

CHAPTER 1

INTRODUCTION

1.1 Overview

This chapter discusses the introduction in section one. Background of research is discussed in section two. Section three discusses on problem statements. Then, section four and five presents the research questions and objectives respectively. This chapter also discusses the significance and rationale of research in section six. Section seven and eight discusses the scopes of research and structure of the study respectively.

1.2 Background of the Research

Within thirty (30) years of Islamic banking has emerged as one of the most rapid growing industries, it has widely accepted by communities and has spread worldwide. One of the uniqueness of Islamic banking that diverges from conventional banking is in terms of their transaction. Even though they perform the same essential functions as conventional counterpart, the transaction is performed in accordance to *Shariah*.

To extent these further, an Islamic bank operated accordance to *Shariah* as it offers interest-free based activities and transactions. It emphasizes on the well-being of public (*Maslahah*). According to Saat et al., (2011), Islamic banking prohibits elements of *Riba'*, *Gharar*, *Maysir*, non-*halal* products and social irresponsible activities. Based on the definitions and the basic guidelines provided by Saat et al.,

(2011), the following summarization of definitions of Islamic bank and Islamic banking are developed in this study. The definition of an Islamic bank is:-

“An Islamic bank is a Shariah business organization that deals with varieties of products and services with the aim to promote fairness and justice to customers as it involved with ethical values and social commitment as disseminated by Islam.”

The definition of an Islamic banking is:

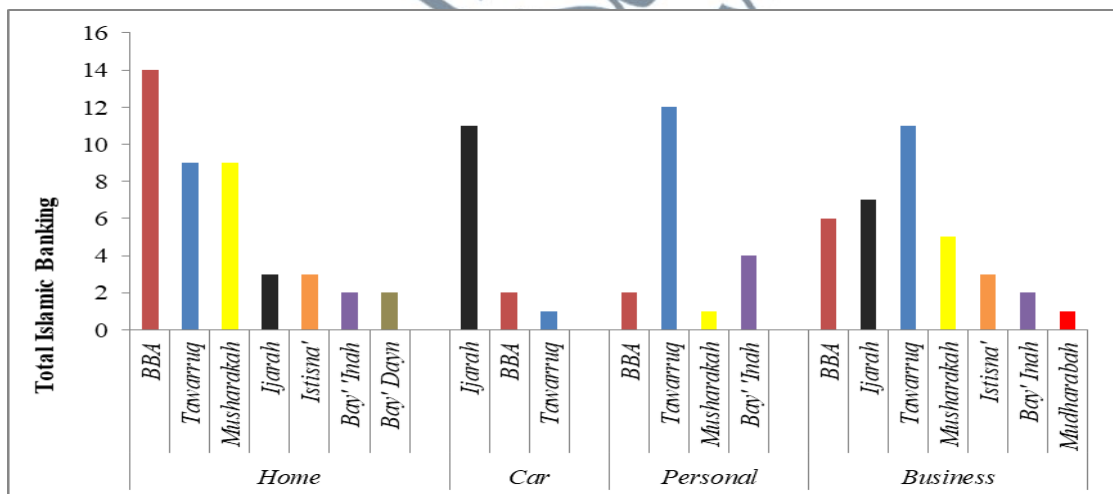
“Islamic banking is a banking system as practiced according Shariah-based compliance.”

Based on the definitions above, Islamic banking system in Malaysia is reflected with the inclusion of dual-banking approach which allows participating in offering Islamic banks' products. Malaysia especially is one of the countries that well-known as global hubs of Islamic banking industry. Since 1983, Bank Islam Malaysia Berhad (BIMB) was established within the conventional banking environment. Then, other banking systems was developed by dual-banking approach in which operates parallel to the conventional counterpart such as Maybank Islamic, CIMB Islamic and others. Currently, there are a total of 16 Islamic banks and 11 development financial institutions (DFI's) has established in Malaysia.

