

Islamic banking opportunities in a non-Islamic economy: Customer perspectives of New Zealand

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ABSTRACT

New Zealand as a representative of a non-Islamic economy holds some unique characteristics. It is small enough to test a new banking concept without many risks at the same time the results can be replicated effectively in larger economies like Australia, Canada, UK and USA. The current study uses four exploratory interviews and a robust literature review to propose frameworks for future studies in this area of knowledge. The results suggest opportunities of a market that can be a source of effective knowledge for successful market entries for Islamic banks around the world. Finding of this study may be of interest of future researchers in this area as well as managers and bankers looking for future markets of Islamic banks.

1. Introduction

Political and economic philosophy of a country is reflected in its banking structure (Berg, 2016). Thus, this may influence the smooth transition of an economy into a global environment. In aligning this knowledge, the current world economy is undergoing a shift, with turmoil and turbulence of recurring reports of recession globally (Hodges & Lapsley, 2016). Many economists and researchers report that the traditional banking system as a contributing factor to this problem (Ile & Lewis, 2013; Cömert, 2013; Jessop, 2013; Lucius, 2013). There has been a trend in the search for alternative financial models such as Microcredit systems or Islamic banking systems (Visconti, & Napolitano, 2013; Gimigliano, 2013). Another alternative was the Islamic banking system, stemming from an interest-free economic transaction model. Muslim societies used this banking philosophy well in the early days of Islam (Wajdi Dusuki, 2008). It recognises a stakeholder-centric transaction that ensures justice for both lending and receiving

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parties through the abandonment of an interest-based transaction philosophy. The principles of this banking system are based on seeking social justice and the banks operate as a party to investment schemes sharing the risks of this investment on an agreed upon share. Modern world economy started experiencing this type of banking through experimentations from Malaysian and Egyptian authorities and finally through the establishment of Dubai Islamic bank (Karbhari, Naser & Shahin, 2004). Since then, Islamic banks have flourished internationally through their presence in over a hundred banks in different parts of the world (Kahf, 1999).

2. The rationale of the research

The financial crisis that shook the global monetary system and subsequently the real estate sector in 2008, originated from the liquidity crisis in May 2007 with the United States of America. Subsequently, other countries were affected at different levels of the economy affecting their trade, real estate, foreign relation even their way of life. The influence of the financial system today has a much wider influence in the way of human lives. A troubled financial system may roll out a series of actions and reactions that lead to total anarchy in the lifestyles and affordability among the population of a country. Therefore, there is a need for a deeper understanding of the mechanisms of financial systems and their pitfalls. The design of financial systems has been highly influenced by the doctrine of governance philosophy that a country adopts. A country may choose from two extremes of Capitalism versus Socialism.

2.1 Capitalism

Based on free-market economic principles of private ownership, open competition and the profit motive is at the core of this philosophy (Phelps, 2007). The nature of this economic philosophy obviously triggers competition for resources that flourish strategic and operational innovations and often risk-taking behaviour. This choice of philosophy has been reported in the literature to define a nation's capacity to grow or even efficiency of utilisation of resources.

2.2 Socialism

At another extreme of the socioeconomic structure is the philosophy that drives the state supremacy over individual freedom. This structure of economy seeks stability and control through governance of ownership of economic assets centrally at a state level. Private ownership of resources is prohibited and individuals are supported for living resources through the suitable distribution of wealth among the citizens. This socioeconomic philosophy has been blamed to be inefficient and caused economic hardship among the citizens in the recent history (Levine, 1986). The world has experienced the abandonment of this philosophy in many countries around the world who were communist in nature. Due to the advancement of production, information and communication and operations technologies, the economies today recently has become more connected, as a result the need for centralised production control has become obsolete today.

