which is interpreted that the profitability of Islamic banking is less than conventional banking [5].

According to Ghannadian & Goswami [6] Quran, the holy book of Islam, has considered the notion of *interest* as usury. The prohibition of interest payment under Islamic law (*Shariah*) stems from treating money strictly as a median of exchange. Muslim scholars denote that raising capital for investment in Islamic banks is an involvement in sharing profit with the user of capital. Islamic economists do not favor the increasing role of debt-financing in the Islamic banking operations as the greater the debt the less the ability of banks to absorb financial shocks. The principles of risk and profit sharing can be applied to Islamic banks' investment tools [6].

The basic principles of Islamic banking are [7].:

(1) Risk–sharing: Financial transactions need to reflect a symmetrical risk/return among the participants to the transactions of Islamic banking.
(2) Materiality:All financial transactions must have material finality, i.e. be directly linked to a real underlying economic transaction; consequently, options and derivatives are banned.
(3) No Exploitation: Neither party to the Islamic transaction should be exploited.
(4) NoFinancing of Sinful Activity: Transaction cannot be used to produce goods banned by the Quran such as alcohol, pork products, gambling, etc.

Islamic banks adopt several modes of acquiring assets or financing projects that may be broadly categorized into four areas: [8].

a. Investment financing: is done according to Musharakah, Mudaraba, estimated rate of return or negotiable rate.
b. Trade financing: is done according to mark-up, leasing, hire-purchase, sell and buy back and letter of credit.
c. Lending: is done according to loans with service charges, non- cost loan for needy people and overdraft.
d. Services: money transfers, bill collections, trade in foreign currencies at spot rate which are provided to clients on commission basis.

Details of the major Islamic financing modes are as follows [9]:

(1) Murabaha: is trade financing or mark up sale on mutually agreed profit. It involves the banks' buying what the merchant wants, then selling it back to him later at an agreed price. Murabaha is a cost plus

financing and the excess of the agreed price over the current purchase price.

(2) Mudaraba: is a profit and loss sharing contract where the bank provides funds while the other party provides expertise and management. Profits accrued are shared on a pre-agreed basis; losses are borne only by capital provider. Mudaraba is accounted to 10% of Islamic banking operations.
(3) Musharakah: is an equity participating contract providing for profit/loss sharing in the joint business where the financer provides a portion of the total funds and all partners may participate in management. Profits are distributed in pre agreed ratios, but losses are borne strictly in proportion to respective capital contribution.
(4) The Muzaraa: involves sharing of profits and losses between farmers and the bank in business form.
(5) Istisnaa: involves sharing profits and losses between a manufacturer and the bank.
(6) Ijara: is a lease or a lease –purchase agreement. It is a contract of financing between the bank and the client where the bank gets the rent of the commodity from the client.
(7) Bai'aSalam: is a trade based Islamic finance which is a deferred delivery purchase where a seller informs the buyer cost, selling price and payment date.
(8) Sukuk: it is an Islamic bond based on profit &loss sharing, requires real assets not debts. Sukuk are used by Islamic banks to attract long-term finance from Sukuk holders [10].
(9) Al- Qurd al Hassan: is a benevolent loan with zero-interest and charges, extended by Islamic banks to needy persons and poor household families.
(10) Direct Equity Investment: purchasing shares on the open market.
(11) Tawarruq: is an Islamic securitization of Sukuk to get liquidity. Islamic securitization is allowed in Islamic banking as the bank is not selling a debt, which is forbidden in Islamic law (Abdulrahim: 2014) [10]. Islamic securitization is used as a hedging tool by Islamic banks, while the conventional banks use several hedging tools as derivatives such as options, future and forward contracts based on interest [11].
(12) Takaful Insurance: is another product of Islamic finance based on sharing of profits and losses of insurance operations. Takaful insurance is provided by cooperative insurance societies to cover risks and it is free of interest [12].

A study has shown that 87% of the operations of the ten largest Islamic banks world-wide adopted the following financing modes: *Ijara*, *Mudaraba*, *Murabaha* and *Musharakah* modes [13].

