

Islamic Banking System in the Kingdom of Bahrain: Competitiveness in the Global Banking Industry

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Abstract Islamic finance has shown a greater degree of competitiveness during the financial crisis and it had affected globally. The Islamic Finance industry has seen a remarkable double digit growth in the past. The study is an attempt to evaluate the relationship between the level of effectiveness of the Islamic Banking System in the Kingdom of Bahrain and its relationship to competitiveness in the global banking industry. It studied the level of effectiveness of the Islamic Banking system and its competitiveness in the global industry in terms of business service expansion, pricing transactions, equity funds management, investment approach, business performance and found out the problems affecting this industry to attain a quicker and transparent solution to Islamic finance through Shariah way. We surveyed 100 respondents from different Islamic banks and were asked them to rate the operators on the basis of certain criteria and to express their levels of relationship between the level of effectiveness of Islamic banking system in Bahrain and its competitiveness in the global industry. Their responses were analyzed and certain conclusions arrived at using weighted mean scores, Standard Deviation and Correlation. It showed a highly significant relationship between the effectiveness of the Islamic banking system and the competitiveness in the global banking industry. The Islamic Banking system has to improve its effectiveness of the system to achieve competitiveness through innovative strategies and products and services.

Keywords: *competitiveness, Islamic Banking system, global network*

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1. Introduction

Islamic banking is an Islamic form of banking system, formulated to conform to the principles of Sharia law which prohibits the fixed payment or acceptance of interest for money loans. Early Islamic Banking concept includes bills of exchange, partnerships, capital accumulation, and other economic techniques which were adopted during the early Islamic Capitalism. These principles were applied by Islamic banks in commercial institutions within the Muslim community. Today, Islamic banks are concerned on identifying effective strategies that can provide banking network expansion and competitiveness in the banking industry.

This study will evaluate the competitiveness of the adoption of Islamic banking system in the Kingdom of Bahrain, with the global banking industry in terms of pricing transactions, banking services expansion, equity funds management, investment approach and banking performance. Islamic finance cannot be dismissed as a passing fad. Islamic finance has shown remarkable growth in the past 5 years. This industry has to face some challenges but in this there is an opportunity in the global financial system. The biggest danger to all financial activity is the Euro zone crisis. This crisis is like a disease. It has led to a fall in the economic growth and the capital inflows where Islamic Finance is born. Islamic finance has

been spared due to its strict Sharia compliance on its products and services. This research will help in combining Islamic finance with real economic activities of trade.

Many well established banks in the Middle East and Africa have opted to convert undercapitalized and non performing banks to tap the rising demand for Sharia compliant products and services and avoid the heavy investment and logistics of acquiring a completely new bank like National Bank for Development, Egypt was acquired by Abu Dhabi Islamic Bank.

There are a number of factors which have strengthened Islamic finance

- a. Transnational bodies like IFSB and AAOIFI have been set up to help Islamic Finance to face the problems the industry is facing.
- b. The Islamic bankers have developed their skills. The competition between conventional and Islamic has made the Islamic capital market stronger.
- c. The global banking sector has been deregulated. This has assisted Islamic banking for creating and carrying out new ideas and allowing it to become flexible within the system.
- d. Globalization has also resulted in the growth of Islamic finance by creating more opportunities for Muslim countries.
- e. Informational Technology has facilitated banking operations by spreading knowledge and information to client's capital markets and investors.

2. Research Method: TE Approaches, Analysis and Results

Descriptive method will be utilized in the study. Under this method, the descriptions generated from responses will be gathered from the survey dealing with the Islamic banking system in the Kingdom of Bahrain. This method will enable the researcher to gather opinions and perceptions of the respondents on the Islamic banking system in the areas investigated in the study and its relationship with competitiveness in the global banking industry.

Data that will be used in the study will be obtained through a questionnaire that will be distributed to the managers, employees and customers of selected Islamic banks in the Kingdom of Bahrain.