2.3 Mixed economy

Capitalist philosophy has become dominant in the modern economic world due to its adoption by leading countries in terms of economic prosperity and share of global trade. However, it is hardly the most favourite or the most popular among the economies around the world. Other than only a few capitalist economies, there is a tendency to adopt a mixed type of approach in managing their economic philosophy (Popkova, Chechina, & Sultanova, 2016). Major public goods in those countries are controlled by the government, whereas marketable product/services are left to be sold by the influence of market forces. The profit incentive is available for all and companies to compete for their share of the

market by providing products/service meeting a customer need. One of the variant economic systems adopted in few of the Islamic countries are found to be following Islamic principles and Shariah law system. Total accumulative value of Islamic financial systems of the world is estimated at USD \$2.1 trillion by the end of 2015 (Ashfaq, 2016). Today, over 300 institutions around the world are involved in managing assets and running their business in Islamic way. Only a few decades ago pioneers and advocates of Islamic financial systems hardly envisaged this growth. On the other hand, this growth needs to be reinvestigated with the view of rationalising its objective to establish sustainability. At an operational level, there is a clear need for establishing credibility among the customers if they even want to compete with the 400 years old western banking system. The Accounting and Auditing Organisation for Islamic Financial Institutions (AAOIFI) was established in 1991 that proposed governance, ethical and shariah rules for investment and financing instruments being run in this sector.



Fig. 1. Comparison of GDP Growth rate among countries

2.4 Banking implications

The type of economic philosophies certainly influence the banking principles in different parts of the world. Both interests based and interest-free banking systems have evidently been practised and found to be effective or non-effective in their countries context. Saymeh and Orieqat (2013) reports similar but slower impacts on Middle Eastern and North African (MENA) countries for the global financial crisis in 2007-2008. A comparison of the annual GDP growth rate between developing and developed economies demonstrates clear disparity in *modus operandi* (Figure 1). Interestingly, the impact of financial crisis on North American and Euro market is much worse than that of Arab world and Australian-New Zealand market. Is there a country effect or is that the practice of their banking policies as claimed in Saymeh and Orieqat (2013)? This may indicate the first research gap in this domain of knowledge.

2.5 Islamic banking principles

The major difference between traditional banking practices and Islamic banking practices lies within the running of business processes as per the Islamic legal framework that balances the actions for this world with the life hereafter. This research envisages an investigation on the suitability of Islamic Banking Principles as a remedy for the global economic crisis by establishing the acceptability of this novel banking system in the non-Islamic economies. New Zealand being a comparatively smaller

economy and its close socio-economic relationship with Australia due to the geographic location of being proximal, provides us with a good opportunity to carry out a study followed by action research within this country. Positive results obtained should influence the acceptance of Islamic Banking System globally.

This adoption of a new interest-free concept of a banking system by the Muslim populated countries leaves us with two basic questions:

- 1) Is this newly found age-old concept a remedy to the current problem in the global economy?
- 2) If this has remedied the economic problems locally, can this be applied in a global context?

3. Objectives of the research

The study aims to achieve the following objectives:

1. Understanding the knowledge gap of the role and applicability of Islamic banking system in a global context.
2. Testing the effectiveness of Islamic banking system in transforming a non-Islamic economy.
3. Developing a conceptual framework for the effective role out of Islamic banking system in non-Islamic economies.

4. Literature review

Islamic banks have been established in three different types of countries around the globe (Karbhari, Naser, & Shahin, 2004): 1) among the Islamic Shariah countries (Pakistan); 2) among the countries where population are predominantly Muslims (Bangladesh and Malaysia) ; and 3) non-Islamic economies where Muslims are minorities (United Kingdom and New Zealand). Literature reports a unique set of challenges in establishing Islamic banks among each of these categories of countries. However, these challenges represent from environmental, organisational, or even in some cases from customer specific perspectives. Figure 2 outlines the impediments those are reported in the earlier research. Since this study focus on the possibilities of an Islamic bank in New Zealand, we concentrate on the impediments found in a non-Islamic economy in developing our understanding. There has been a fundamental debate among the scholars about the definition of interest as compared to *riba* in an Islamic context. As a result, this lack of consensus led to various interpretations of this fundamental question of Islamic banking philosophy leading to a lack of consensus in practices around the world (El-Gamal, 1997). This certainly hinders the acceptance of this type of banking practice (Iqbal & Mirakhor, 1999).

