

## Problems and Challenges Facing Islamic Banking



**Naveed Ahmad Lone**  
*ICSSR Doctoral Fellow*  
*University Lucknow, India*

Many of today's problems derive from the fact that the world in which we live is rapidly becoming a global village. However, the pace at which the technology has created this global village has been far ahead of the human competence to adjust the changing scenario and as a consequence of that human life has gone suffocating and is cramped for time and space. In the contemporary postmodern and post industrialization era human life has taken onto itself a materialistic connotation and we as humans have been left to no better than a machine which is relevant as long as productivity is high and depreciation less. As such, the economic system that has over time given birth to this state of affairs needs to be re-visited. If there is a scope of rectifying it, that need to be done otherwise it needs to be shunned and a new system which is free of such vices has got to be advocated and put in place. In this paradigm different economic systems such as capitalism, socialism etc. had emerged with the same aim i.e. the achievement of well-being of the followers with the help of their institutional setup. Although the methods adopted by them for achieving this end are dramatically opposed. In the situation of despair and despondency, humanity is

anxiously looking forward to a system which could deliver it from the present economic mess created by the dominant economic philosophies of the modern age. Islam perhaps offers that system.

In every time, there had been and will be challenges and problems for Muslim Ummah, and we as Muslims have to face these problems and offer solutions. We have to be a part of the solution not the problem. Same is the case with economic system. Today the whole world is looking for an ideal economic order. What better system can we have than the one proposed by the creator Himself! Our duty is only to explore and complete the set of rules and regulations governing our economic life. The object of the Islamic economic structure is to ensure the greatest good to the greatest number. This entails seeking of universal welfare, i.e. welfare of all mankind.

This is the fact that the emergence and growth of the Islamic economic system is the phenomenon that has generated considerable interest in the financial world across the Globe. One recent example of this RBI has recently despite a number of hardships, given consent for Islamic Banking

in India having a meager 14% of Muslim population in the country. Why should not be so, as the Islamic economic system offers solution to the problems which were created by other –isms. But at the same time, we should remember; what could sustain Islamic Banking and finance till now, can hardly be expected to guarantee its continued progress in the future.

The foremost and severe problem is that despite the growth of Islamic banks over the last 40 years, many people in the Muslim and non-Muslim world do not understand what Islamic banking actually is. The basic principle is clear, that it is contrary to Islamic law to make money out of money and that wealth should accumulate from trade and ownership of real assets. However, there does not appear to be a single definition of what is or not an Islamic-banking product. There is not a single definition of Islamic banking, rather any activity, any task, or any method of banking fulfilling the criterion laid down by Shari'ah constitute the Islamic banking system. A major issue here is that it is the Shari'ah Councils or Boards at individual Islamic banks that actually define what is and what is not Islamic banking, and what is and what is not the acceptable way to do business, which in turn can complicate assessment of risk for both the bank and its customer. More generally, the uncertainty over what is, or is not, an Islamic product has so far prevented standardization. It is also an added burden on the banks that they have to educate customers in new markets. They have also to well educate the existing and new customers about the new methods and modes of financing through banks and also the new systems of banking business.

There is no systemic analysis and research and no real efforts to introduce the modes

of Islamic Banking at ground level, so the practitioners blame the following factors:

- a) Lack of committed entrepreneur.
- b) Lack of committed professionals who can create new instruments.
- c) Lack of committed sponsors who can pressurize the professionals.
- e) Shortage of skilled professionals.

Bankers due to the nature of their job have to be pragmatic and application-oriented. There is and will be need for the bankers practicing in Islamic banks to mold or modify the prevailing practices in accordance with Shari'ah to suit the requirement for transactions at hand. However, being immersed in the travails of day to day banking, they find little time and inclination to do any research work, which can make substantial contribution to the Islamic banking. On the other hand, Islamic scholars active in researching Islamic banking and finance, typically have normative approach. Very few of them are knowledgeable about modern banking system or the needs of the customers.

