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HOW 'ISLAMIC' IS ISLAMIC BANKING? A REVISIT

Eliza Nor [1*]
Anwar Allah Pitchay[2]
Muhammad Usman[3]

[1]School of Management, Universiti Sains Malaysia, USM, Malaysia, (Email: eliza.nor@usm.my
[2]School of Management, Universiti Sains Malaysia, USM, Malaysia, (Email: anwarap@usm.my)
[3]School of Management, Universiti Sains Malaysia, USM, Malaysia, (Email: musmanfinance@gmail.com)

*Corresponding author

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Abstract: *It has been widely argued in the literature that there is no much difference between Islamic banks and conventional banks in terms of their regulation, operational expectations, operational dynamics and organizational structures (Asutay, 2007; Siddiqi, 1999). Taking into account this argument, the present paper attempts to deliberate the issues by giving a special attention to Islamic subsidiaries of conventional banks in Malaysia. The establishment of Islamic subsidiaries of conventional parent banks has raised many unresolved issues. Based on extensive review of the theoretical and empirical literature related to Islamic banking and Islamic economics, the present research has identified three major challenges facing Islamic banks that may contribute to the minimal level of Shariah compliance. The first challenge is the divergent objectives between the parent conventional banks and their Islamic subsidiaries. The main objective of the conventional parent bank is profit maximization (maximizing the shareholders' wealth) while the main objective of the Islamic subsidiary (theoretically) is to comply with Shariah rulings (profit motive is only secondary). The managers who are supposed to implement and abide by the Shariah rulings have also need to follow the directives from top management that comes from the conventional parent bank. Since the Islamic subsidiary is a subset of conventional parent bank, its objectives need to converge with the objectives of the parent bank. The second challenge is the profit maximization motive of Islamic banks and finally is the managers' background can be a challenge in the Shariah compliance process if the managers do not have indepth Shariah background.*

Keywords: *Shariah Compliance, Conflict of Interests, Islamic Subsidiaries, Malaysia*

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Introduction

Islamic finance and banking had been founded nearly four decades ago. However, until today, there has been many unresolved issues and controversies surrounding the industry and the emergence of new issues that goes hand in hand with the development of Islamic banking and finance even though there are many avenues for Shariah scholars, practitioners, and academicians to discuss the ongoing issues. One of the main reasons for the unresolved issues is due to the fact that there is no clear separation between Islamic banking and conventional banking as both banking systems coexist in the same economy. Even though Islamic finance had been founded as early as in the era of Prophet Muhammad SAW, its development was much slower than its conventional counterpart. Conventional banking and finance had been accepted and practiced in most countries around the world for centuries. Therefore, the development of Islamic finance has partly been benchmarked from conventional banking. In country such as Malaysia where there exist Islamic banks, the co-existence of conventional banks could hardly be avoided as these banks were initially established as conventional banks. The opening of Islamic window is to meet the growing demand and interest of the public with Islamic banking products.

The successful implementation of Islamic banking system in the Middle East has encouraged the Bumiputra Economic Congress to set up Islamic Banking in Malaysia. As a result, in 1983, the Islamic Banking Act was enacted in Malaysia and the first full-fledged Islamic bank, Bank Islam Malaysia, was established. In 1999, the second Islamic bank, Bank Muammalat was established. Until today, these are the only full-fledged local Islamic banks in Malaysia. Other local Islamic banks are in the form of subsidiaries of their conventional parents. These include Affin Islamic Bank Berhad; Alliance Islamic Bank Berhad; AmBank Islamic Berhad; CIMB Islamic Bank Berhad; Maybank Islamic Berhad, Public Islamic Bank Berhad; and RHB Islamic Bank Berhad.

In 1993, Bank Negara Malaysia provided an option to conventional banks to open Islamic windows which offered Shariah compliant banking products to customers through their conventional branches. As a result, 21 Islamic banking windows were established by their conventional parents. In 2002, Bank Negara Malaysia had allowed conventional banks to open Islamic subsidiaries to replace the existing Islamic windows and these subsidiaries are governed by the Islamic Banking Act 1983 (Mohamed Ariff, 2017).