Islamic banks are facing several challenges such as the few investment products of Islamic banking and the few hedging instruments used by Islamic banks to cover the systematic and non-systematic risks. Although eliminating interest from the economy earned recognition in Islamic countries, the controversy about its legitimacy and impact on macroeconomics are still not solved.

The overview of previous studies is as follows:

1. The study of Ghannadian & Goswami [6], aimed at discussing the Islamic banking principles and characteristics. The study concluded that Islamic banks are considered as specialized banking that can help promoting growth in developing economies and may be considered as a structural change in financial institutions. The study looks at Islamic banking system as potential for providing liquidity and money creation through offering transactions accounts with compensation for inflation and to risk-avoiding depositors. The study recommends adopting a banking system based on risk and profit sharing similar to the Islamic banking, a system where funds are invested on basis of sharing profits and losses, the moral issues and offering save returns. [6].
2. The study of Siddiqi [1], aimed at evaluating the differences between the theory and current practice in Islamic banking in the light of achieving the *Shariah* objectives of meeting the society needs based on non-exploitation, justice and welfare. The study concludes that there is a gap between the theory of Islamic banking and its practices. The implication on macroeconomic stems from the difficulties in applying the Islamic banking theory on the banking operations and the diversion in the fiqh issues which lacks consensus among Islamic scholars such issues are still unresolved. Models of Islamic commercial banks are based on

two-tier *Mudaraba* which builds an alternative system of finance free of interest (*riba*) [1].

3. The study of Khan, [13] aimed at discussing to what extent actual banking practices do live up to the ideal principles of Islamic banking and how different are the Islamic banks from conventional banking. The study concludes that after three decades of the introduction of Islamic banks, there still substantial divergences between the ideals of Islamic banks and their practices. Islamic banks still remain not totally indistinguishable from conventional banks and Islamic banking cannot claim that they provide an alternative to conventional banking and finance [13].
4. The Study of Ahmad [14] aims at discussing the challenges facing Islamic banks which include: severe competition of conventional banks, shortages of talents staff, the uncertain relationship with central banks, the absence of special legislation organizing the activities of Islamic banks, the need for more corporate governance, lack of credit rating, lack of credit information center, difficulty of attracting deposits of customers, heavily reliance on equity financing, having high cash/deposit ratio with extra non-invested liquidity, mostly invest their funds into direct investment through *Musharakah* and *Mudaraba*, difficulty of keeping high quality services for clients, difficulty of having new innovative financial products [14].
5. The study of Yahya & Muhammad [15] is investigating the difference in the efficiency level between conventional and Islamic banks in Malaysia. The study was limited to two Malaysian banks for 3 years excluding foreign banks from the study using Data Envelopment Analysis (DEA) to measure banks efficiency. The study found that there are no significant differences in the level of efficiency between Islamic and conventional banks in Malaysia and Islamic banks are performing as well as conventional banks for two years out of three years of the study (2005-2008) [15].
6. The study of Gerrard & Cunningham [16], aimed at discussing the attitude of Muslims and Non-Muslims in Singapore on what to do if the Islamic bank does not have profits to distribute to shareholders and about the various financial criteria used. The study concluded that 66.5% of Non-Muslims answered the 1st question that they would withdraw their deposits while 62.1% of Muslims said they would keep their deposits. Differences were obvious among Muslims and Non-Muslims regarding the financial criteria to be used where non-Muslims had higher percentage than Muslims preferring higher interest [16].
7. The study of Dusuki [17], aimed at investigating the perspectives of seven types of stakeholders in Malaysia on the philosophy and various objectives of Islamic banking. The study revealed that respondents regards Islamic banks as institutions that uphold social objectives and promote Islamic values towards their staffs, clients and general public, besides contributing to social welfare of the community, promoting sustainable development projects and alleviating poverty. The policy implications of the study are: Islamic banks should not be profit oriented only but achieve economic objectives of Islamic law, besides being successful in integrating social goals with financial innovation [17].
8. The study of Kunhibava & Rachagan [18] has the objective of comparing the *Shariah law* and the conventional law in relation to Islamic banking and making the comparison between the two. The researchers selected Malaysia as a case study for investigating. The study concluded that the convention law in Malaysia has accommodated *Shariah* law to govern Islamic banking operations. Thus, there is no separate or a special law for Islamic banking in Malaysia [18].
9. The study of Di Vanna [19], aimed at discussing how banks offering *Shariah*-compliant products will develop in the future. The study concluded that Islamic banks are facing competition from conventional banks in term of new financial products and services which require them to go beyond the staple products such as Islamic credit cards, *Sukuk* and Takaful cooperative insurance. Hence, innovative products will become the cornerstone in the next generation of Islamic banking. Islamic banks should provide products that differentiate them from conventional banks and to demonstrate that they are cost-effective [19].
10. The study of Research Foundation of CFA Institute [20] aimed at discussing the emergence of contemporary Islamic

