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A Compliance of Islamic Banks with the Principles of Islamic Finance (Shariah): An Empirical Survey of the Jordanian Business Firms

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Abstract

This paper examines the degree of Jordanian Islamic banks' compliance with the principle of Islamic finance which is consistent with Sharia (Islamic Law), sourced from the Quran and the Sunnah. The study has been conducted by distributing questionnaires to corporate customer dealing with various Jordanian Islamic banks**;** the sample has been selected by simple random sampling approach with sample size of 30 firms. A total of 150 questionnaires were distributed and only 124 have been analyzed. The study used descriptive statistics, and one-sample t-Test to answer the questions of the study. The most important Findings in this study were**:** Jordanian Islamic banks compliance with the principle of Islamic finance which is consistent with Sharia (Islamic Law), funded businesses consistent with dealing with usury transactions that not dealing with Ribain the financing business. Compliance to avoidance of gambling and speculation (maysir) in any party, the highest arithmetic mean depending in the Likert scale was finance projects that deal with activities, goods and services and industries is not forbidden (haram).The lowest arithmetic mean that is significantly less than the test value in the Likert scale which is (3) related with risk-sharing, which means that Jordanian Islamic Bank has not been a sufficient part to share the risk and sought to transfer the most part of the risk to the financier party by obtaining adequate guarantees which ensure recover his capital. At the last point to be recommended to the Jordanian Islamic banks were emphasized their attentions towards determining the exact mechanism by which profit and loss should be determined. This is one area where more work needs to be done.

Keywords: Islamic Banking, Islamic Finance (Shariah), Riba, Maysir, Jordan

1. Introduction

Islamic finance is a dynamic industry that is widely regarded as a competitive alternative to conventional financing solutions. Islamic finance has developed rapidly over the last 40 years, showcasing their dynamism with a wide array of innovative financial products and services on offer Islamic finance or financial activity which is structured so as to align with the teachings of Islamic law (sharıah).

This study attempts to investigate the degree of the compliance on the Islamic banks on offering clients varied services compliant with the Islamic principles. These principle include: avoided interest (riba), gambling (maysir) and uncertainty (gharar), forbidden (haram) activities and commodities, an emphasis on risk-sharing, the desirability of materiality, and consideration of justice relating to finance. In order to meet the rising demands among Muslim clients who are placing their money in Islamic banks in ordering to reap a fixed interest rate which they considered as haram [prohibited] according to shariah.

Since borrowers and investors have become more knowledgeable and with the increased competition, they are seeking the best financial deals or returns on investment. This fact suggests Islamic banking and finance can work in a modern context and will continue to attract clients as long as they continue to make profits for shareholders and investment depositors.

Finally, this study surveys the attitudes and perceptions among business firms dealing with Islamic banks, towards the compliance of these banks with the key principles underlying Islamic law (shariah).

1.1 Problem statement

The savings and loans crisis as well as the banking crisis have all given fresh impetus to finding new ways to minimize the financial crises and they have been considered as an important opportunity for the Islamic finance to move more directly into the mainstream.

The ethical principles that underlie the Islamic financial system have been a popular topic recently,(Hawser ,2008) states that Islamic financial institutions fare better than their conventional counterparts during times of economic distress due to the system's emphasis on the ethics and Sharia (Islamic Law) principles.

Therefore this study will consider the degree of Jordanian Islamic banks' compliance with the principle of Islamic finance which is consistent with Sharia (Islamic Law), sourced from the Quran and the Sunnah, which are followed by the consensus of the jurists and interpreters of Islamic law.

1.2 Literature Review

The establishment of Islamic banks has grown rapidly since it was first introduced four decades ago. Then, the Islamic banking system has spread to the whole world and is accepted by both Muslims and non-Muslims. Additionally Islamic banks can no longer be regarded as business organizations established to fulfill religious obligations, but as business entities competing side by side with the conventional banks in attracting clients and retaining them.