The absence of Shari'ah-compliant legal framework is major trouble which the Islamic banking system in particular and Islamic economic system in general in facing. The present-day conventional banking laws prohibit banks to engage directly in business activities using depositors' funds. On the other hand this is the base on which Islamic banks and banking methods are built. So, new legislation becomes inevitable. In this Iran has passed a comprehensive legislation to establish Islamic banks, followed by Pakistan, Malaysia and few other countries. But if Islamic banking system has to flourish this should be done worldwide. Islamic law offer its own frame works for execution of

commercial and financial contracts and transactions. The commercial and banking laws appropriate for implementation of Islamic banking and financial contracts do not exist. On the contrary the present day conventional banking laws contain provisions that are narrowly defined and thus prohibit the scope of Islamic banking activities within conventional limits. If there are disputes to be handled, present banking laws are not sufficiently acquainted with the rationale of the operations of Islamic banking. In non Muslim countries, the central banks are very stringent in granting licenses for Islamic banks to operate. In order to establish an Islamic bank in a non Muslim country, it must also meet the additional requirements of the governmental as well as non governmental authorities. Thus, apart from legal constraints, there are economic constraints as well as political too.

The problem which lays with regard to investment management boils down to risk management in modern times and regrettably the risk management is still under developed in Islamic financial theory and practice. In addition to this fact, in Islamic perception, it is one of the areas of conventional finance which is in need of drastic reforms. So, this actually represents a double challenge-to develop Islamic techniques of risk management and to see that these new techniques are free from ills with which conventional methods are suffering.

The need for professional bankers and managers for Islamic banks cannot be ignored. Various Islamic banks are run by direct involvement of the owner himself, or by those managers who have not much exposure to Islamic banking activities, nor are they familiar with conventional banking

methods. Consequently, many Islamic banks are not able to face challenges and stiff competition. There is a need to institute professionalism in banking practice to enhance management capacity by competent bankers committed to their profession. This gives rise to a need for banking professionals to be properly trained in Islamic banking and finance. This training in itself is hindered by hurdles. Firstly it is a time consuming process, which is aggravated by two other factors. One the number of persons that need to be retrained and second the additional staff that needs to be recruited and trained to carry out the increased work load. Principles are still to be laid down and techniques and procedures are still to be evolved. It is only after the satisfactory achievement of these principles so that proper training can begin. This delay and the resulting confusion appears to be among the main reasons for the banks to stick to modes of financing that are not ideal from Islamic perspective.

Regarding constraints, absence of Islamic money market is one of the intense problems. The activities of the Islamic banks as a consequence are not demand oriented and do not reflect flexibility to structural shifts in the economic setting as well as to changes in preferences of the depositors. It is known to the bank management that a certain portion of the short-term deposits is normally not withdrawn at maturity; so these funds can be used for medium and in some cases long-term financing. However, a precondition for this usage is that the bank must be able to obtain liquidity from external sources in case of unexpected withdrawals and emergencies. In the absence of Islamic money markets, the Islamic banks cannot invest their surplus

funds i.e., temporary excess liquidity to earn any income rather than keeping it idle. In present times the government treasury bills, approved securities or other bonds and certificates are interest bearing. With the result, the Islamic banks cannot invest the permissible excess part of their reserves to earn income.

Islamic banking like any other system, however well established it may be, cannot flourish exclusively on its built-in elements. It has to depend on a number of supportive and link-institutions. For identifying suitable projects, Islamic banking need to use services of economists, lawyers, management consultants, auditors, other financial and insurance companies compatible with Shari'ah. They also need research and training forums in order to develop entrepreneurship skills among their clients. Such supportive services properly oriented towards Islamic banking are yet to be devised.

We Muslims have been entrusted with the duty of conveying the message of Islam to all mankind. Islam is not only a set of religious beliefs but a complete code of conduct covering all the aspects of an individual as well as society. While accepting Islam as the best way of life for ourselves, most of us are unwilling to share this truth with those to whom the message has not yet been conveyed.

Despite the successful acceptance of this system there are some problems. These problems are mainly in the area of financing. However, with some minor changes in their practices, Islamic banks can get rid of all these cumbersome, burdensome, and sometimes doubtful forms of financing and offer a clean and efficient interest-free banking. For that purpose as Muslims we should engage in a

struggle to make the world better place for humans as a means to find the way to our Lord, as we all are given only one chance to live.