finance, Islamic banking sources and uses of funds, models of corporate governance and challenges and future outlook for Islamic banking. The study concluded that Islamic banking sources of funds are shareholder equity, customers' saving accounts, customers' current accounts, and customers' investment accounts. The Islamic banking uses of funds are credit loans, credit purchasing and trading of commodities, leasing equipment and equity financing projects. The rate of return in Islamic banking is based on agreed upon rate of return and variable rate of return according to the outcome of investments [20].

11. The study of Al-Balawi [21] "Banking System in Islamic countries: Saudi Arabia and Egypt", aimed at discussing Islamic banking system in Saudi Arabia and Egypt. The researcher concluded that banking system in Saudi Arabia is a dual system that deals with both the conventional banking and Islamic banking. In Saudi Arabia there are 11 banks besides branches of foreign banks and other financial institutions. Saudi Arabia participated in establishing Islamic Development Bank in Jeddah which functions as an Islamic banking group. Dar-Al-Mal Al-Islamic, Dalla Al-Baraka and Al-Rajhi banking and its Investment Company were established as interest-free banking operations on the condition that they are not use the word Islamic in their names as the government does not want to divide banks into Islamic and non-Islamic. In Saudi Arabia, *riba* (usury) is illegal. However, most of the banking institutions in Saudi Arabia operate on universal banking models and provide a broad range of financial products and service, besides managing mutual funds [21].

3. COMPARATIVE OVERVIEW OF ISLAMIC AND CONVENTIONAL BANKING

Islamic banking is based *Shariah* law of *Quran* and *Sunnah*, is prohibiting the use of *riba* (interest or usury) and *gharar* (speculation and gambling) in transactions of lending money, sales on credit, exchange of goods and customers deposits using mostly *profit and loss sharing*, *Murabaha* and *Mudaraba* as modes of financing, while the conventional finance theory concentrates on financial intermediation of banks, seeking the optimum financing of the firm, looking for efficient investment portfolios with low risk assets and lowering the transactions and information costs, besides concentrating on asset/liability matching, and the role of central bank as the last resort providing guarantees for depositors and applying corporate governance, risk managements and bankruptcy law in case of default to keep stability of banking institutions and financial markets [21].

Saudi Arabia and Egypt", Ph.D Thesis at School of Law in Stanford University. USA.

Islamic scholars aspire to build an Islamic banking system as an alternative to the conventional banking system which is based on interest and maximization of profit according to the classical economic theory. Some economists and financial experts see that Islamic banking is distinctive from the conventional banking theory as Islamic banking aims at achieving general welfare, justice and fairness through the prohibition of *riba* (interest) which is considered an exploitation of the disadvantaged people [1]. Islamic banks are far away from using derivatives and lending on margin which led to the international financial crisis. Moreover, the strength of Islamic banking is its concentration on asset based financing where real assets are considered the guarantee for the bank operations, not relying on debt based financing as in convention banking which is vulnerable to speculation. Hence, Islamic banking promotes the spread of real sector in the economy affecting positively the balance of payment, employment and production. Islamic scholars do not favor increasing the role of debt-financing in Islamic banking as the greater the debt the less the ability to absorb financial shocks.