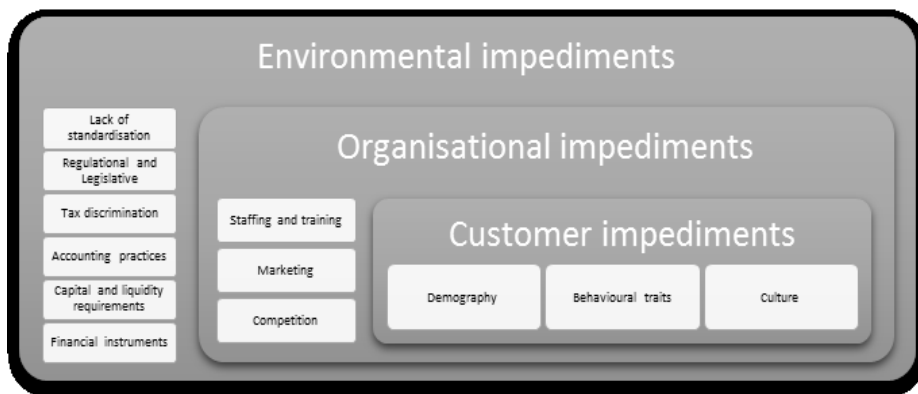


Fig. 2. Impediments of Islamic banking establishment in a Non-islamic country

Conventional banks in non-Islamic economies are strictly controlled by widely tested mechanisms from central banks (Bourkhis & Nabi, 2013). Due to the novelty of the concept in relation to current economic practices the lack of understanding led to ambiguity about possible regulatory mechanisms in non-Islamic economies (Karbhari, Naser, & Shahin, 2004). This also influences strict requirements from the government such as higher capital and liquidity (Bourkhis & Nabi, 2013). Islamic banks also face discriminatory tax treatments where interest in traditional banks are tax-deductible and profit in Islamic banks are taxable. Another environmental impediment that comes as part and parcel of Islamic banking package is the availability of limited financial instruments. They only have the choice of profit and loss sharing (PLS) as long-term financial instruments that limit their opportunity (Kahf, 1999). Finally, at the environmental level, the impediment that has been found from Ismail and Latiff (2001) is the insufficiency of International accounting standards to capture the actual practices of Islamic banks. Due to the variances in practices being influenced by the interpretation of Islamic banking interest-free concepts, it is difficult to standardise their accounting practices (Abdel-Magid, 1981).

Although environmental impediments play important role in inhibiting adoption of Islamic banking system, the organisational impediments may also influence the success of these banks in a non-Islamic society. For example, insufficiently trained staff to manage specialized and challenging banking operation of Islamic banks may result in inefficient operation and lack of innovation. This is perhaps why Iqbal (1997) identifies inefficiency of staff and lack of training as contributing factors to slow innovation in Islamic banks. Furthermore, educating the customers about their products remains a challenge for Islamic banks (Karbhari, Naser, & Shahin, 2004). And also, Islamic banks constantly faces competition from conventional banks both to switch new customers and also with similar products for same market share (Muslim clients) (Shepherd Jr, 1996).

However, the biggest challenge for Islamic banks comes from selling the idea among a market of customers who have been brought up with a history of banking with conventional banks with a specific set of demographic, behavioural and cultural traits. The current study proposes an empirical study to test this assumption based on the earlier literature analysis.

5. Methodology and data Source

This study was designed as a desk analysis of current literature to identify the current understanding of Islamic banks followed by in-depth interviews of representatives for New Zealand service providers and recipients. Four interviews were conducted to capture some exploratory indicators that will help us design a survey tool to understand the feasibility of Islamic banking among the customers of the New Zealand market. A qualitative research philosophy was adopted due to the exploratory nature of this study. Convenient sampling was used to ensure representation from all concerned stakeholders in this scenario. While conducting the interviews it was explained clearly to the interviewees that their anonymity will be maintained during the reporting process and the objectives of this study were discussed.

6. Findings

Four interviews were conducted. One with one of the director of AMANAH ETHICAL, second and third with customers who use traditional banking and the final with a bank manager from a traditional bank in New Zealand. Summaries of the the four interviews are presented in the following section..

