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THE IDEAL OF ISLAMIC BANKING: A SURVEY OF STAKEHOLDERS' PERCEPTIONS

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Abstract: Islamic banking has always been proclaimed as an institution which is different from conventional banking in many respects. The first and most significant difference is the abolition of *riba* in all its financial transactions. Another distinctive feature of Islamic banks is in respect of their discharge of religious and social responsibilities which is portrayed in their commercial dealings and other activities. This prohibition, together with the noble vision to promote social-welfare of the society, forces banking to adopt new methods of operation based primarily on profit-loss sharing (PLS) arrangements. Yet, evidence on the current practice by Islamic banks worldwide suggests that the majority of financing operations are not based on equity. Rather, Islamic banks have consistently favoured the use of debt-based modes of financing. This poses suspicions amongst unconvinced Muslims and other critical outsiders who observe that Islamic banks in reality are no different from conventional banks since the net result of Islamic banking operations is the same as that of conventional banking. This paper aims to survey the viewpoints of various stakeholder groups of Islamic banks with regard to the Islamic banking practices in Malaysia. By adopting the stakeholder approach, this study will be of potential relevance to Islamic banks, particularly in their policies and dealings with the aim to secure benefits for the widest possible constituency.

Keywords: Islamic banking, stakeholder, profit-loss-sharing, survey, perception study.

1. INTRODUCTION

Ideally, the revolutionary departure of interest-free Islamic banking from the conventional system is exemplified by a vision to move from a debt-based financial intermediary to an equity-based and risk-sharing arrangement (principally *mudarabah* and *musharakah* contracts). In other words, an ideal Islamic banking model is reflected through its balance sheet structure that is dominated by profit-loss-sharing (PLS) on both assets and liabilities sides. In such arrangements, it is believed that the depositors who share the risk with the bank on the liabilities side will naturally absorb any adverse outcomes on the assets side of the bank's balance sheet. The value of the depositors' funds represents the real assets value of the banks. Thus, Islamic banking theoretically is deemed to be a good alternative to the conventional system due to its robustness and the potential stability that the system may provide (Khan and Mirakhor 1987; Siddiqui 2001).

However, there are reasons to believe that the ideal structure of Islamic banks based on profit-loss sharing (PLS) principles may indeed prove to be a mirage. This is because only a minuscule portion – generally well under 5 percent of the assets of Islamic banks consists of financing instruments based on genuine profit sharing or profit and loss sharing (Lewis and Algoud 2001). By far, the most common financing method is the debt-based instruments like *murabahah* (cost-plus sale) and *ijarah* (leasing), which some may argue it as a cumbersome form of interest or simply a backdoor to *riba*. (Kuran 2004)

Despite the scepticism amongst the Muslim economists towards the debt-based instruments, their alternative view on Islamic banking predominantly structured by equity-based products is also not without criticism. One of the known opponents to the idea of overemphasizing the superiority of PLS is Ismail (2002), who argues that such argument is unfounded in any Qur'anic text and even is incompatible with the methodology of *Shari`ah* (Islamic Law). He further stresses the importance of debt-based contracts in Islamic banking which have a clear indication of permissibility, based on various verses of Al-Qur'an.

This paper attempts to analyse these views by way of a survey conducted on a sample of 1500 respondents representing seven different stakeholder groups of Islamic banks in Malaysia, namely customers, depositors, managers, employees, regulators, *Shari`ah* advisors and local communities. This study will help to better understand the actual attitudes and perceptions of diverse stakeholders towards the ideal structure of Islamic banking. Not many studies like this are available and hence, a study that investigates various stakeholders' opinion of Islamic banking in a dual-banking system like Malaysia will add a new dimension to the existing literature.

The remainder of the paper proceeds as follow: The following section reviews literature that discussed the ideal structure of Islamic banking. The dominance of debt-based contracts in Islamic banking is further analysed in section three. Research methods and analysis tools adopted in this study are elaborated in section four. While the findings and discussion are offered in section five, the conclusion is presented in the final section.

2. THE IDEAL STRUCTURE OF ISLAMIC BANKING

There are generally two dissenting views delineating the structure and objectives of Islamic banking. One vision is the framework offered by many mainstream Islamic economists that is represented in this study as Chapra's model. The other is that of Ismail (2002) and shared by many Islamic banking practitioners who tend to think less theoretically and deductively than the economists. These different settings will be discussed in turn.

Chapra's Model

The first view, referred to as Chapra's model, favours PLS and places greater social welfare responsibilities and religious commitments upon Islamic banks in order to achieve the Islamic economic objectives, including social justice, equitable distribution of income and wealth, and promoting economic development of Islamic banks (Lewis and Algaud 2001). Many Islamic economics writers subscribe to this view, including Sadr (1982); Siddiqi (1983, 1985); Ziauddin Ahmad (1984); Ahmad (2000); Siddiqui (2001); Haron, 1995, 2000; Ahmad, 2000; Rosly and Bakar (2003); Haron and Hisham (2003); Naqvi (2003) and others. These writers even go further to argue that equity-based financing is the only principle representing a true spirit of Islamic banking system which departs significantly from the interest-based system. Although they do not fully negate the use of other *Shari`ah* permissible debt-based contracts alongside the equity-based contracts, they do assert that the socio-economic objectives including social justice, economic growth, efficiency and stability which the Islamic economics seeks to achieve is better served by resorting to primarily equity-based contracts.