Islamic finance can be broadly described as a financial service or product principally implemented to comply with the main tenets of Sharia (or Islamic law). For Muslims, Sharia law serves as the principle source of guidance for all areas of their lives (Gohar ,1999) The term "Sharia" can be roughly translated as "Islamic law" In turn, the main sources of Sharia are the Holy Quran, Hadith, Sunna, Ijma, Qiyas and Ijtihad. More specifically the Holy Quran contains the literal words of Allah as revealed to Muhammad, whereasthe hadith are the recordings of the Prophet Muhammad's actions and words as documented by his contemporaries and later followers via oral tradition (Gohar , 1999).Sunna On the other hand, refers to the habitual practices and behaviors of Muhammad during his lifetime(Gohar , 1999).It has been agreed on that Ijma is the consensus among religion scholars about specific issues not envisaged neither in the Holy Quran nor in Sunna, popularly translated to mean "consensus of jurists.(Hammond , 2007).In addition to what has stated earlier, Qiyas is the use of deduction by analogy to provide an opinion on a case not referred to in the Quran or Sunna in comparison to another case referred to in the Quran and Sunna (Hammond , 2007).Finally,Ijtihad represents a jurists’ independent reasoning related to the applicability of certain Sharia rules in cases not mentioned in either the Quran or the Sunna.(Hammond , 2007).

The guiding principles regarding Islamic finance represent the theological norms upon which the Islamic finance industry rests and the structural parameters of shariah compliant financial activity, distinguishes Islamic financial activity from conventional financial activity, these main Islamic principles include the following:

- The prohibition **of Riba** means that any predetermined payment over and above the actual amount of principal is prohibited (usually interpreted as usury or interest). Riba has been interpreted by many classical scholars as unjustified gain resulting from an unfair exchange of counter-values between contractual parties. Numerous Islamic scholars have justified this prohibition on the basis that in Islam, money itself is not considered to have any intrinsic value; currency should only have value as a medium of exchange rather than as a commodity for exchange. Instead, participants in the financial activity are encouraged to earn legitimate profit through risk sharing and effective involvement in an economically beneficial activity.

- The prohibition of uncertainty (**Gharar**) **and** gambling **(maysir**), find support in the roots of Islamic law Preventing speculation, exploitation and unfair gain. These roots have been interpreted as forbidding games of chance and all kinds of gambling which allow someone to get something too easily. More over and linked to the notion of speculation as illegitimate in Islamic finance, the prohibition of gharar acts to prevent activity in which there is an excessive level of uncertainty, ignorance or confusion, encompassing the transparency, full disclosure of information, and good governance, though legitimate rational business risk is permitted and indeed encouraged in Islam.

- Islamic economic principles also place strict limits on the **type of activity**, **transaction**, or **company** that can be invested in. There are important areas which are explicitly prohibited including the making or selling of alcohol, pornography, and pork products. Earning money through the involvement in these prohibited industries is forbidden (haram), and Muslims must refrain from any connection with such activities whether directly or indirectly support practices or products that are forbidden (or discouraged) by Islam.
- An emphasis **on risk-sharing**, the provider of financial funds and the entrepreneur share business risk in return for a pre-determined share of profits and losses. The lender must share in the profits or losses arising out of the enterprise for which money was lent.
- The desirability of **materiality**, a financial transaction needs to have "material finality", that is a direct or indirect link to a real economic transaction, value-based innovation.
- Consideration of **justice**, a financial transaction should not lead to the exploitation, (unfairness) of any party to the transaction.

These principles followed and retrieved among the several agencies that pass guidelines and regulate Islamic financial systems internationally such as: The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI) in Bahrain, Islamic Financial Services Board (IFSB) in Malaysia, Islamic International Rating Agency (IIRA), International Islamic Financial Market (IIFM) in Bahrain, and International Islamic Fiqh Academy in Saudi Arabia. These agencies are considered as a structure of various regulatory bodies based in different countries, with different membership prepares ethics and Sharia standards and requirements for evaluating products and services provided from Islamic financial institutions.