As time passes by, there has been growing issues related to Islamic banking due to the existence of conflicts between Shariah objectives and business objectives. The former is built around Islamic concepts but the latter is based on capitalist economy. Shariah scholars' tasks are to ensure compliance of Islamic banks to Shariah objectives. On the other hand, the managers are the ones who are responsible in the implementation of Shariah rulings. At the same time, managers are also responsible to adhere to the corporate objectives as set by the board of directors. Therefore, managers are stuck in the middle between meeting Shariah objectives and business objectives. This conflict may lead to the lack of Shariah compliance in Islamic banks. Besides the differences between business and Shariah objectives, the background of the managers and staff can also play an important role in ensuring Shariah compliance in Islamic banks.

Since the establishment of Islamic banking and finance, issues and challenges surrounding this industry have been widely debated among academicians, practitioners, and regulators around the globe. Numerous literature has discussed the similarities of the Islamic bank products with that of their conventional counterparts' (see for instance, Dusuki & Abozaid (2007); Kuran (2004); Siddiqi (2006); Yousef (2004)). On the other hand, the issues on Islamic banking practices and operations have received minimal attention in the literature. It has been argued that there is no much difference between IB and CB, in terms of their regulation, operational expectations, operational dynamics and organizational structures (Asutay, 2007; Siddiqi, 1999). To fill up this gap in the literature, this paper place special attention to the operations of Islamic subsidiaries of conventional banks based on a newly developed conceptual framework.

The rationale of choosing Islamic subsidiaries of conventional banks are twofold. First, the establishment of Islamic subsidiaries by conventional banks have become a popular practice not only in Malaysia, but worldwide. Islamic banking business has become a lucrative business since the inception of Islamic finance nearly forty years ago. Many conventional banks try to grab this opportunity by establishing their own Islamic subsidiaries. As mentioned above, in Malaysia, the majority of Islamic banks are in the form of subsidiaries of conventional banks. Second, the issues and controversies surrounding Islamic subsidiaries are expected to be more serious as compared to its full-fledged counterparts as the former is under the control of non-Islamic conventional bank. On the other hand, issues/conflicts related to Shariah for full-fledged Islamic banks may be less pronounced as these banks stand on their own and the decision making process is not influenced by conventional parent banks.

The paper is organized as follows. The next section reviews the theoretical and empirical literature on Islamic banking. This is followed by the discussion on the operations of Islamic banking in theory and reality. The challenges in realizing Maqasid al-Shariah in Islamic banks are presented in the fourth section. The final section offers recommendations and conclusion.

Literature Review

This section will review related literature on (1) Islamic economics vs capitalist economics; (2) the similarities between Islamic banks and conventional banks; (3) Maqasid al –Shariah and the protection of wealth; and (4) the definition of Shariah compliance.

Islamic Economics vs Capitalist Economics

Before discussing the issues related to Islamic banks, it is important to begin the discussion by highlighting the differences between the capitalist and Islamic economics since Islamic economics and Finance is only a small subset of a big capitalist economics. Thus the influence of the former on the activities related Islamic economics and finance is almost unavoidable as the whole world is governed by the capitalist economics. The differences between the two

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economics can be seen clearly theoretically only. In reality, the daily activities, in both the Muslim and non-Muslim countries, are influenced by capitalist economics.

IBF has been built based on the neo-classical methodological framework which focuses on individual self-maximisation and ignores maximisation of societal well being (Asutay, 2007, pp. 168). This approach contradicts Islamic economic teaching which emphasizes the balance for both self interest and societal well being. Islamic banking and finance is the institution of Islamic economics which finances and regulates economic activity in an Islamic framework. Thus, there is a requirement for IBF institutions to operate and utilize instruments, rules and regulations of the Shariah. IBF is expected to operate based on the Islamic economic system. Since IBF has not considered Islamic economics as its operational framework, IBF has been operating based on the neo-classical economic model. As a result, the practical approach adopted by IBF has encouraged capitalism throughout the Muslim world.

Muhammad Zahid (2015) has argued that the Muslim world has become champion of riba and secularism (the separation between daily lives/activities/education from religion). Muslims have also been supporting the fiat money and the fractional reserve system introduced by the Western world. This is the results from the collapse of the Ottoman Caliphate in Turkey in 1923 and the rise of the Western world and the spread of secular ideology.

The summary of the differences between capitalist and Islamic economics is presented in Table 1 below.