These writers almost consistently affirm that the Islamic banking model should predominantly be based on equity to be congruent with the spirit of *Shari`ah* and overall Islamic worldview. In their opinion for Islamic banks to be different from conventional banks, they must aim at promoting Islamic norms and values as well as protecting the needs of Islamic society as a whole without undermining its commercial viability.

Wahbah Al-Zuhayli, a renowned *Shari`ah* scholar, also endorses the socio-economic framework of Islamic financial institution in his famous book *Al-Fiqh Al-Islami wa-Adillatuh*, "*The primary goal of Islamic financial institutions is not profit-making, but the endorsement of social goals of socio-economic development and the alleviation of poverty*" (Al-Zuhayli, 2003: 350). Therefore, for Islamic banks, while making profit from the business is acceptable, the accumulation of profit without utilisation for the betterment of the community is forbidden. In promoting balanced economic and social development goals, Al-Zuhayli further asserts that Islamic banks must consistently adhere to the prescribed guidelines by the *Shari`ah*. These include transparency in the documentation and operation, having sense of accountability to diverse stakeholder groups and respect to the *Shari`ah* rulings passed by the *Shari`ah* advisors, even though the rulings are in conflict with their profit-making goal. With this bigger goal, Islamic banks are likely to be sensitive to the needs of the society, promote more social welfare programmes and activities, and make more contributions towards the needy and the poor.

For example, the replacement of interest-based financial intermediation by PLS modes of financing inevitably promotes small and medium entrepreneurship or micro-entrepreneurs. Unlike conventional banks with their collateral-based lending and creditworthiness paradigm, favouring more established businesses and corporate clients, Islamic banks on the other hand, with their emphasis on PLS instruments are compatible with the needs of micro-entrepreneurs. Hence, small entrepreneurs with viable projects that are normally shunned by conventional banks due to insufficient collateral might be perceived otherwise by Islamic banks[1].

Therefore, according to Haron (1996), the Islamic banking system will become an efficient model in mobilising and allocating resources in the economy as a result of the interest elimination and the profit-sharing concepts. Entrepreneurs, for example, by associating themselves with Islamic banks will become more ethical in conducting their business in such a way that funds will be used properly and the sense of selfishness is reduced considerably (Haron 1996).

Ismail's Model

An alternative setting for Islamic banking is proposed by Ismail's framework. According to this view, an Islamic bank should act as a normal commercial entity that aims at maximising profits as long as it is done in a manner consistent with Islamic law (Lewis and Algaud 2001; Satkunasegaran 2003). This view also stresses the equal importance of other debt-based contracts which have a clear indicative of permissibility, based on *Shari`ah* rulings in the *Quran* and *Hadith* of the Prophet (peace be upon him). For example, Ismail (2002) quoted the longest verse of the Quran which explains the procedure and requirement of a debt-based transaction, "*When you deal with each other in transactions involving future obligations in a fixed period of time, reduce them into writing…and get two witnesses, out of your own two men*" (2:282).

The sales contracts which are *Shari`ah*-compliant encompass *murabahah* (cost-plus sale), *bai' bithaman ājil* (deferred payment sale), *bai' al-salam* (purchase with deferred delivery), *bai' al- istisna*' (commissioned manufacturing), and *ijarah* (leasing). Hence, the overemphasis placed on PLS modes of financing are believed to be inappropriate and unfounded in any Quranic text and even incompatible with the methodology of *Shari`ah* (Ismail 2002).

Furthermore, Ismail's framework identifies that the bank's main responsibility is towards the shareholders and depositors and hence it should not to be burdened with other responsibilities. Social welfare responsibilities should be fulfilled by other bodies such as the government. Without doubt, Islamic banks need to pay zakah as part of their 'social contribution' while complying with the *Shari`ah* requirement. However, the use of shareholders' funds or depositors' money for other social activities, which are not required by the law may jeopardise the viability of Islamic banking[2].

This view is somehow similar to the Western worldview, particularly Friedman's concept of corporate responsibility which contends that society is served by individuals pursuing their self-interest (Adam Smith's invisible hand). Friedman's famous quotation 'the business of business is business' clearly implies that profit maximisation is the only legitimate and overriding objective of a commercial institution, provided that it operates within the prescribed rules of the game (Friedman 1967, 1996).

Indeed, Friedman's argument reflects the prevailing worldview of neoclassical economics which has long been entrenched in the notion of the self-interested economic man. The crux of this argument is the efficacy of Adam Smith's invisible hand in harmonising self-interested behaviour to secure an end that is not a part of anyone's intention. The argument also depends on the ability of the rest of society to create the conditions necessary for the invisible hand to operate and to deal with the problems of externalities, inequalities, and instability, without the aid of business corporations (Boatright 1993). For example, Adam Smith's invisible hand argument says that by giving the public a product it wants at a reasonable price, a business unconsciously transfers the profit motive into consumer welfare. If a company makes a profit, employees will benefit through higher wages, and the company will grow, enabling it to employ more people and contribute to the community in the form of taxes (Lantos 2001). Hence, business and economic activities, in the classical view, are justified partly on the ground that they secure the well-being of society as a whole.