The structure of Islamic banking is summarized as follows [6]:

a. Bank assets: are resources in access of prudent liquidity reserves dictated by transaction needs, would be invested in equity.
b. Debt contracts: are resorted to when the bank has low return volatility or when liquidation value of the collateral covers outstanding loans.
c. The bank equity: should be invested in the bank assets and could be considered a guarantee to investors in case of banks' losses as equity contributes to capital adequacy.

d. Bank liabilities: are invested in transactions and investment accounts and have unguaranteed return. Holders of liabilities could have a share in profits or losses generated by the bank's investment and would have a claim on such investments senior to the bank's stockholders.

The following economic and financial criteria of Islamic banks differentiate them from conventional banks [22].

(1) Islamic banks mostly invest in real economy rather than financial securities.
(2) Islamic banks do not deal with derivatives.
(3) Islamic banks avoid dangerous speculation and gambling (*gharar*).
(4) Islamic banks do not deal with interest rate but use *Musharakah*, *Murabaha*, *Mudaraba* and *Ijarah* as tools of investment.
(5) Islamic banks do not deal with Margin financing due to its high risks.
(6) Islamic banks avoid the conventional securitization of loans which led to the explosion of mortgage bubble.
(7) Islamic banking does not favor debt as a source of finance due to its high leverage risk. These economic and financial criteria enabled Islamic banks survive the global financial crisis that started in 2008 after the mortgage Crisis in USA. Comparison of Islamic and conventional banks is shown in Table 1.

Table 1. Comparison of islamic and conventional banking

Economic theory	Conventional banking	Islamic banking
1-Interest rate	Allowed to charge interest on borrowing and lending of banks	Dealing with interest is forbidden by *Shariah* Islamic Law
2-Rate of Return	Rate of return is mostly a fixed amount or percentage of interest on bank investment.	Rate of return could not be determined in advance so it is changeable according to profit or loss of investments.
3-Capital Adequacy	Is a requirement by a central bank based on Basel Accords.	It is a requirement applied by Islamic banks according to Basel Accords.
4-Capital Guarantees	Conventional banks guarantee capital but charge more interest.	Islamic banks do not guarantee capital as losses are deducted from capital.
5-Liquidity	Minimum liquidity is a requirement determined by Central bank.	Islamic banks follow the minimum liquidity decided by the central bank. Liquidity is high in Islamic banking.
6-Profitability	Maximization of Profit is the main objective of conventional bank.	Profitability is an objective besides welfare, no exploitation and justice .
7-Hedging Risks	Financial Risks are hedged by derivatives.	Islamic banks use Islamic *Tawriq* (Securitization).
8-Portfolio Diversification	Diversification of investments is used to lower banking risks.	Portfolio diversification is also used by Islamic banking.
9-Source of Finance	Capital from shareholders is the main source of capital besides interest –based borrowing .	Capital is an important source of financing but interest-based borrowing is not allowed.
10-Debt Financing	Conventional banks frequently use debt financing.	Islamic banks do not favor debt financing, as it is based on interest payment.
11-Lending	Conventional banks charge interest when lending clients.	*Musharakah*, *Mudaraba*, *Murabaha* and Ijara are used as financial modes.
12-Accounting Standards	The International Accounting Standards are applied.	Use Standardsof Islamic Commission for Accounting and Auditing.
13-Bonds	Conventional banks use bonds as a source of finance based on interest.	Bonds are not allowed in Islamic banks due to the interest to be paid.
14. Sukuk	Bonds are used in conventional banks based on interest payment.	*Sukuk* are used by Islamic banks to get financing based on real assets not debts.

Source: Researcher based on Literature Review and Previous studies

4. ANALYSIS AND DISCUSSION OF THE EMPIRICAL RESULTS

The descriptive analysis of the characteristics of respondents shows that they are selected equally from three universities of Taif, King Abdul-Aziz and Um-al Qura; a high percentage of them are assistant professors (44%) followed by associate professor (30%), professors (20%) and lecturers (6%). Their qualifications are mostly Ph.D (93%) followed by M.A degree (7%). About 40% of respondents have experience less than 5 years followed by 33% of them have experience between 6-10 years and 27% of them have experience more than 10 years.