Table 1: Comparison between Capitalist Economics and Islamic Economics

Capitalist Economics	Islamic Economics
methodological individualism	*Socio-tropic individual*, not only individualism but social concern is a prerequisite
self-interest oriented individuals who (a) seek their own interests, (b) in a rational way, and (c) try to maximise his/her own utility	socially concerned God-conscious individuals who (a) in seeking their interests are similarly concerned with the social good, (b) conducting economic activity in a rational way in accordance with the Islamic constraints regarding social environment and hereafter; and (c) in trying to maximise his/her utility seeks to maximise social welfare as well by taking into account the hereafter.
Market exchange	*Market exchange* is the main feature of economic operations in the Islamic system; however, this system is filtered through an Islamic process to produce a socially

	concerned and environmentally friendly system. In this process, socialist and welfare state oriented frameworks are avoided to prevent curbing of incentives in the economy.
One dimensional utility function *homoeconomicus* (the economic individual in a market system)	*Two-dimensional utility function* *Homoislamicus* (obedient human-being)

Source: Asutay (2007, pp. 171)

From the table above, the differences between the capitalist and Islamic economics are obvious, where the former stresses mostly on individualism while the latter focusses not only on the individual wellbeing but also on the wellbeing of the society as a whole. Islamic economics also is concern on life in the hereafter while the capitalist economics is only concern on the worldly life.

Similarities between Islamic Banks and Conventional Banks

Islamic banks have two main goals: profitability and social goal. However, profitability should not be the sole goal as IB has to conform to the social goal as set by Maqasid al Shariah in Islamic finance, that is fair distribution/circulation of wealth. Wealth circulation means that the funds should be circulate in the society from the rich (surplus sector) to the poor (deficit sector). Warde (2000, pp. 174-175) has summarized the functions and role of Islamic banks in the society as follows (based on the Handbook of Islamic Banking (vol. 6, p. 293):

(1) Broad social-economic benefits: investment policies must focus on the following sectors: agriculture, housing, and health services sectors
(2) Job creation and focus on promising economic sectors (agriculture, manufacturing, and technology-intensive activities)
(3) The promotion and stimulation of entrepreneurship: through profit-and-loss sharing (PLS) mechanisms such as mudarabah and musharakah, banks must give priority to small enterprises
(4) The promotion of social justice and equality and the alleviation of poverty
(5) The regional distribution of investments: (a) channeling money to under-invested areas; and (b) investing savings mostly in the area where they have been mobilized so that people would benefit from their savings

Based on the above functions and role of Islamic banks, it is clear that the role of Islamic banks is to provide financing to entrepreneurs with new ventures in sectors that utilize new technology (for example information technology, biotechnology, nanotechnology). However, these entrepreneurs may lack experience and track records as their business are small and new. They may need a lot of funds for expansion and due to that, they may seek funding from Islamic banks. However, due to the nature of their business as mentioned above, these entrepreneurs may lack collateral to offer to the banks. Entrepreneurs with new business ventures, lack track records and collaterals, are most probably be excluded from obtaining financing as their businesses are risky with high probability of failure. As a result, their applications may be turned down. This leads to the issue of financial exclusion by Islamic banks. According to Asutay (2007, p. 177), financial exclusion from personal banking has become a major issue. Comparing debt financing in both type of banking, entrepreneurs rejected from conventional banks may also receive the same treatment from Islamic banks.

Theoretically, Islamic banks should provide financing which are equity based in nature, such as mudarabah and musharakah (M&M). Both mudarabah and musharakah are based on profit and loss sharing (PLS), where both the financier and the entrepreneur share the profit and loss according to a pre agreed ratio. These type of financing are suitable for entrepreneurs with new ventures. In reality, however, Islamic banks has been avoiding M&M financing. Aggarwal and Yousef (2000), Iqbal and Molyneux (2005), Hasan (2007) and Nagaoke (2007) have provided evidence that Islamic banks seldom provide long term financing to entrepreneurs seeking for funding.

Asutay (2007) argues that equity financing contributed more to economic growth as compared to debt financing since the former is long term in nature as compared to the latter. Avoidance of equity financing by IBF indicates that IBF is not particularly interested in economic development and social welfare. Instead of offering PLS type products, IBF are more interested in offering financing with fixed return such as murabaha, bay bithaman ajil, and ijarah.