Obviously, there is no significant difference between the two models, only in degree and emphasis. Both essentially argue that Islamic banks ought to be socially responsible – one explicitly and the other implicitly. While Chapra's model puts greater emphasis on direct social commitment of Islamic banks, Ismail's view on the other hand, asserts that social objectives can be attained indirectly by the banks being continuously profitable, viable and sustainable.

With these two dissenting models of Islamic banking, Lewis and Algoud (2001) argue that a probable consequence of the difference is that modes of operation will likely vary between banks in the alternative systems. Obviously, those who subscribe to Ismail's view will certainly be more concerned with making profits to ensure institutions remain viable and sustainable in the long-run. The question remains whether such endeavour is commendable from *Shari`ah* and stakeholder perspectives especially looking at the current trend of Islamic banks that are perceived as institutions operating with no obvious difference from their counterparts. On the other hand, the proponents of Chapra's model conjecture a financial system based on PLS instruments that will ensure the realisation of socio-economic objectives envisaged by Islamic economics. An examination of the actual workings of Islamic banking in practice should therefore be studied with these distinctions in mind.

3. IDEAL VERSUS REALITY

Despite the strong tendency in the literature, especially amongst the proponents of Chapra's model to emphasise theoretical superiority of Islamic banking based on equity over conventional banking, the practices of Islamic banks are found to diverge in important ways from the intellectual doctrines underpinning their role in the economy. Almost all Islamic banks across the globe today resort to the second line fixed return techniques or debt-based instruments.

Observers point out that the use of PLS instruments, namely *mudarabah* and *musharakah* financing, have declined to almost negligible proportion (Lewis and Algaud 2001; Kuran 2004; Yousef 2004; Iqbal and Molyneux 2005). In many Islamic banks' asset portfolios, short-term financing, notably *murabahah* and other debt-based contracts account for the great bulk of their investments. Yousef (2004) refers to the strong and consistent tendency of Islamic banks to utilise debt-like instruments in the provision of external finance as '*murabahah syndrome*'. Table 1 provides the evidence on the dominance of mark-up instruments which are heavily emphasised by Islamic financial institutions worldwide.

Table 1
Evidence of Murabahah Supremacy as Modes of Financing

	Share of Murabahah in Total Financing (%)	Share of mark-up instruments in Total Financing (%)
Middle East and North Africa	67.0	85.6
East Asia	44.7	70.4
South Asia	67.5	92.2
Sub-African Africa	48.4	55.7

Source: Yousef (2004)

Many writers, such as Siddiqi (1983), Obaidullah (1999), Chapra and Khan (2000), Khan and Ahmed (2001) and Dar and Presley (2000) outline some of the salient reasons for the lack of using PLS. It is realised that large scale resorting to PLS instruments could pose much more serious risks and hazards to the Islamic banks. Islamic banks are believed to be exposed to greater risks since the variation of the rate of ultimate return to the banks of their investments is greater. This is due to the inherent vulnerability of PLS contracts to agency problems (moral hazard and adverse selection problems) since the banks are unable to monitor the actual efforts performed by the borrowers. This exposes the banks to exploitation and deception by entrepreneurs who might have disincentives to put in effort and have incentives to involve in adopting un-ethical accounting practices to conceal true profits. The restrictive role of shareholders (investors) in management insofar that no voting rights are available further accentuates the risk exposure of Islamic banks.

Other issues related to PLS that make them less attractive or prone to failure if used include the issue of property rights which are not properly defined or protected in many Muslim countries; the non-existence of secondary markets for trading in financial instruments, particularly *mudarabah* and *musharakah*, which leads to inefficiency in financial resources mobilisation[3] and the unfair treatment in taxation which further hamper the use of PLS instruments[4] (Dar and Presley, 2000).

Therefore, Islamic banks under these circumstances, cannot afford to increase their risk exposure to any large extent, especially in the wake of severe competitions from conventional banks which are already established and hence more competitive. This induces Islamic banks to resolve to debt-based contracts which have some desirable features such as simplicity, convenience and safety (Iqbal and Molyneux 2005). Although the use of debt-based instruments creates difficulties of their own, especially when the repayments are on a deferred basis and other unresolved *Shari`ah* issues pertaining to late-payment penalty, asset possession, rebates, benchmarking, etc., it is widely thought that such instruments are relatively less risky than the equity-based contracts.

Nevertheless, the large tendency of Islamic banks world-wide to structure their balance sheet predominantly based on debt-based assets received much criticisms. Siddiqi (1983), Ahmad (1994), Siddiqui (2001), Rosly and Bakar (2003), Warde (2000; 2004) and others argue that a financial system built dominantly around the debt-based modes of financing can hardly claim superiority over an interest-based system on grounds of equity, efficiency, stability and growth. Even they stress that these modes of financing cannot be expected to remove the injustices of the interest-based system since they actually mimic the standard debt contract in the conventional banking system.