The analysis of the empirical results reveals the following:

a) Relating to the question: whether the principles of Islamic banking are different from those in the economic and finance theory?The gross mean (4.516) which is statistically significance, shows that the respondents strongly agree that the following principles of Islamic banking are distinguished from those in the economic and finance theory: avoiding riba financing, uncertainty and speculation, permitting accumulation of Halal (unforbidden) wealth, asserting profit and loss sharing, promoting Sukuk and mutual takaful insurance, permitting collection of Zakat (Islamic tax), developing Islamic ideals, welfare, unexploitation, profit is not guaranteed, promoting equity participation and seeking fatwa (religious advice).
b) In relation to the question: whether the sources of funds in Islamic Banks are similar to those in economic and finance theory? The gross mean (3.795), which is statistically significance, shows that the respondents almost agree that most of the following Islamic bank's sources of funds are similar to those in economic and finance theory: shareholder equity, saving accounts, current accounts and investment accounts.
c) Relating to the question: whether the uses of funds in Islamic banks are different from those in economic and finance theory? The gross mean (3.286), which is statistically significance, shows that the respondents almost agree that the following uses of funds of Islamic banks are distinguished from those in economic and finance theory: credit loans, commodities' trading, lease of equipment and equity financing projects.
d) In relation to the question: whether the rate of return in Islamic banking is different from that in Conventional banking? The gross mean (3.789), which is statistically significant, shows that the respondents almost agree that the rate of return in Islamic banking is different from that in conventional banking.
e) Concerning the question: whether the capital structure of an Islamic bank is different from that in economic and finance theory**?** The gross mean (3.353) , which is statistically significance, shows that the respondents almost agree that the following capital structure in Islamic banks is different from that in conventional banks: shareholders equity, Sukuk and avoiding debt financing.
f) Regarding the question: whether the financial models of an Islamic bank are different from those in economic and finance theory**?** The gross mean (4.560), which is statistically significance, shows that the respondents strongly consider the following financing models of Islamic bank different from those in economic and finance theory: Murabaha, Mudaraba, Musharakah, Ijara, Bai' Al-Salam, Istisna'a financing, Tawarruq (Securitization), Sukuk and Al-Qard Al-Hassan (loan without charges).
g) In relation to the question: whether corporate governance in Islamic banking is similar to that in finance theory? The gross mean (3.522), which is statistically significance, shows that the respondents almost regard the following practices of corporate governance in Islamic banks are similar to those in the finance theory: accountability, transparency, disclosure, trustworthiness, internal auditing, external auditing and risk management.
h) Concerning the question: whether Islamic banks suffer from different problems to those of the conventional banks? The gross mean (3.789), which is statistically significance, shows that the respondents almost agree that the problems of Islamic banks are different from those of conventional banks in the following aspects: diverse interpretation of Islamic banking principles, lack of standardization of Islamic finance, controversy over acceptable transactions, lack of diversifications in

Table 2. Characteristics of sample's respondents

Variable	Category	Frequency	Percentage
1-University	Taif	10	33.3%
	King Abdel-Aziz	10	33.3%
	Um Al-Qura	10	33.3%
	Total	30	100%
2-Academic Position	Professor	6	20%
	Associate Professor	9	30%
	Assistant Professor	13	44%
	Lecturer	2	6%
	Total	30	100%
3-Experience	Less than 5year	*12*	40%
	5-10	*10*	33%
	More than 10	*8*	27%
	Total	*30*	100%
4-Education	Ph.D	28	93%
	M.A	2	7%
	Total	30	100%

i) *Source: ResearcherComputation*

financial products, low quality of services, undeveloped risk management, replacing Arabic with conventional banking terminology, lack of unified legislation and shortage of Shariah scholars. The empirical results are shown in Appendix 2.

5. CONCLUSION AND RECOMMENDATION

The study aims at investigating whether Islamic banks have a unique Islamic financial system different from that in the economic and finance theory. The research methodology is descriptive and analytical based on collection of primary data from a questionnaire and secondary data from reports and articles on Islamic banking.