Purposive sampling was adopted in the selection of respondents from the respondent banks in the Kingdom of Bahrain as only some branches of these banks were used to float the questionnaire. This study gathered perceptions of total of 100, consisting of employees, managers and customers of selected Islamic banks in the Kingdom of Bahrain, who were then present during the administration of the questionnaires in the respondent companies. The study was done in only few branches of these banks. To simplify the necessary statistical calculations, computer software was used. For this purpose, the Microsoft Excel

will be used for data management while the SPSS will facilitate the analysis of the data. An appropriate coding system will be designed to enable the gathered data to fit into the computer software application.

As shown in the [Table 1](#), the overall level of effectiveness of the Islamic Banking System in the Kingdom of Bahrain in terms of Banking Services Expansion has an overall weighted mean of 3.853 which indicates that the system is effective in catering to both international and Islamic banking needs and the lowest weighted mean of 3.795 shows that Islamic banking system should consider provision of added value of financial products and services to the needs of the global banking industry while complying with Shariah requirements. The level of effectiveness of the Islamic banking system in terms of business expansion has the highest weighted mean of 3.853. It means that the Islamic banking system provides varied banking services and Islamic financial solutions.

According to the effectiveness of the Islamic Banking System in the Kingdom of Bahrain in terms of pricing transactions has an overall weighted mean of 3.686. It offers transparency in the pricing transactions with a highest mean of 3.879 and it provides inflation-adjusted prices for financial products' pricing with a lowest mean of 3.59. This means the system should concentrate on standardization of its product prices. ([Table 2](#))

Table 1. Level of Effectiveness of the Islamic Banking System in the Kingdom of Bahrain: Banking Services Expansion

Banking services expansion		
Indicators	WM	Interpretation
Provides banking convenience and time saving, through online banking around the globe.	4.03	Effective
The system caters to both international and Islamic banking needs.	3.807	Effective
Provides varied banking services and Islamic financial solutions.	3.853	Effective
Allows financing solutions to business trade based on principles of Shariah in meeting global requirements of capital.	3.783	Effective
Considers provision of added value of financial products and services to the needs of the global banking industry while complying with Shariah requirements.	3.795	Effective
Overall weighted mean	3.853	Effective

Table 2. Level of Effectiveness of the Islamic Banking System in the Kingdom of Bahrain: Pricing Transactions

Pricing transactions		
Indicators	WM	Interpretation
Islamic banks pricing transactions are linked and based on benchmarking of interest rate.	3.71	Effective
Promotes consistency in market-based pricing.	3.481	Moderately Effective
Provides inflation-adjusted prices for financial products' pricing.	3.59	Effective
Offers transparency in the pricing transactions.	3.879	Effective
Allows Islamic Banks to profit by offering financing facilities permissible by the Shariah law.	3.771	Effective
Overall weighted mean	3.686	Effective

Table 3. Level of Effectiveness of the Islamic Banking System in the Kingdom of Bahrain: Equity Funds Management

Equity Funds Management		
Indicators	WM	Interpretation
Ensures stable return by participation in market growth prospects which are Sharia compliant.	3.987	Effective
Islamic bank pricing transactions are linked and based on benchmarking of interest rate.	3.819	Effective
Promotes consistency in market-based pricing.	3.719	Effective
Provides inflation-adjusted prices for financial products' pricing.	3.59	Effective
Offers transparency in the pricing transactions.	3.71	Effective
Overall weighted mean	3.765	Effective

Table 4. Level of Effectiveness of the Islamic Banking System in the Kingdom of Bahrain: Investment Approach

Investment Approach		
INDICATORS	WM	Interpretation
Project risk and profitability determine funding decisions.	3.698	Effective
Results in an establishing a link between project market risk to the rate of return required.	3.59	Effective
Investment approach results in avoidance of interest bearing investments.	3.71	Effective
Manages investment policies consistent with customer's objectives.	3.698	Effective
Profits earned from investments, investment channels, and investment's terms and conditions conform with Islamic Shariah.	3.84	Effective
Overall weighted mean	3.707	Effective