Rosly and Bakar (2003) further define ethics of banking as conduct of a business, which favours a system of distribution that embraces risk-sharing and value-addition by participating agents. In this manner, according to them, the taking and receipt of interest in Islam is considered immoral as it secures a future stream for the lender who negates the perils of uncertainty. Hence the modes of financing like *murabahah* and *ijarah* which resemble the interest-based financing are also regarded immoral since they operate in a similar fashion.

Islamic banks are also criticised for not giving priority to long-term development projects over short-term projects aimed at quick profits. This attitude is similar to that of the conventional banks that prefer short-term investments since banks work on the basis of small reserves and hence, must be able to liquidate their assets fairly quickly, if the need arises. The short-term structure of the Islamic banks' assets is even more pronounced with the predominance of debt-based contracts or fixed return modes like *murabahah* and leasing on the asset side of Islamic banks' balance sheet. The structure of deposits on the liabilities side which is not sufficiently long term further accentuates the reluctance of Islamic banks to get involved in long-term projects. Moreover, the predominant use of debt-based contracts in the lending practices entices Islamic banks to adhere mainly to the financial criteria such as collateral and creditworthiness, like the conventional banks; and hence they pay little attention to non-financial considerations (Kuran 2004). Thus, from a substantive standpoint, Islamic banks do not operate very differently from their conventional counterparts.

Hence, according to these critiques, debt-based instruments, even though they are approved by *Shari`ah* scholars, are expected to be kept at a minimum, while at the same time there is a need to gradually increase the number of equity-based contracts in the current Islamic banking practices, if the overall social welfare objectives as envisioned in Islamic economics are to be realised. This will also reduce scepticisms amongst the public especially the unconvinced Muslims, as well as other critical outsiders, who observe that Islamic banks in reality are no different from conventional banks since the net result of Islamic banking operations is the same as that of conventional banking

4. RESEARCH METHODOLOGY AND HYPOTHESIS

Hypothesis Development

As discussed in the preceding sections, there are many conflicting expectations of Islamic banking practices discussed in the literature. This exploratory study attempts to fill the gap in current Islamic banking literature by providing insights into diverse stakeholder groups' perceptions toward Islamic banking characteristics and operations. This is done by eliciting stakeholders' perceptions towards five statements listed in Table 2. These characteristics were identified and adapted from the literature of Islamic banking as discussed in earlier sections.

Table 2
Description of Statements

Statement Number	Description	Literature
1	*The Profit-Loss-Sharing principle is the only principle representing a true spirit of Islamic banking system.*	Siddiqi (1983,1985); Ziauddin Ahmad (1984), Chapra (1987, 2000b); Ahmad (2000); Siddiqui (2001); and Rosly and Bakar (2003).
2	*Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight those products.*	Ahmad and Haron (2001) and Siddiqui (2001).
3	*Islamic banking must adopt a profit maximisation principle in order to survive in the competitive business environment*	Ahmad and Haron (2002).
4	*Social welfare issues should be left to the government and other non-profit organisations, not Islamic banks*	Lewis and Algoud (2001), Satkunasegaran (2003).
5	*The goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community*	Sadr (1982); Siddiqi (1983,1985); Ziauddin Ahmad (1984); Ahmad (2000); Siddiqui (2001); Haron, 1995, 2000; Ahmad, 2000; Rosly and Bakar (2003); Haron and Hisham (2003); Naqvi (2003) and others.

On the basis of these statements, the study aims to investigate the following main hypotheses:

H_1: ***There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of agreement that the Profit-Loss-Sharing principle is the only principle representing a true spirit of Islamic banking system.***

H_2: ***There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of disagreement that Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight those products.***

H_3: ***There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of agreement that Islamic banking must adopt a profit maximisation principle in order to survive in the competitive business environment.***

H_4: ***There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of disagreement that social welfare issues should be left to the government and other non-profit organisations, not Islamic banks.***

H_5: ***There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of agreement that the goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community.***

Instrument

The data were collected by ordinary mail as well as self-administered questionnaires distributed by hand to seven stakeholder groups of two fully-fledged Islamic banks in Malaysia (namely Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad). The stakeholder groups were financing customers, depositors, branch managers, employees, Shari`ah advisors, regulators (Bank Negara officers) and local communities (those who have no banking relationship with any Islamic banks). The choice of these diverse groups was based on the grounds that they represent the primary groups of stakeholders of Islamic banks in Malaysia. It follows closely the widely quoted definition of stakeholders, which is "*any group or individual who can affect or is affected by the achievement of the firm's objectives*" (Freeman, 1984: 21).