The following conclusions could have limited generalization due to the constraint of the small size of the sample:

1. Islamic banking is based *Shariah* law of *Quran* and *Sunnah*; it has interest-free banking operations which prohibits *riba* (usury or interest), *gharar* (uncertainty and speculation), debt-financing and other financial transactions such as gambling, alcohols, adultery and pork. Such a prohibition does not exist in the general macro and micro economic theory.
2. Islamic banks comply with unique financial modes which make them distinguished from conventional banks. Such modes include *Equity Sharing*, *Murabaha* (cost plus) *Mudaraba* (trading at agreed prices), *Ijarah* (leasing) *Musharakah* (equity sharing) and *Sukuk* as an asset-based source of finance.
3. Islamic banking concentrates on asset based financing such as *Sukuk*, where real assets are considered the guarantee for the bank operations not relying on debt based financing as in conventional banking which is vulnerable to speculation.
4. Islamic banks mostly invest in real economy; they do not deal with derivatives, they avoid speculation and gambling (*gharar*); they do not deal with margin financing due to its high risks; they avoid commercial securitization of loans which led to the explosion of mortgage bubble and they do not favor debt as a source of finance due to its high leverage risk.
5. Islamic banks do not guarantee a specific rate of return as they use profit and loss sharing according the outcome of investment.
6. Islamic banking is still not considered totally as a substitute but a complementary model of finance to conventional banking. It is a special type of banking satisfying the financial needs of a large sector of the population in Islamic countries and satisfying the increasing demand on Islamic financial products in non Muslim countries.
7. Islamic banks face several obstacles not similar to those of conventional banks due to the gap between their ideal principles and their actual practices; sever competition from conventional banks in attracting customers' deposits;

providing low quality services, shortage of talent staff, the uncertain relation with central banks, absence of a special legislation for Islamic banks, lack of corporate governance and risk management, lack of credit rating, absence of a credit information center for Islamic banks, high cash/deposit ratio which denotes high liquidity, heavily reliance on equity financing and lack of new innovative financial products.

In view of the foregoing findings from this study, it is hereby recommended that:

i. Islamic banks should not be profit oriented only but also achieve the social goals of unexploitation and welfare.
ii. Islamic banks should go beyond the staple products such as credit cards; *Sukuk* and *Takaful* cooperative insurance, by providing innovative financial products that differentiate them from conventional banks.
iii. Islamic banks should be able to demonstrate that they are a cost-effective provider of high quality financial services.
iv. Islamic banks should have more diversification in their investment portfolios.
v. Islamic banks should strengthen their corporate governance, risk management and hedging for unseen risks.

COMPETING INTERESTS

Author has declared that no competing interests exist.

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APPENDIX

Appendix 1. Major Islamic Banks around the World

No.	Name of islamic bank	Country
1	Islamic Development Bank (IDB)	Saudi Arabia
2	Baraka Investment Co.	Saudi Arabia
3	Al-Rajhi bank	Saudi Arabia
4	Kuwaiti Fiance House	Kuwait
5	The International Investor	Kuwait
6	ABC Islamic Bank of Bahrain	Bahrain
7	Faisal Islamic Bank of Bahrain	Bahrain
8	Jordan Islamic Bank	Jordan
9	Arab Islamic International Bank	Jordan
10	Al-Baraka Bank	Sudan
11	Dallat Al-Baraka	UK
12	Dar al Mal Al-Islami	Switzerland
13	Bank Islam	Malaysia
14	Bank Muamalat	Indonesia
15	Al-Falah Investment Ltd.	India
16	Al-Ameen Islamic Financial Corporation	India
17	Amana Mutual Fund Trust	USA
18	America Finance House	USA
19	Faylaka Investment Inc.	USA
20	Takaful USA	USA

Source: Ghannadian, Farhad & Goswami (2004) developing economy banking :thecase of islamic banks. International journal of social economicsvol.31, no.8. New York