Over the years, Islamic banking in Malaysia has developed well with an increasing number of players meeting public demand in financial products aligned with Islamic teachings. It has also firmed its position as a viable and vibrant component of the banking system. The average growth annually of total banking

system was approximately 18 to 20 % according to annual report of Bank Negara Malaysia (BNM) and the total assets valued at approximately RM 628.6 billion in year ended 2018. One of the activities that contributed to the growth of Islamic banking in Malaysia is mainly from deposits, investment and financing instruments. In fact, although each activity has its own specialty, they offer similar contributions towards the welfares of the people (Kahf, 2015). With that, this study viewed into the financing instruments.

In general, financing is refers to Islamic financing contracts that interest cannot be charged on (Lone, 2016). In addition, the financing is structured using discounts, sale or lease, profit participation, or repurchase agreements and it is based on application of funds (Saat et al., 2011; Lone, 2016). Besides, it is noteworthy because it has a great function in stabilizing the economy of the country and especially the Muslim community (Aziz, 2013).



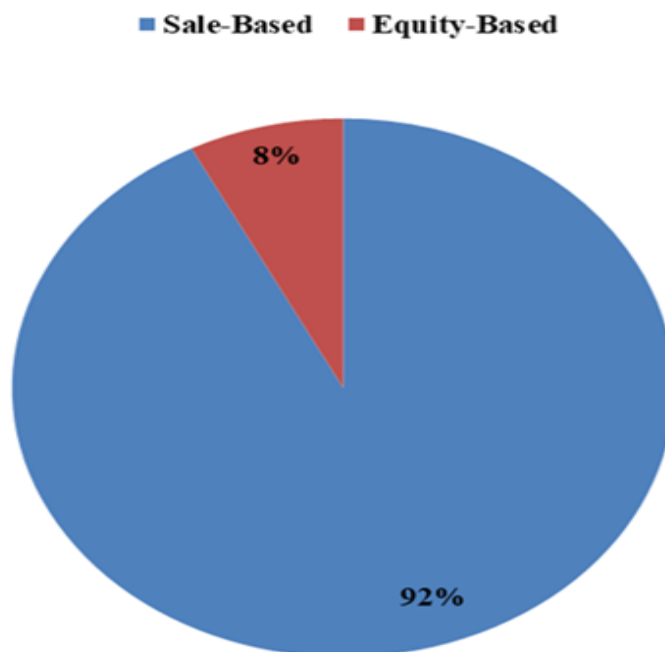
Source: Bank Negara Malaysia (2018)

Figure 1.1: Financing Types by Purposes of Islamic Banking in Malaysia

In diversifying the existing financing instruments, the sale-based financing (SBF) such as *Bai' Bithaman Ajil (BBA)*, *Tawarruq*, *Ijarah*, *Istisna'* and *Bai' Inah* and equity-based financing (EBF) such as *Musharakah* and *Mudharabah* was introduced (see figure 1.1.).

These types of financing offered by Islamic banking in Malaysia, in general, are innovation of the conventional loan, which the practices not only stressed on financial efficiency, but also consider on social and ethical efficiency (Hanif, 2011). Besides that, the uniqueness of these types of financing is known as pure and justice contracts since it has strong moral dimension which it facilitate social, economic and financial activities that are free from *Riba* and gambling activities (Lone, 2016). Likewise, these types of financing products helps in reducing the impact of harmful products and practices as well as it uphold the principle of financial justice.

Until present, however, there are various issues associated with the implementation of sale-based financing (SBF). One of the issues include global acceptability from *Shariah* point of view, prohibition of *gharar* for the case of financing an uncompleted property or other types of goods, rebate, price and the issue of form against substance which mimicking conventional loan. For example in *Tawarruq* contract, Fa-Yusuf & Ndiaye (2017) stated that this contracts still doesn't meet the validity of purpose requirement as a sale-contract and the structures are a *Hilah* (trick) to legitimize or circumvent interest-taking. The raise the issue of '*Gharar*' in BBA as its application in practice is proven to be defective and contains many flaws, if involves abandoned housing projects in Malaysia (Dahlan et al., 2017). Thus, it skewed to more profit-driven interests than serving the factual necessities of a just society.