Currently research on Islamic banks has received special attention from various researchers in different areas, a study developed by Othman an Owen (2001). Compares the service quality and customer satisfaction between full-fledged Islamic banks and conventional banks offering Islamic banking products and services in Kuwait. Othman an Owen found that the compliance to Islamic principles is the most significant criteria for customers to choose to patronize Islamic banks.

Khattak and Ur-Rehman (2010) carried out a study on customer satisfaction and awareness of Islamic banking system in Pakistan. They found that most of the customers adopted Islamic banking for religious reasons, Ahmad & Haron (2002) study the most important factors for selecting bank services in Malaysia, most respondents indicated that the economic factors and religion were important factors for selecting bank services. Although most respondents had a low level of knowledge about Islamic banking products, especially modes of financing, Okumus (2005) in Turkey studied the primary reason for the use of Islamic bank products; most respondents agreed that religion was the primary reason for the use of Islamic bank products. A secondary motivation was interest-free principle. Most customers were aware of the basic Islamic products and services, but not more advanced Islamic financing techniques, Ramadhani et al(2011)studied the effect of service quality toward customer satisfaction of Islamic banking services business in Indonesia. The results showed that Service Quality is a big influence on customer satisfaction; the dimensions are very supportive of the formation of service quality for sharia-based service businesses compliance with Islamic law (sharia). Moreover Gait and Worthington (2008) studied the attitudes, perceptions and knowledge of Individual consumer, business firm and financial institution towards Islamic financial products and services. The study found that religious conviction is a key factor in the use of Islamic finance, also Islamic principle of risk sharing with borrowers have been considered as a substantial barrier to the most financial institutions engaging in Islamic methods of finance.

Indeed, the roots of Islamic law have been interpreted by classical scholars as establishing basic precepts to which Islamic finance services and products should adhere to Shariah principles adopted are intended to ensure the validity of the entire operation of Islamic finance.

1.3 Research Methodology

1.3.1 Sample of the study

This study has been conducted by distributing questionnaires to corporate customer dealing with various Jordanian Islamic banks. We have targeted respondents from making Interview to Islamic banks mangers to determine the corporate customers dealing with these banks. The sample has been selected by simple random sampling approach with sample size of 30 firms, 150 respondents from these firms, the major respondents in these firms were financial managers with a good educational level.

1.3.2 Instrument

The data of this study were obtained through survey questionnaires distributed to respondents at 30 different corporate customers dealing with Islamic banks in Jordan. The questionnaire is divided into two sections. The first section includes the demographic information of the respondent (age, gender, occupation, and educational level, expertise, Islamic modes of finance used). In the second section, respondents were asked to indicate the level of compliance to the Principle of Islamic Finance (Shariah) on a five-point Likert- scale, ranging from “excellent” to “very poor”. Most of the questions included in the questionnaire have been adapted from Shariah law (Islamic Law) as mentioned above in the Literature Review.

1.3.3 Procedure

The questionnaires were filled by the financial managers in the corporate customer dealing with Jordanian Islamic banks. The Jordanian Islamic banks are (Jordan Islamic Bank, Islamic International Arab Bank, Jordan Dubai Islamic Bank). The questionnaires were distributed to 150 respondents at 30 different corporate customers; in two months (April 2013 to May2013) the questionnaires were distributed with the help of enumerators. A total of 150 questionnaires were distributed and only 124 have been analyzed.

1.3.4 Analysis

The responses obtained from the survey were tested for the internal consistency and reliability using Cronbach alpha tests. In order to measure the level of compliance on Islamic banks, descriptive statistics and other appropriate statistical methods were means and one-sample T-Test to answer the questions of the study.

1.4 Research Findings

In order to full fill the main objective of this study which is to investigate the degree of compliance on the Islamic banks on offering clients services that are compliant with the Islamic principles, the data have been analyzed and the results of the study shown in table (1) would reflect the following.