The questionnaire contains two sections: the first section was designed to gather information about the sample's personal, demographic and economic characteristics. In the second section, the respondents were asked to indicate, on a five-point Likert-type scale, ranging from "strongly disagree" to "strongly agree", the five statements pertaining to Islamic banking operation. Initially, a list of 10 statements was gathered from past studies. Before the final questionnaire was sent out, a pilot study was conducted to determine the appropriateness and relevance of these statements in the instrument. A total of 41 respondents were invited and participated in this trial run. Based on the respondents' feedback, the list of statements was reduced to five.

The questionnaire was originally prepared in English and then translated into Malay by using backward translation method with an assistant from an expert in both languages to reduce translation bias and error. Only minor discrepancies were observed between the original instrument and its back translated version which was easily resolved by the translator.

Data Collection

The mail survey was used in the study primarily on branch managers, employees, regulators and Shari`ah advisors of the respective Islamic banks. For the fieldwork survey, the drop-off approach was conducted in such a way that data were collected through self-administered questionnaires distributed by hand to individuals, namely customers, depositors and local communities at 52 Islamic banks' branches in the four selected states representing four main regions of Malaysia; namely Kelantan (Eastern), Johor (Western), Penang (Northern) and Kuala Lumpur (Central). These efforts were deliberately taken in order to seek wider representation of bank stakeholders.

Respondents were randomly selected from Islamic banks' financing customers, depositors and local communities who visited the sampling locations during the chosen time intervals, in order to eliminate the sampling frame errors and to ensure the representation of the population under study in the sample units. Following the data collection procedures outlined by similar banking studies the questionnaires were distributed during various working hours of the same day (morning and evenings), as well as various days of the week, to reduce any potential bias owing to high concentration of bank customers during certain hours of the day, or certain days of the week or month (Creyer and Ross 1997; Gerrard and Cunningham 1997; Metawa and Almossawi 1998; Naser, Jamal et al. 1999; Owusu-Frimpong 1999; Jamal and Naser 2002; Abbas, Hamid et al. 2003; Sureshchandar, Rajendran et al. 2003).

About 20 to 40 respondents were approached at each Islamic bank's branch. The researcher counted every seventh bank customer who had completed a transaction. They were politely approached, and the purpose of the study was explained. Then they were asked if they would be prepared to fill in the questionnaire. Once they had agreed to participate, the researcher then handed over the designated questionnaire to the participating respondents to be answered either in English or in Malay according to their preferences. The researcher then left the respondent alone to answer the questionnaire and did not interfere in any way, so as to avoid any potential bias such as the respondents feeling intimidated, threatened or being influenced by the researcher. Once completed, the respondent either returned the questionnaire to the researcher or to any of the bank staff. Table 3 shows the number of distributed questionnaires; the number of usable returned and completed questionnaires (the response rate), the overall response rate and the strategy used in distributing the questionnaire for each group.

Table 3:
Target Groups, Response Rate and Methodology Used

Target Groups	Distributed Questionnaire	Usable returned and completed Questionnaire	Response Rate (%)	Methodology Adopted in Distributing Questionnaire
Customers	400	367	92	By Hand (fieldwork)
Depositors	400	383	96	By Hand (fieldwork)
Local Communities	400	280	70	By Hand (fieldwork)
Employees	400	335	84	Mail Questionnaire
Branch Managers	134	100	75	Mail Questionnaire
Regulators	36	25	69	Mail Questionnaire
Shari`ah Advisors	10	10	100	Mail Questionnaire
Total:	1780	1500	84.27	

In general, from the total of 1780 questionnaires distributed, 1541 were returned, out of which 1500 were usable (completed), yielding a response rate of 84%. This response was considered large enough and sufficient for statistical reliability and generality (Tabachnick and Fidell 1996; Stevens 2002). This high response rate undoubtedly improved the validity and reliability of the survey since the greater the response rate is, the more accurate it estimates parameters in the population sampled (Pallant 2002). Hence, no further attempt was made to increase the sample size.

Analysis

Presumably not all stakeholder groups would homogeneously apply the same degree of agreement or disagreement towards the various statements of Islamic banking operation and characteristics. It is fair to assume that different stakeholder groups may differ in their expectations and perceptions towards Islamic banking. To investigate the perception of different stakeholder groups of Islamic banks, the Kruskall-Wallis test was applied.

Kruskal-Wallis is a non-parametric test also known as a distribution free test which requires a less strict assumption about underlying population and the type of data to be analysed (De Vaus 2002). Unlike the parametric test (such as F-Test) which requires data to be measured on interval levels and that samples are drawn from normal distribution populations, non-parametric tests do not require the shape of the underlying distribution to be specified even though samples need to be selected at random (Norusis 2004). It is also more suitable for treating samples made up of observations from several different populations, and when measurement of the variables is in an ordinal scale. Although it is not as powerful as a parametric test, increasing the sample size can increase its power to that approaching its parametric equivalents (Sekaran 1992).