Source: Bank Negara Malaysia (2019)

Figure 1.2: Percentage of Total Financing of Islamic Banking in Malaysia

Still, majority of Islamic banks prefer the safer haven of SBF even though its more relying on the transfer of risks as impact more on equity risk taken by customers compared to EBF which is more concentrated on risk-sharing as impact risk to bank's equity. These matters have been proved by reports from BNM as there is only approximately 8% participation in EBF as shown in figure 1.2 above.

Also, these matters indirectly urge the government, particularly the BNM to encourage EBF which is more equitable and reflect to the spirit of Islam (*see guidelines of Musharakah and Mudharabah set out by BNM on BNM website*). The aims of the policy are to provide reference on the *Shariah* rulings associated with equity-based, then to set out key operational requirements with regard to the

implementation of the contracts and to promote end-to-end compliance with *Shariah* requirements which include adherence to sound banking practices and safeguarding customers' interest.

According to Al-Zuhayli (2007), EBF are the best contract in financing because it based on profit-and-loss sharing (PLS) and the flexibility of these types of contracts are designed by Islamic scholars to comply with the principles of Islam and therefore with the *Shariah*. Also, it's provide the efficiency in restructuring process as the contracts need not to be tied to the banks' sale price. The performance of EBF depend on the productivity and viability of the project, thus these contribute to achieve balanced society as envisioned by Islamic economics (Ahmed, 2008).

EBF derived from *Musharakah* and *Mudharabah* contract are superior over any sale-based financing (SBF) as the element of profit and loss sharing is considered to be closer to justice and the spirit of *Shariah* (Aziz, 2013). Therefore, it is deemed to be a better alternative to SBF. Since EBF are relatively neglected in the market, the product experiences many issues surrounding its implementation which influenced its inherent capability of becoming a better financing product.

Despite the positive development of the Islamic banking industry, more effort and attention are still required in order to ensure that the development and growth of the industry can guarantee that the objectives of the *Shariah* Law are achieved. The general aim of this research is to see how far the potentiality of implementation of EBF. As such, the specific aims to achieve are first to explore the issues in EBF in perspective of Malaysian key personnel of Islamic banking. In the course of achieving the objective, this study surveys different groups of respondents who are involved with the operation of Islamic banking activities, using semi-structured interviews.

Then, this research is aim to investigate whether cognitive and affective have positive effect on attitudes (ATT) and intention (INT). In the course of achieving the objective, this research conducts the survey questionnaires among *Muslim* in Malaysia who are users and non-users of financing. For attitudes, there are two dimension attitudes that will be examined: ATT towards sale-based financing (SBF) for user of financing (focus on their current financing) and ATT towards EBF for users and non-users of financing. Then, this research also aims to investigate the mediator effect on INT to purchase EBF.

1.3 Problem Statements

There are two (2) major issues that identify in this research, first in context of supply-side (bank) and second, in the context of demand-side (customers). The context of supply-side is includes of complexities of financing and misconception matters. Then, the context of demand-side is including of acceptability matters.

In the recent years, Bank Negara Malaysia (BNM) has issued a number of *Shariah* contract-based regulatory policies which were intended to promote consistency of *Shariah* contract application in Islamic financial products and services (BNM, 2019). These policy documents (PDs) prescribed *Shariah* parameters and operational requirements which should be applied and consequently may have an impact to the way Islamic finance transactions are being structured executed and reported.

This review is also timely in view of the fact that three major Standards, namely MFRS 9 Financial Instruments, MFRS 15 Revenue from Contracts with Customers and MFRS 16 Leases would be mandatorily effective in 2018 and 2019.

The review also considered how these recently issued Standards would interact with the requirements stipulated in the PDs. As such, the review noted only several contracts which are commonly used by the Islamic financial institutions.

The practices of EBF in Malaysian IB in general have been in the limelight mainly due to negative testimonies on the outcomes of implementation. Reports done by the regulation of BNM in legal aspects regarding the EBF performance for example, found that there is inadequacy of disclosure from BNM since the review noted that EBF such as *Musharakah* and *Mudharabah* are less commonly used for financing.

Specifically in EBF practices, one of the aims of its implementation is to offer true risk-sharing practices that would enable the parties in the contracts to minimize the nature of specific risks. However, latest findings reported by Izhar (2010) and Abedifar et al., (2012) are incongruent with this aim. It was found that greater complexities of financing in EBF that arising from the nature of specific risks of the contracts contributed to low level involvement of EBF in Malaysian IB.