6.1 Director of Amanah Ethical

Amanah Ethical is a boutique fund management group located in Auckland, New Zealand. Amanah Ethical provides ethical investment solutions to New Zealand and international investors. Currently, Amanah Ethical group currently consists of two companies, Amanah Trust Management (NZ) Limited and AmanahNZ KiwiSaver Limited, both which are licensed under the Financial Markets Conduct Act 2013 to manage AmanahNZ and Amanah KiwiSaver Plan respectively. Two ethical investment products provided by Amanah Ethical is Amanah KiwiSaver Plan and AmanahNZ. Amanah KiwiSaver Plan is a registered KiwiSaver scheme under the Financial Markets Conduct Act 2013, and is managed by AmanahNZ KiwiSaver Limited. Amanah KiwiSaver Plan has one investment fund, Amanah Growth Fund - all investments of Amanah Growth Fund comply with ethical investment mandate.

AmanahNZ is a registered managed investment scheme under the Financial Markets Conduct Act 2013, and is managed by Amanah Trust Management (NZ) Limited. AmanahNZ is U.S. dollar denominated and invests up to 50 international equities, or cash. All investments of AmanahNZ comply with ethical investment mandate.

The director believes that there is a great potential for Islamic banking in a western economy like New Zealand. He highlighted that the opportunities of Islamic banking in New Zealand which are two-fold. Firstly, with the increasing number of the immigrant mix in the population, there is an opportunity to service a niche market in New Zealand. Secondly, the principles of Islamic banking particularly with the shared ownership context there is an opportunity to service the difficult real estate market where the customers are increasingly finding it difficult to access financial loans from commercial traditional banks.

He claims that

“The nature of shared ownership will have a very positive impact in terms of outcome as the banks will have their role to control inflated prices of real estate through managing the demand side of the equation”.

Their organisation currently deals with the Superannuation scheme that has a growing market demonstrating the demand for this kind of product from the first set of customers. However, between the retail business and the real estate business, he believes strongly that

“the major influx of interest will come from the second set of customers who are the people from the general population of New Zealand who need a solution badly to get into the heated real estate market”.

6.2 Non Muslim customer who uses traditional banking

The customer, a professional, New Zealand citizen in his 40's has savings and fixed accounts in two banks in New Zealand. The customer feels quite secure banking with a traditional bank where his money is secured with the backing of the central bank of New Zealand.

However, he feels

“ constrained with the current charges that the traditional bank imposes on him on a regular basis, just because he is saving under the traditional banking system. He mentioned with great dissatisfaction about the exuberant rates of withholding taxes and regular bank fees to maintain the account”.

In terms of government policies regarding the real estate ownership, the customer was unhappy and claimed that

“ I feel stressed about the regulatory moves from the banks due to government policies that are being imposed on home owners like me”.

He felt that it is becoming very difficult to service his loan with the increasing amount of interest being charged on his home loan.

6.3 Muslim customer who uses traditional banking customer

The customer, a professional Muslim, an immigrant from an Asian country who is currently a New Zealand citizen in his late 30's has savings and fixed accounts in three banks in New Zealand. He was very excited about the Islamic banking system and felt it would be a great opportunity for him to practice an interest-free banking system if it is available in New Zealand.

However, since its very new and not very popular in a western economy, he said that,

“ I am sceptical whether this can be implemented in a non-Muslim majority country as the demand needs might not be sufficient to implement a banking system within this country.

And he does not think the general population of New Zealand will have an interest in a non-traditional banking system. Having travelled globally and has seen the success of Islamic banking in countries such as Malaysia and Pakistan, he is very positive that the system will work in New Zealand...

“I am very hopeful of its success in New Zealand. However, he is also sceptic about the regulatory requirements and believes although this may be a popular opportunity there may be resistance from the traditional bankers to maintain their market share”

He is a believer in not interest based banking and believes this may create opportunities for both customers and lenders.

6.4 Bank manager (traditional banking system)

The bank manager of a local New Zealand bank which uses the traditional banking system is aware Islamic banking system. However, he is not aware of the minute details about the whole system and was very quick to comment that

“As I was never trained in this banking system, I am not able to furnish further details”.

Although he realises the value of niche customer segmentation, he doubts there will be ever a big enough market to service banking systems for Muslims only. He is also sceptic about non-Muslim customers taking up this kind of system and there might be a trust issue that exists in such a novel system. He believes New Zealand customers are very traditional by nature and it will be difficult for them to take a system which never has been tested in a western economy.