This study also adopts a simple descriptive statistical approach i.e. mean and standard deviation. Using this approach, the study hopes to seek consensus among respondents by way of extracting their views and understanding on the objectives and ideal structure of Islamic banks. A similar methodology was used effectively in a previous study to analyse the perception of respondents to various issues on Islamic banking operation (See for example Rosly and Seman, 2003). A high mean with low standard deviation on the given statement would imply a consensus reached by the respondents. As generally acknowledged, a mean is the most important measure of central tendency (Kachigan 1986). A mean only pinpoints the centre of the data. Thus, using the mean alone can be meaningful only if the dispersion is small. However, if the measure of dispersion is large, this is an indication that the data is not clustered closely. Therefore, the mean is not reliable; that is, it is not representative of the data. The responses were also tested for internal consistency and reliability using Cronbach alpha tests.

5. RESULTS AND DISCUSSION

Comparing Stakeholder Groups' Perceptions

Table 4 provides the results of the Kruskall-Wallis (K-W) test to investigate whether any significant differences exist in the perceptions of multiple stakeholder groups towards different statements posed to them. The general null hypothesis reads:

> ***H_0:*** ***There are no significant differences in the various stakeholder groups' opinion when distinguishing various statements about Islamic banking.***

Table 4

Kruskal-Wallis Test to Compare Different Stakeholder Groups' Perceptions

Variable	Stakeholder Groups	N	Mean Rank	Chi-Square (χ^2)	Asymp. Sig. (*p*)
Statement 1 *"The Profit-Loss-sharing principle is the only principle representing a true spirit of Islamic banking system"*	Employees Customers Depositors Local Communities Regulators Managers Shariah Advisors	332 361 378 278 25 99 10	815,79 772,01 746,94 717,77 540,56 523,05 366,90	χ^2= 59.11	0.000
Statement 2 *"Islamic Banking products and services available in Malaysia are similar to that of conventional banks, except that the banks use different names to highlight those products"*	Depositors Customers Local Communities Regulators Employees Managers Shariah Advisors	378 362 277 24 334 100 9	853,80 840,80 819,36 671,10 542,76 480,51 262,67	χ^2= 189.02	0.000
Statement 3 *"Islamic banking must adopt a profit maximisation principle in order to survive in the competitive business environment"*	Managers Employees Shariah Advisors Customers Depositors Local Communities Regulators	100 332 10 363 376 279 25	927,87 842,13 831,70 711,72 689,07 678,20 640,06	χ^2= 64.84	0.000
Statement 4 *"Social welfare issues should be left to the government and other non-profit organisations, not Islamic banks"*	Customers Managers Local Communities Employees Depositors Regulators Shariah Advisors	363 99 280 332 377 25 10	705,28 794,88 769,60 749,46 746,77 697,74 684,90	χ^2= 7.44	0.282
Statement 5 *"The goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community"*	Shariah Advisors Regulators Local Communities Customers Depositors Employees Managers	9 25 279 358 378 331 100	844,17 813,90 768,44 763,06 745,25 695,51 685,09	χ^2= 11.486	0.074

The K-W Test above reveals that there is a significant disagreement among stakeholder groups pertaining to 3 out of 5 statements about Islamic banking characteristics and operation. Except for statement 4 and statement 5, the chi-square values for the three other statements (χ^2 = range from 59.11 to 189.02) are higher than the tabulated chi-square value, χ^2 =12.59 at 0.05 confidence interval; 6 degrees of freedom. The observed significance level for the three variables is evidently lower than the 0.05 confidence level implying that the variations between the seven stakeholder groups in perceiving the three statements about Islamic banking are likely to hold in the population. Hence hypotheses H_1, H_2 and H_3 can be rejected.

An inspection of the mean ranks for the stakeholder groups suggests that employees, customers and depositors were positioned at the highest mean rank for both Statement 1 and Statement 2, while managers, employees and *Shari`ah* advisors scored the highest mean rank for the Statement 3 variable. To delineate the pattern of response more clearly, the frequency results are presented in Table 5 below.

Table 5:
Stakeholders Perceptions of Islamic Banking Operation

	Statements	Disagree (%)	Do not know (%)	Agree (%)	Mean	Std. Dev.
1.	*The Profit-Loss-Sharing principle is the only principle representing a true spirit of Islamic banking system.*	10.1	12.5	77.4	3.99	0.961
2.	*Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight those products.*	53.7	12.4	34	2.71	1.25
3.	*Islamic banking must adopt a profit maximisation principle in order to survive in the competitive business environment.*	12.7	3.2	84	3.99	0.953
4.	*Social Welfare issues should be left to the government and other non-profit organisations, not Islamic banks.*	74	6.8	19.3	2.34	1.038
5.	*The goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community.*	4.4	3.6	92.1	4.21	.759

Note: 1 = strongly disagree; 5 = strongly agree

From Table 5, the mean for **Statement 1** is 3.99. It implies that, in general, the respondents agree with the view that profit-loss-sharing is the only principle representing a true spirit of Islamic banking system. This is confirmed by the majority of respondents (77%) who agree with the statement. This particular finding substantiates assertions made by Rosly and Bakar (2003) and other earlier Islamic economists (e.g. Siddiqi 1981, 1983, 1985; Chapra 1985, 2000b; Ahmad 2000; Siddiqui 2001 and others) who strongly argue that, unless Islamic banking institutions resolve to PLS financing instruments, the socio-economic justice as envisaged by the Islamic banking system would never materialise. Only a minority (10.1%) disagree with **Statement 1** following the line of argument forwarded by Ismail (2002), who staunchly defends the use of other Islamically-approved financial instruments such as deferred contracts of exchange or fixed-rate instruments like *murabahah, bay' istisna, ijarah* etc..