Appendix 2. Descriptive analysis of questionnaire paragraphs

SerialNo.	Questionnaire Paragraphs	Mean	STD	t-test
1	The principles of Islamic banking are different from those in the economic and finance theory			
1.1	Financing must not involve *riba* (receiving or giving interest).	4.538	1.253	3.650*
1.2	Financing should avoid *gharar* (uncertainty and speculation such as gambling)	4.106	1.208	4.923*
1.3	Permit accumulating of *halal* wealth (unforbidden) and wastefulness is avoided	4.310	0.964	1.691
1.4	Asserts profit and loss sharing	3.855	1.369	2.641*
1.5	Promoting Islamic *Sukuk* bond and cooperative and mutual takaful insurance	4.367	0.675	6. 843*
1.6	Permitting collection of Zakat (Islamic Tax).	4.158	0.795	0.806
1.7	Developing Islamic ideals in Islamic finance.	4.256	1.417	6.612*
1.8	Profit is not guaranteed	4.227	0.829	2.723*
1.9	Shareholders funds are based on equity participation.	3. 796	0.685	1.119
1.10	Seeking religious Fatwa in Islamic banking	3.379	1.190	1.598*
	Gross mean	4.516		
2	Islamic Bank' Sources of Funds are Similar to those In Economic and Finance Theory			
2.1	Shareholder Equity	3.875	0.789	2.135*
2.2	Saving Accounts	4.450	1.210	3.890*
2.3	Current Accounts	4..457	0.876	2.275*
2.4	*Sukuk*	2.254	1.124	9.175*
2.5	Investment Accounts	3.940	2.674	9.498*
	Gross mean	3.795		
3	Uses of Funds in Islamic Bank are Different From			

SerialNo.	Questionnaire Paragraphs	Mean	STD	t-test
	Those In Economic and Finance Theory			
3-1	Credit loans	2.174	0.643	5.241*
3-2	Purchasing and Trading of commodities	3.759	1.095	2.236*
3-3	Lease of Equipment	4.151	0.986	1.862
3-4	Equity Financing of Projects	3.063	1.652	2.078*
	Gross mean	3.286		
4	Rate of Return in Islamic Bank Is Different From That In Economic and Finance Theory			
4-1	Agreed upon rate of return	3.456	0.983	1.878
4-2	Variable rate according to investments' outcome	4.123	1.176	2.341*
	Gross mean	3.789		
5	Capital Structure in Islamic Banking Is Different From That In Economic and Finance Theory			
5-1	Shareholders' Equity	2.174	1.359	2.785*
5-2	Use *Sukuk* and avoid Debt Financing as Bonds.	4.532	0.987	5.321*
5-3	Gross mean	3.353		
6	Islamic Banks' Financial Model Is Different From That In Economic and Finance Theory			
6.1	*Murabaha*	4.367	1.051	6.733*
6.2	*Mudaraba*	4.671	1.397	3.453*
6.3	*Musharaka*	4.541	0.978	4.530*
6.4	*Ijara*	4.766	0.649	5.161*
6.5	*Bai' Al-Salam*	4.832	0.981	2.356*
6.6	*Istisna'a* financing	4.572	1.034	1.346
6.7	*Tawarruq* (Securitization)	3.463	1.541	1.752
6.8	*Sukuk*	4.921	0.974	3.761*
6.9	*Qard Hassan* (loan without charges)	4.910	0.865	4.789*
	Gross mean	4.560		
7	Corporate Governance In Islamic Banks Is Similar To That In Economic and Finance Theory			
7.1	Accountability	4.211	0.970	3.411*
7.2	Transparency	4.320	0.871	4.675*
7.3	Disclosure	4.442	0.897	5.765*
7.4	Trustworthiness	3.221	1.345	1.478
7.5	*Shari'a* Compliance	2.121	1.567	6.387*
7.6	Internal Auditing	3.229	1.008	2.084*
7.7	External Auditing	3.056	1.231	1.762
7.8	Risk Management	3.605	0.761	2.652*
	Gross mean	3.522		
8	8-The Problems of Islamic banks are different from those of Conventional banks.			
8.1	Diverse interpretation of Islamic banking principles	4.750	0.986	2.336*
8.2	Lack of standardization of Islamic finance	3.439	1.453	1.562
8.3	Controversy over acceptable transactions	3.531	0.981	2.287*
8.4	Lack of diversifications in financial products	3.224	1.076	3.761*
8.5	Low quality of services	3.025	1.124	1.764
8.6	Undeveloped risk management	3.123	1.367	1.345
8.7	Replacing Arabic terminology in Islamic banking with conventional banking terms	4.014	0.891	2.013*
8.8	Lack of a unified legislation of Islamic banking	4.327	0.876	1.761
8.9	Shortage of *Shari'a* Scholars to apply *Shari'a* Compliance	4.678	1.125	2.036*
	Gross mean	3.789		