In particular, the report found misconception matters over the accepted universal definition that gives the general idea that all types of financing in IB is all about contract without knowing the nature of the contracts itself. In addition to the misconception matters reported by BNM, a study by Abdul-Rahman & Nor (2016) and Sallehuddin & Saiti (2016) revealed that EBF could promote the cooperation in participation among parties through risk-sharing.

In contrast, Mirakhor (2010) and Sulaiman (2017) reported that the EBF contract, in reality, is not exclusively risk-sharing since it not generally friendly with financial intermediaries. Hence, at the end it tends to be same with SBF which is more

to risk-transfer. In addition, in terms of reality of returns, in such of reality situation, when shareholders assume high returns on their equity at the lowest risk, management will pursue the best return by offering SBF than EBF.

From perspective of demand-side, Malaysian governments' aspiration to develop and strengthen its position as comprehensive and competitive financial center is being stifled by acceptability matters on local Muslims have of EBF in Islamic banking.

Studies from Kuala Lumpur Malaysia and Morocco, perceived norms has great impacts on customers' attitudes of financing compared their perceived beliefs (Abduh & Razak, 2012; Echchabi & Aziz, 2012; Amin et al., 2014). Meanwhile the studies from Klang Malaysia stated that perceived beliefs have great impact on their attitudes in selecting the financing (Alam et al., 2012; Amin et al., 2018). However, the study from Morocco stated that perceived norms does not impacts attitudes but perceived beliefs have do so (Badaj & Radi, 2018). In Middle-east, ATT does influenced by both perceived beliefs and norms (Bizri et al., 2017) but perceived norms gives larger effects in ATT even though customers have lack of knowledge on Islamic banking in the case of South Africa (Bodibe et al., 2018).

Religiosity plays important roles in measuring the ATT among customers. Studies from Malaysia stated that knowledge (KW) plays key role in identifying customer's religious beliefs (RB) as thus impact their ATT and INT in selecting financing (Harun et al., 2015). Dali et al., (2019) found that Islamic religiosity measurement is multi-dimensional. However, further studies need to be conducted to test the application of this religiosity scale in many different contexts.

On top of that, knowledge on basic principles and objectives of IB are important as it not only impacts the perceptions but has greater impacts on ATT itself. Studies from Malaysia and South Africa found that customers possessed poor self-reported knowledge on Islamic banking but they have high level of awareness (Halim & Norizatuon, 2001; Bodibe et al., 2018). Also, studies from Indonesia and India have the same results (Sari et al., 2014; Islam & Rahman, 2017).

Also, issues on awareness (AW) about retail and financial instruments of Islamic banking still have risen in previous studies. Studies from GCC and MENA reported that customers were generally unaware regarding the use of specific Islamic method of financing (Bely & Kuehn, 2004). Also, Nigeria and Kuwait has the same results as they found that customers are not aware about the concept of financing contracts available on IB (Naser et al., 2013; Kewuyemi, 2015). However, in Pakistan, customers are satisfied with the services offered but they are not aware about the contracts available in Islamic banking (Raza & Azeem, 2014). Malik et al. (2011) reported that lack of government intervention on Islamic banking impacts on the level of awareness among community in UK. Still in Malaysia, customers are not fully conversant with the financial products available in Islamic banking (Ahmad & Al-Aidaros, 2017).

Attitudes (ATT) play the important roles in identifying the intention (INT) to purchase or adopt. Theoretically, in behavioral studies, ATT affect the buying decisions of customers. However, the study from Libya found that negative ATT impact the INT of customers to purchase financial products (Albashir et al., 2018). Malaysia and India also have the same results (Ali & Athambawa, 2013; Lajuni et al., 2017). In Pakistan, service quality influenced by ATT but limited to their INT

(Rizwan et al., 2014).

Therefore, in such situations, the implementation of EBF in Malaysian IB through discussion a different lens contexts of supply and demand-side which emphasize of exploration of the major issues in perspective of banks and come-out with investigation of factors that influence INT to purchase EBF and test for mediation effects are crucial in the context of to see how far the potential use of EBF. By doing so, banks are engaged in exploration of issues and strategies and good for them to better focus which factors to focus on to implement the EBF.