Table (1)

Principles of Islamic	**mean**	**t**	**sig**
prohibition of Riba	4.03	13.24	.000
The prohibition of(Gharar) and gambling (maysir)	4.52	17.64	.000
forbidden (haram) activities, industries, transactions	4.76	19.76	.000
An emphasis on risk-sharing	2.21	-2.57	.000
The desirability of materiality (real economic transaction)	4.34	18.54	.000
Consideration of justice to all parties	3.49	9.66	.001
Total	3.87	15.45	.000

The Compliance of Islamic Banks with the Principles of Islamic Finance (Shariah)

The most important Findings in this study can be summarized in the following:

The arithmetic mean of the Jordanian Islamic Bank compliance to Islamic principle (Sharia law)in accordance with the prohibition of Riba(usually interpreted as usury or interest) was amounted to (4.03) depending on Likert scale, and the value of (t) was (13.24) and the value of sig(0.00) In other words, Islamic banks funded businesses consistent with the commitment to the Islamic Bank with dealing with usury transactions that not dealing with Ribain the financing business.

Jordanian Islamic Bank is financing productive projects where the arithmetic mean was (4.52) and the value of (t) was (17.64) and the value of sig (0.00).this is an indicator of the Islamic Bank compliance to the Islamic principle (Sharia law) to the avoidance of gambling and speculation (maysir) in any party, and the bank's dependence on adequate information and disclosure and transparency in funded business is high.

- Jordanian Islamic Bank finances projects that deal with activities, goods and services and industries is not forbidden (haram) with the highest arithmetic mean of (4.76), and the value of (t) was(19.76) and the value of sig (0.00) which means Islamic bank financed activities and industries that are in line with the permissible of Islamic sharia law. Jordanian Islamic Bank has not been a sufficient part to share the risk and sought to transfer the most part of the risk to the financier party by obtaining adequate guarantees which ensure recover his capital, with the arithmetic mean (2.21) and the value of (t) was (-2.57) and the value of sig(0.00) Which is significantly less than the test value in the Likert scale which is (3). More specifically most Jordanian Islamic banks have been limiting their funding in Murabaha transactions which depend on achieving agreed profit rate with taking adequate guarantees and procedures to secure it.

Jordanian Islamic Bank finances investment projects with clear physical material with the arithmetic mean (4.34) and the value of (t) was (18.54) and the value of sig(0.00) sense that Islamic Banks ensure and study the relevance and realism of funding projects and its role in the development of the economy as a whole.

There is an indicator of the Jordanian Islamic Bank in achieving justice among all the contracting parties with the arithmetic mean (3.49) and the value of (t) was (9.66) and the value of sig (0.001).This ensures that the contracts should not lead to the exploitation, (unfairness) of any parties. Although the arithmetic mean is close to the test value in the Likert scale which is (3), as the corporate customers agreed that Jordanian Islamic Banks tend to finance contracts toward their benefit, they are trying to transfer the most part of the risk to the financier party.

1.5 Conclusion

It can be concluded in this study that Islamic law (Shariah) essentially contains the parameters within which the practice of Jordanian Islamic banking can be undertaken. While the abolition of interest-based transactions is a central tenet of the Islamic economic system which lies in the profit or loss system (PLS).

In Jordanian Islamic Banks financing of any economic or business activity turns into an ownership stake, and have an incentive to make the joint venture work, forcing them to finance only those ventures that are sound and to avoid speculative ones.

More over and in order to be consistent with their own philosophy, Islamic Banks must be financing productive and material investment to create additional capital and wealth. Furthermore, returns should not be fixed regardless of the profits.

The analysis in this study show that Jordanian Islamic banks could not share sufficient risk with another party on financing venturing and thus they continue to behave like a risk averse investor.

Another important finding can be seen in this study, Jordanian Islamic banks financed activities and industries that are not forbidden (haram or discouraged) by Islam, and Islamic financing system is a system that emphasizes justice and avoids injustice to burden the riba of the loan. A number of financing instruments have been introduced by Muslim scholars in order to achieve these objectives.

A last point to be made in this study is that, Jordanian Islamic banks must emphasize their attentions towards determining the exact mechanism by which profit and loss should be determined. This is one area where more work needs to be done.

Finally the researcher also recommended future studies to be pursued further on different facets of the financial and compliance with Islamic Shariah as the basis for Islamic finance and shariah identity.

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