The results of K-W Test in Table 4 also showed that there were significant differences in the opinion of the stakeholder groups on the statement. Employees, customers and depositors were ranked higher than other stakeholder groups in perceiving the importance of Islamic banks to realise the ideal of Islamic banking based on PLS instruments. On the other hand, *Shari`ah* advisors, managers and regulators were observed assigning lower ratings to the idea that PLS is the only principle representing a true spirit of Islamic banking system. The result of this analysis may be explained on the grounds that, *Shari`ah* advisors, bank managers and regulators were generally more concerned with the viability and sustainability aspects of the banking business due to the ever increasing pressures on the Islamic banks to be more competitive especially in a country like Malaysia which practices a dual banking system. Since PLS modes of financing are generally perceived as high risk products, Islamic banks therefore resort to debt-based instruments to maintain their viability and competitiveness in the market.

Additionally, **Statement 2** examines perception of respondents towards the current practice of Islamic banking in Malaysia. The statement states: *"Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight their products"*. Referring to Table 5, there are mixed responses obtained from the respondents. The mean score for **Statement 2** is 2.71 and the standard deviation is 1.25. Approximately 54% of the respondents disagree, while 34% agree with the statements. Another 12% are indifferent. Examining the K-W test result (Table 5) also reveals that there is a significant difference in the opinion of the seven stakeholder groups. Again, depositors and financing customers are ranked higher than other stakeholder groups.

This is, however, not a surprising result since there has been much scepticism in the public opinion especially amongst the unconvinced Muslims about the authenticity of Islamic banking practices (Henry and Wilson 2004). Even the Muslim intelligentsias amongst them Ziauddin Ahmad 1984; Chapra, 1987, 2000b; Ahmad 2000; Siddiqui 2001, observe that the extensive use of fixed-return financing techniques i.e. *murabahah, bai' bithamanil ajil* (BBA), *ijarah* etc. in replacement of the PLS instruments (*mudarabah* and *musharakah*) resembles conventional interest-based financing techniques. This will subsequently ignite cynicism amongst the general public as they view the net result of Islamic banks' transactions as similar to that of conventional banks. In this regard, Siddiqui (2001) asserts the difficulty in arguing for the case of Islamic banking especially before common people who might feel that it is nothing but a matter of twisting documents or changing product names. Hence, it is important for Muslims and non-Muslims alike to be assured and continuously enlightened that Islamic banks actually operate purely based on Islamic principles, so that it is not only genuinely Islamic and legitimate from the *Shari`ah* point of view but also enhances their confidence towards Islamic banks.

Next, **Statement 3** examines the perceptions of respondents on the importance of the profit maximisation principle to Islamic banks. From the table 5, even though a vast majority (84%) of the respondents agree that Islamic banks should adopt a profit maximisation principle in order to survive in the competitive business environment, K-W test reveals that there is a significant difference in the opinion of diverse stakeholder groups. Consistent to our earlier findings, branch managers, employees and *Shari`ah* advisors were again ranked higher than other stakeholders. This implies a strong emphasis for Islamic banks to operate in a manner that can generate profits and become more competitive as compared to their conventional counterparts. This outcome of the analysis is also consistent with Ahmad and Haron (2002), who conducted a similar study on corporate customers of Islamic banks in Malaysia.

On the other hand, **Statement 4** examines the perception of the respondents on the issue of social welfare. From Table 5, the respondents seem to hold quite similar views regarding this matter. The mean for **Statement 4** is 2.3406, while the standard deviation is 1.03976. This is further confirmed by the result obtained on Table 4 earlier, where no significant differences were observed among the stakeholder groups on the statement. Therefore it can be deduced that stakeholders are in consensus that social welfare issues should also be seriously taken into account by Islamic banks. This proposition is consistent with the earlier assertions made by Haron (1996); Ahmad (2000); Haron and

Hisham (2003); Rosly and Bakar (2003) who argue that the objective of Islamic banking is much more than the elimination of interests, rather it needs to fulfil the socio-economic and ethical responsibility to serve the ummah. The particular findings apparently reject Ismail's assertion viewing Islamic banks as a normal commercial entity whose main responsibility is to shareholders and depositors alone, while social welfare objectives are to be fulfilled by other bodies such as the government (Lewis and Algaud 2001).

To investigate whether there is a consistency in responses, **Statement 5** was posed to gauge the true perception of respondents on the Islamic banking philosophy and objectives. **Statement 5** states that: "*The goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community*". Table 5 indicates that most of the respondents (92%) agree with the statement while only a small minority (4%) disagree and the remaining 3.6% of respondents seem to be indifferent. With high means and low standard deviation of 4.2107 and 0.75892 respectively, it implies a strong consensus has been reached by the respondents on the statement. This is further supported by the results of K-W test (Table 4), where no significant differences were observed among the stakeholder groups on the statement.