1.4 Research Questions

Main research question:

What is the potentiality of implementation of EBF in Malaysia?

Sub research questions:-

1. Why there is limited implementation of EBF in Malaysian Islamic banking?
2. What are the impact of cognitive and affective among Malaysian *Muslim* users and non-users of financing on their attitudes (ATT) and intention (INT)?
3. Is different dimension of attitudes (ATT) mediates the relationship between cognitive, and affective and intention (INT) to purchase EBF?

1.5 Research Objectives

Main objective:

To see how far the potential use of EBF in Malaysian Islamic banking.

Sub objectives:

1. To explore the issues in EBF in perspective of Malaysian key personnel of Islamic banking.
2. To investigate whether cognitive and affective among Malaysian *Muslim* users and non-users of financing has positive effect on their attitudes (ATT) and intention (INT).
3. To investigate the mediator effect on intention (INT) to purchase EBF among Malaysian *Muslim* users and non-users of financing.

1.6 Significance and Rationale of Research

Besides contributing to the increasing number of literatures in the area financing, this study had been intended to make a contribution in terms of theory and practice by providing a thorough analysis on potentiality of implementation of EBF in Malaysian Islamic banking.

First, this research discovers the outline a profile of indicators of EBF in Malaysia in order to increase the participation of involvements and strengthen the performance of Islamic banking system. As such, this research ascertains the exploration on the real situations of EBF with different dimensions from the views of experts; therefore the suggestions from them are good for implication towards theory development, Islamic banks, and customers and also for policy makers. It is good to expand the limited existing literature studies of potential use of EBF in Malaysia. The significance of the study will be an academic research in Malaysia especially, which has not been widely covered from supply-side which known as banks' and demand-

side which known as customer's perspectives. It covers the variation of aspects as these are the innovation of contribution towards the study.

Second, this research extends the theory development by conducting a meta-analysis of theory of reason action (TRA) and theory of planned behavior (TPB). Based on the results of meta-analysis, the Tri-component Attitude Model was developed based on the results of effect size in the analysis. As such, this research extends the theory development by adapting to four specific models- cognitive, affective and conative measures that applied by the study into a single comprehensive customers' ATT-INT model.

Third, this research extends the theory development of contribution to knowledge in terms of extension the additional four (4) cognitive components such as religiosity beliefs (RB), knowledge (KW), awareness (AW) and understanding (UD) which these components variables are adopted from interviews findings. Also, the new measurement scale of UD constructs are one of the significance for this research.

Fourth, in terms of practical contribution, the significance of this research and the suggestions provided can be implemented to the product development context, for example, IB in Malaysia may enhance the alternative practices in financing such as EBF and offers the variety of products financing that customer-friendly. The results may advise Islamic bank managers as well as the industry to better understand which factors to focus on when they market their products.

Potential use of EBF is under researched in Malaysia in terms the context of *Muslim*. The industry can use this research to help identify their potential *Muslims* customers on their priorities which based on their cognitive and affective towards the conative measures. As such, an increase in potential use of EBF among *Muslim* is

important for the Malaysian economic growth, as it will eliminate the issue of *Muslim* taking conventional loan such as ‘loan-shark’ and other conventional counterparts.

There is a bright future in the financing, with the capacity of the financial industry to develop more strategies in various aspects in worldwide nation as well. At the end, it is fruitful for society, economy and nation which will increase the participation of Islamic banking system that are more products offered based on customer-friendly oriented. The variation of application of financial activities will help the development of Malaysian economics as it is most cost-effective and efficient especially for EBF as a whole. At the same time, the positive development will contribute to Malaysia’s Islamic banking market by strengthen Malaysia as a main play role in this sector.

1.7 Scopes of Research

Regarding the research questions and objectives, the study focusses on EBF and will be scoped only to the Islamic banking in Malaysia to explore the participants’ perspectives and examine the views from customers-side (demand).