Notes: Five Scale Likert is used as follows: Strongly agree (5) Agree (4) Neutral (3) Disagree (2)Strongly disagree. STD = Standard Deviation. =significant t-test at 5%*

Source: Researcher computation

Appendix 3. Questionnaire, Perspectives of Islamic Banking and Its place in Economic Theory: Empirical Evidence from Saudi Arabia

Part I: Personal Information

1- The university I work for is:

T☐if K☐g Abdel –Aziz Um☐Al-Qura

2- My Academic Position is:

P☐fessor Ass☐ciate Professor A☐istant Professor Lect☐er

3- My Academic Qualification is :

P☐. D M☐A

4- Years of Experience

L☐s than 5 5-1☐ Mo☐ than 10

Part II: Questionnaire paragraphs on position of islamic banking in economic and finance theory

No.	**Questionnaire Paragraphs**	**Highly Agree 5**	**Agree 4**	**Neutral 3**	**Disagree 2**	**Highly Disagree 1**
1-Principles of islamic banking Is distinguished from economic theory						
1.1	Financing must not involve *riba* (receiving or giving interest).					
1.2	Financing should avoid *gharar* (uncertainty and speculation such as gambling)					
1.3	Permit accumulating of *halal* wealth (unforbidden) and wastefulness is avoided					
1.4	Asserts profit and loss sharing					
1.5	Promoting Islamic *sukuk* bond and cooperative and mutual takaful insurance					
1.6	Permitting collection of Zakat (Islamic Tax).					
1.7	Developing Islamic ideals and morals in Islamic finance.					
1.8	Profit is not guaranteed as it depends on investments return					
1.9	Shareholders funds are based on equity participation.					
1.10	Fatwa provides religious advice on bank transactions					
2-Islamic bank' sources of funds are similar to those in general economic theory						
2.1	Shareholder Equity					
2.2	Saving Accounts					
2.3	Current Accounts					
2.4	*Sukuk*					
2.5	Investment Accounts					
3- Uses of funds in islamic banks are distinguished from those in general economic theory						
3.1	Credit loans					
3.2	Purchasing and Trading of commodities					

No.	Questionnaire Paragraphs	Highly Agree 5	Agree 4	Neutral 3	Disagree 2	Highly Disagree 1
3.3	Lease of Equipment					
3.4	Equity Financing of Projects					
4-**Rate of return in islamic banks is different from that in general economic theory**						
4.1	Fixed rate agreed upon rate					
4.2	Variable rate according to investments					
5-Capital structure of islamic banks is different from that in economic theory						
5.1	Shareholders Equity					
5.2	Use *Sukuk* and avoid Debt Financing as Bonds.					
6-Islamic banks' financing mode1s are different from those in general finance theory						
6.1	*Murabaha*					
6.2	*Mudaraba*					
6.3	Musharaka					
6.4	*Ijara*					
6.5	*Bai' Al-Salam*					
6.6	*Istisna'a* financing					
6.7	*Tawarruq* (Securitization)					
6.8	*Sukuk*					
6.9	*Qard Hassan* (without Charges)					
7-Corporate governance in islamic banks is similar to that in general finance theory						
7.1	Accountability					
7.2	Transparency					
7.3	Disclosure					
7.4	Trustworthiness					
7.5	Shari'a Compliance					
7.6	Internal Auditing					
7.7	External Auditing					
7.8	Risk Management					
8-Problems of islamic banks are different from those of conventional banks						
8.1	Diverse interpretation of Islamic banking principles					
8.2	Lack of standardization of Islamic finance					
8.3	Controversy over acceptable transactions					
8.4	Lack of diversifications in financial products					
8.5	Moderate quality of services					
8.6	Undeveloped risk management					
8.7	Replacing Arabic terminology with conventional banking terms					
8.8	Lack of unified legislation of Islamic banking					
8.9	9- shortage of Shari'a Scholars to apply Shari'a Compliance					

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