Table 5. Level of Effectiveness of the Islamic Banking System in the Kingdom of Bahrain: Banking Performance

Banking performance		
Indicators	WM	Interpretation
Tracks, monitors sales, margins, and bank's operational performance.	3.686	Effective
Provides access to timely and reliable information in order to formulate better business decisions.	3.638	Effective
Provides development of effective plans, monitoring, and allocation of resources.	3.6	Effective
Develops effective measurement of performance against strategic organizational and global initiatives.	3.686	Effective
Monitors bank's financial goals on areas of profitability, growth, and net assets' return.	3.746	Effective
Overall weighted mean	3.671	Effective

Table 6. Problems encountered by the respondent companies in gaining competitiveness in the global banking industry

Problems encountered in gaining competitiveness in the global banking industry		
Indicators	WM	Rank
Difficulty in covering the risk of currency fluctuations due to Shariah restrictions.	3.771	11
Unfamiliarity of the basic principles of the Islamic Banking System.	3.722	10
Islamic banking activities do not flexibly react to economic structural shifts and changes in customers' preferences.	3.506	7
Integrating Islamic Banking approach with conventional banking.	3.573	8
Inadequate Islamic financial instruments essential in meeting pre-condition for the effective transformation of fund maturity.	3.481	6
Islamic bank operations are not fully covered by existing government laws.	3.204	1
Inadequate liquidity instruments in many Islamic banks.	3.308	2
Lack of diverse banking products to cater to the growing needs of customers.	3.358	3
Introduction of modern technology in Islamic banking operations.	3.397	4
The need for Islamic banking experts and professionals.	3.419	5
OTHER PROBLEMS	3.633	9
Overall weighted mean	3.4883	

Table 7. The relationship summary

Level of Effectiveness		Competitiveness		
			Decision	IP
Business Services expansion	Pearson Correlation	.544**	Significant	Moderate degree of correlation
	Sig. (2-tailed)	0		
	N	100		
Pricing transactions	Pearson Correlation	.651**	Significant	Moderate degree of correlation
	Sig. (2-tailed)	0		
	N	100		
Equity Funds Management	Pearson Correlation	.563**	Significant	Moderate degree of correlation
	Sig. (2-tailed)	0		
	N	100		
Investment approach	Pearson Correlation	.645**	Significant	Moderate degree of correlation
	Sig. (2-tailed)	0		
	N	100		
Banking	Pearson Correlation	.698**	Significant	Moderate degree of correlation
	Sig. (2-tailed)	0		
	N	100		

** . Correlation is significant at the 0.01 level (2-tailed).

The overall effectiveness of the Islamic banking system in terms of equity Funds management is effective with 3.765, which shows that it ensures stable return by participation in market growth prospects which are Sharia compliant. The policy of standardization of the prices should be followed consistently to face competition in the global network. (Table 3)

The respondents view to profits earned from investments, investment channels, and investment's terms and conditions conform with the Islamic Shariah. The lowest mean of a 3.59 shows that the system should concentrate more in establishing a link between project market risk to the rate of return required. (Table 4)

As shown in the Table 5 above, the overall weighted mean of 3.671 indicates that the Islamic banking system in Bahrain is effective in banking performance. It monitors bank's financial goals on areas of profitability, growth, and net assets' return with a highest weighted mean of 3.746 and a lowest mean of 3.6. This shows that the system provides development of effective plans, monitoring, and allocation of resources. Around 500 Shari'ah – compliant fund products were in the market by the end of 2008 which amounted to US\$ 35 billion (DE Ramos, 2009). According to Dr. Chitra Suresh and Mohammed Bardastani (2016), there was no significant difference in the financial performance between conventional and Islamic banks. The level of Competitiveness of the Islamic Banking System in the Global Banking Industry in terms of banking services expansion, pricing transactions, equity funds management, investment approach and banking performance has an overall weighted mean of 3.588, 3.657, 3.724, 3.715 and 3.686 respectively which indicates that the system is competitive. The highest weighted mean of 3.686 indicates that the system shows competitiveness in providing banking convenience and time saving, through online banking around the globe. The lowest mean of 3.51 means the system considers provision of added value of financial products and services to the needs of the global banking industry while complying with Shariah requirements. The system should offer more transparency in the pricing transactions.