Again, this result supports our earlier finding showing that respondents have a high expectation with respect to the social-welfare commitment of Islamic banks. This expectation certainly goes beyond the traditional capitalistic view perceiving corporations as having sole purpose of maximising profits and protecting shareholders' interest while neglecting the interest of society at large. Hence, it signifies the importance of Islamic banks as *Shari`ah*-based institutions to be more concerned about their social-welfare commitment and not merely follow the trend of their counterparts that only concern about maximising profits.

6. CONCLUSION

This paper discusses the findings of a survey conducted on the multiple stakeholders of Islamic banks with the aim to gauge their opinion and understanding about the overall performance and operation of Islamic banking in Malaysia. The result reveals that the majority of stakeholders of Islamic banks highly regard Islamic banking institutions as entities with distinctive characteristics distinguishing them from their conventional counterparts. Apart from the prevailing perception of Islamic banks as interest-free institutions, Islamic banks are equally perceived as organisations characterised by ethical norms and social commitments without undermining the commercial aspects of doing business.

Apparently, the aforementioned results clearly show that, while the general consensus believe that Islamic banks should adopt a profit maximisation principle mainly to remain competitive and sustainable in the present business world, a vast majority feel that social welfare issues should also be taken into account by the Islamic banks. These findings corroborate Chapra's model of Islamic bank who views Islamic banks as having dual purposes i.e. realising social and economic objectives. This is also in line with propositions made many Muslim economists like Sadr (1982); Siddiqi (1983, 1985); Ziauddin Ahmad (1984); Ahmad (2000); Siddiqui (2001); Haron, 1995, 2000; Ahmad, 2000; Rosly and Bakar (2003); Haron and Hisham (2003); Naqvi (2003) and others who see Islamic banks as organisations that must not be solely profit-oriented, but also aim to promote Islamic norms and values as well as to protect the needs of Islamic society as a whole.

Apart from balancing between profit and social commitments, the respondents also expect Islamic banks to strictly observe *Shari`ah* guidelines in their operation which include to gradually resort to profit and loss sharing mechanisms which are perceived to be nearer to the ideals of Islamic banking. Islamic banks are expected to reflect their Islamicity in their actual practices in terms of providing high quality and satisfactory services, protecting the interest of their stakeholders, and most importantly, continuously improving their products and services to make them more in line with the precepts of *Shari`ah* so that any doubt of their legitimacy can be alleviated.

All in all, it is not impossible to achieve an ideal model of Islamic banking which is a balance between profit-orientation and a manifestation of social-welfare commitment. This necessitates an active involvement and cooperation of those behind the veil of Islamic banking including the practitioners, policy-makers and regulators, to ensure Islamic banks stay in focus towards becoming a perfect model of Islamic institutions. Without doubt, the government also plays a major role in formulating and promoting necessary strategies and appropriate policies to ensure the realisation of an ideal Islamic banking system.

NOTES

[1] Al-Harran (1990) contends that the ideal operation of the Islamic bank is to emphasise the project viability and usefulness together with the intrinsic trustworthiness of a person while placing collateral at a very minimum significance. As such, the small saver, investor, trader and producer become more

important, rather than merely focusing on individuals who are financially well-off or with collateral worthiness. For example, the experience of Sudanese Islamic Bank (SIB) in implementing the *musharaka financing* concept to small rural farmers in Sudan has proven without doubt that such profit-loss sharing technique is applicable and can bring benefits to the rural community. For details refer to (Al-Harran 1990).
[2] Dr. Abdul Halim Ismail's position on this matter was confirmed through an interview which was conducted on 19th July 2004 at 11.30 a.m. Dato' Dr. Abdul Halim Ismail, formerly with Bank Islam Malaysia Berhad, is also known as 'the Father of Islamic Banking of Malaysia'. Presently he serves with BIMB Securities Sdn. Bhd. as the Executive Director. He was also recently appointed as a member of the National Shariah Council of Bank Negara Malaysia.
[3] The inexistence of secondary markets for equity-based products exposes banks to the problem of liquidity. Furthermore, equity financing is not feasible for funding short-term projects due to the ensuing high degree of risk. This makes Islamic banks rely on some other debt-based instruments, especially mark-up instruments, to ensure a certain degree of liquidity.
[4] The current treatment in taxation does not provide an incentive for banks to offer equity-based products. For example, with the current practice of b*ay` bithaman 'ajil* (deferred cost-plus sale), banks immediately transfer ownership to clients who have to bear all the taxation expenses. Whereas, in diminishing partnership or *musharakah mutaniqisah* contract, banks need to bear a certain amount of tax expenses proportionate to its equity ratio. Interest payments are recorded as expenses in income statements of firms, before arriving at the taxable income. Dividends are nevertheless deducted from the after-tax income. Accordingly, the higher the interest expense, the lower the tax liability; but the tax liability remains the same irrespective of the dividend amounts. This further justifies the argument for favouring debt over equity.

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