7. Discussion and Analysis

The current study from the above interviews finds some very important traits which are common with the findings of a similar study conducted among the UK markets (Karbhari, Naser, & Shahin, 2004). However, the unique nature of New Zealand market (being geographically apart from rest of the world) also poses some unique opportunities and challenges in exploring the feasibility of this type of banking in a non-Islamic economy. The real estate industry in this economy has recently become a very important factor in controlling personal finances of individual customers as house prices are skyrocketing (Cerutti, Dagher & Dell'Araccia, 2017). The customers from this country are also being charged high banking fees that may be a driver to look for alternatives. Personal traits such as the demography and behaviour have been reported in the literature to influence other banking practices as Internet banking (Gan, Clemes, Limsombunchai & Weng, 2006; Adapa & Roy, 2017) therefore, these can also be important factors influencing the Islamic banking adoption in New Zealand. Although the religious beliefs were hypothesized to have influence in this decision there was no visible influence identified from the interviews.

Therefore, a summary of drivers was prepared from this study that is reported in Figure 3 of this article. These are mainly support from the regulators, effective human resources planning, careful strategic marketing can help the Islamic banks gain successful outcome among the customers from New Zealand.

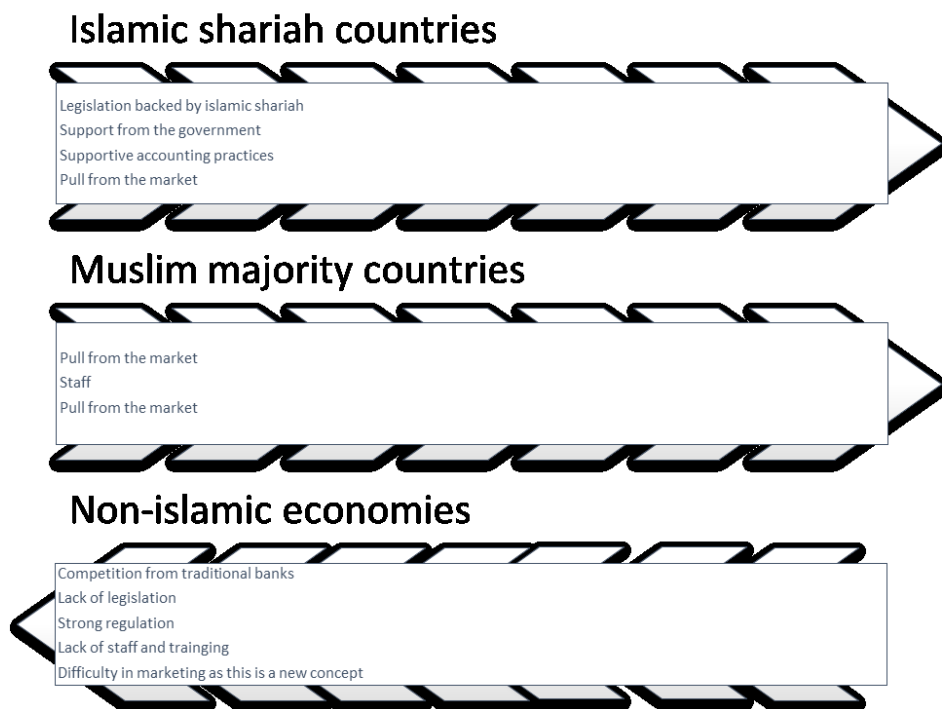


Fig. 3. Drivers of Islamic banking establishment in a Non-islamic country

8. Conclusion

Although this study aimed to capture possible drivers of success for Islamic banks among New Zealand customers, the study is limited by the exploratory nature. This study further proposes a research

aimed to test the viability of Islamic banking in a non-Islamic economy through an action research model where a framework can be created based on an extensive survey in the target market to identify various characteristics and requirements of the target market. Both primary and secondary data can be used in this research to develop the framework. The developed framework will be tested in partnership with an existing Islamic bank to enter into the targeted market through a pilot project on a small scale. The effectiveness of the framework will be measured through in-depth interviews with the stakeholders of the project. Both the initial survey and the follow-up interviews will adopt a purposive sampling as the study can focus on the stakeholders of Islamic banking in New Zealand. The follow-up interviews can adopt the Fuzzy Delphi technique comparing perceptions over a time series of the stakeholders.

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