There is no significant relationship between the level of effectiveness of the Islamic banking system in the Kingdom of Bahrain and competitiveness in the global banking industry.

As shown in the Table 6 above, the problems encountered by the respondent companies in gaining competitiveness in the global banking industry has an overall weighted mean of 3.4883. The highest weighted mean of 3.771 shows that the Islamic banks face more problems in covering the risk of currency fluctuations due to Shariah restrictions. The lowest weighted mean of 3.204 shows that most of the Islamic bank operations are fully covered by existing government laws. They should provide more diverse products to attract all types of customers towards this system. There is need for people qualified in Islamic Finance to join this industry.

The Table 7 above shows the level of effectiveness of the Islamic Banking System in the Kingdom of Bahrain and its relationship to competitiveness in the global banking industry. The computed r value in terms of business services expansion is .544** with .000 probability value. The computed r value in terms of pricing transactions is .651** with .000 probability value. The computed r value in terms of equity funds management is .563**

with .000 probability value. The computed r value in terms of investment approach is .645** with .000 probability value. The computed r value in terms of banking performance is .698** with .000 probability value.

The significance level is less than .01 (0 standard error) which means there is highly significant relationship between the level of effectiveness of the Islamic Banking System in the Kingdom of Bahrain and its relationship to competitiveness in the global banking industry. This means that the Islamic Banks have to work hard in improving the effectiveness of the banking services expansion, equity fund management, banking performance, investment approach, pricing transactions to achieve competitiveness in the global banking industry through innovative strategies and improvement of policies through good corporate governance, marketing of products and awareness campaigns.

3. Conclusion

According to many respondents there has been lower demand for Islamic based facilities due to its fee based trade financing activities. Today's industry is much focused on asset finance and so it is necessary to promote this product. Trade financing of Islamic products are more attractive than real estate financing. There is a lack of quality Sharia compliant products. We have to put in lot of effort to further develop Islamic financial markets, the infrastructure and research and development to encourage innovation and improving the legal and regulatory framework. Islamic finance has greater prospects and opportunities across regions and so it is necessary to explore new possible linkages to markets through Islamic Finance. Innovation in Islamic Finance is not only to create new products but also to enhance existing products and services.

4. Recommendations

There should be parameters of standardization in policies procedures, regulatory framework and products and services. There should be harmonization of Sharia rules. The Islamic finance industry should cope with the new trends in the Islamic finance industry. There should be more awareness campaign to attract customers in to Islamic finance industry. More efforts should be taken on the promotion and marketing side for trading Islamic Finance products.

The Sharia compliant products and mutual funds need to compete efficiently with conventional funds for that they have to reach the economies of scale. Political support is necessary to promote Islamic finance globally. The regulators of the Islamic Financial institutions should solve the Sharia regulatory issues through sound Sharia governance system or model. According to many respondents Islamic banks should follow the same Sharia supervisory rules and requirements as those of conventional banks. Islamic banks should be allowed to integrate into global markets so that they will compete with other institutions to innovate and meet the needs of customers to take decisions quickly. The Islamic finance industry needs to develop human resources by giving specialized training

and research which will ensure a great deal of talent and expertise for long term development of the industry. The institutional infrastructure should be developed to create a healthy competitive environment for the Islamic finance industry to meet sustainable development and growth.

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