

ISLAMIC BANKING SYSTEM IN
MALAYSIA: HOW WORKABLE IT IS?

by

MOHD NAJIB BIN MOHD SAAD

92076091

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CONTENTS

ABSTRACT	3
ACKNOWLEDGEMENTS	4
LIST OF FIGURES	5
LIST OF APPENDICES	6
CHAPTER ONE INTRODUCTION	7
CHAPTER TWO: HOW ISLAMIC BANKING SHOULD BE ?	11
CHAPTER THREE: ISLAMIC BANKING SYSTEM IN MALAYSIA	15
CHAPTER FOUR: LITERATURE REVIEW	29
CHAPTER FIVE: REVIEW OF STUDIES ON BANK ISLAM MALAYSIA BERHAD	32
CHAPTER SIX: HYPOTHESIS, DATA, AND ANALYSIS	41
CHAPTER SEVEN: CONCLUSIONS AND RECOMMENDATIONS	47
APPENDIX	49
FOOTNOTES	56
REFERENCES	57

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ABSTRACT

"Those who benefit from interest shall be raised like those who have been driven to madness by the touch of the of the Devil; this is because they say: "Trade is like interest." While God has permitted trade and forbidden interest. Hence those who have received the admonition from their Lord and desist, may have what has already passed, their case being entrusted to God; but those who revert shall be the inhabitants of the fire and abide therein forever."

(Surah Al-Baqarah, verse 275-281)

The principles of Islamic Banking System were established in the Quran 14 centuries ago. The emergence of the system is often related to the revival of Islam and the desire of Muslims to live all aspects of their lives in accordance with the teachings of Islam. Now, an organization of financial institutions operating on these principles has existed worldwide and more formal coordination could result in a nearly global Islamic financial network. Since the establishment of the Dubai Islamic Bank and the multinational Islamic Development Bank in 1975, over 100 such banks have opened for business worldwide. These banks have attracted deposits estimated at over \$10 billion. In Malaysia, the Islamic bank established in the country, Bank Islam Malaysia Berhad commenced its operation on March 1, 1983.

The Islamic banks in need to comply with the Quranic

1.1 INTRODUCTION

The evolution of the Malaysian financial system can be divided into four stages. It started with the commodity money stage also known as Barter Trade, then the birth of paper currency and later to financial intermediation. The system is now in its maturity stage where a variety of specialised financial institutions have emerged to effectively meet the needs of both surplus and deficit units in the economy. The Malaysian financial system, as in other countries can be divided into three:-

- 1) the banking system;
- 2) the non-banking financial intermediaries and
- 3) the financial markets

The banking system comprises the monetary institutions and non-monetary institutions. The monetary institutions are those institutions whose principle liabilities are generally deposits received from customers. Commercial banks (including Bank Islam Malaysia Berhad) are the only institutions allowed to operate current accounts.

The non-monetary institutions which are closely linked to the monetary institutions. These institutions include finance companies, merchant banks and discount houses.

The non-banking financial intermediaries which are supervised by various Government departments and agencies, can be divided into five groups of institutions, namely the