In this study, the data were collected through both interviews and survey questionnaires. This study had been just limited to the participants who have a brief knowledge on financing, *Shariah*, legal, operational and RMPs only and respondents who were *Muslims* customers at the Islamic banks in Malaysia (users and non-users of financing) compared with non-*Muslim*. As such, they were found to be absolutely aware and familiar with the financing practices (Amin et al., 2014). Therefore, they provided good indication to the factors that potential use of EBF.

Although this study contributes to the literature of Islamic banking research in

Malaysia, the limitations and difficulties were faced during the execution of this study and Chapter 7 elaborates on these limitations in detail.

1.8 Organization of Study

Chapter 1 provides the reader with background information of the research problems which it stated in the problem statements, as such, development of research questions are pointed out in this study and stipulates the purpose as well as the research objectives. The thesis' introductory chapter continues with a discussion of the significance and rationale of study as it highlights the contributions of the study as a whole and identifies the scopes of research. The chapter concludes with an overview of the structure of the study.

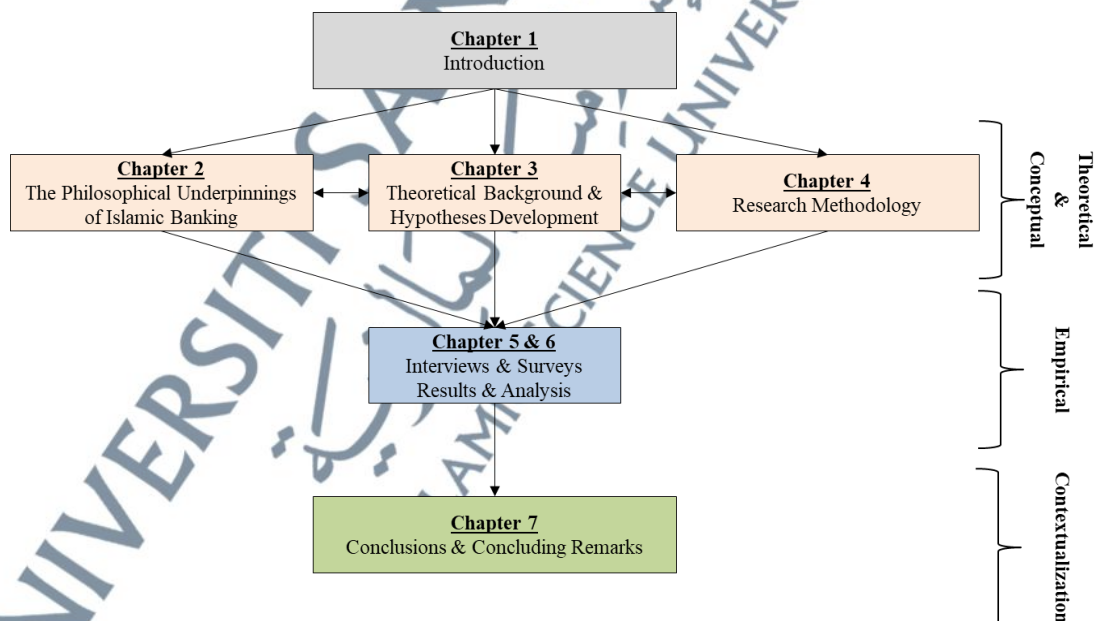


Figure 1.3: Structure of the Research

Following the introduction in this first chapter, the thesis continues with the remaining six (6) interrelated chapters (see figure 1.3). An overview of chapter 2 to Chapter 7 is as follows:-

Chapter two presents philosophical underpinnings of Islamic banking.

Chapter three is discussion on theoretical background and hypotheses development

Chapter four is explanation briefly the research methodology.

Chapter five is devoted to the presentation and discussion of interviews results and analysis.

Chapter six is devoted to the presentation and discussion of survey results and analysis.

Chapter seven is devoted to the presentation and discussion of recommendations and concluding remarks.

1.9 Chapter Summary

This chapter discussed the introduction in section one. Background of research is discussed in section two. Section three discussed on problem statements. Then, section four and five explained on research questions and objectives respectively. This chapter also discussed the significance and rational of research in section six. Section seven and eight discussed the scopes of research and structure of the study respectively.