On the other hand, the operations of Islamic banks tend to mimic those of conventional banks', where (1) both are avoiding providing financing to entrepreneurs with risky business and (2) both depend heavily on debt financing to ensure fixed returns (Warde, 2000, p. 22). As a result, the objective of penetrating and serving rural areas was not fulfilled. Most evidence highlights the preference of Islamic banks to invest in short-term commercial transactions as opposed to manufacturing or agriculture sectors (Warde, 2000, p. 175). As argued in Asutay (2007) and Warde (2000), the main sectors that IB should focus on are agriculture, manufacturing and technology-intensive industry.

The establishment of the conventional banks are based on the fractional reserve system, whereby the expansion of money supply is realized through the multiplication of loans. Under this system, the commercial banks use their excess reserves from the money deposited in the banks by depositors to make profit by charging interests to the borrowers (see for instance, Mishkin (2016)). This system is against the Islamic teaching as the profit obtained is from ribawi sources and the banks use other people's money (depositors' money) to earn profit.

Islamic banks, like its conventional counterparts, create money through debt financing (Zaman, 2020). The effects caused by the credit expansion of both conventional banks and Islamic banks are almost the same. Such credit expansion can be associated with artificial scarcity (due to greed, self-interests), trade distortion (due to wealth accumulation, inflation, financialisation of capital), inherent booms and bust (business cycles); ecological destruction (deforestration) and wealth polarisation (wealth concentration in the hands of a few; income inequality). As world debt increases because of the nature of the money supply, the corporate interests served by the debt allow for the rich to get richer. Over the last decade, more and more wealth has been concentrated in fewer and fewer hands (Jha, 2013, p. 356-359).

Sabirzyanov, R. & Hashim, M. H. (2015) argue that Islamic banking and finance has created bubble economy from debt financing through the fractional reserve system. Islamic banks like conventional banks support the expansion of money supply that leads to inflation in the economy. Even though there is an increase in the price levels, there is no change in the GDP growth rate because the amount of the real production in the economy may remain the same.

Empirical evidence has supported the argument that there is no much differences between IB and CB. Chong and Liu (2009) have empirically investigated the differences between IB and CB and found that Islamic banking is not very different from conventional banking. On the asset side of Islamic banking, only a very small portion of financing is based on the PLS principle. A large majority of Islamic bank financing in Malaysia is still based on non-PLS modes that are permissible under the Shariah law, but ignore the spirit of the usury prohibition. Their study shows that, in practice, Islamic deposits are not interest-free. A possible explanation on why the Islamic deposits are not interest-free is that the depositors' funds are mostly invested in non-PLS financing in practice. Due to heightened competition from conventional banking, the returns on the Islamic deposit accounts are linked to the returns on conventional-banking deposits. They conclude that Islamic banking, as it is practiced today in Malaysia, is similar to that of conventional banking, and therefore, the benefits of Islamic banking exist in theory only.

A study on the similarities of IB and CB has also been conducted in the context of Pakistan. Hanif (2016) has selected five contracts/products (deposits, Murabaha, Ijarah, Diminishing Musharaka and Sukuk) for analysis. Findings suggest that although financial contracts take into account the legal form, however, economic substance is more in line with conventional banking. It is found that despite differences in philosophy, financial results of the Islamic financial system match with conventional banking, primarily due to the linkage of pricing with inter-bank offered rate (IBOR), ignoring market mechanism/prices of goods and services being offered. It has also been argued that the implementation of Shariah-based financial contracts are more demanding than Shariah-compliant contracts. Islamic banks prefer Shariah-compliant financial contracts because they are similar to conventional financial products (Hanif, 2018).

More recently, a study conducted on the perception of IB customers in Malaysia discovers that the majority of respondents do not perceive that Islamic banking is fully Shariah compliant, suggesting the importance of the implementation of PLS system in the current financial system. The results also suggest there is no much difference between IB and CB since both are focusing on efficiency and maintaining existing service (Rahmi, Azma, Obad, Zaim & Rahman, 2020).

Evidences have shown that Islamic banks have failed to fulfil all the requirements set by the El Hawary fourfold taxonomy (El Hawary, Grais and Iqbal, 2004: 5) in their present practices: (1) risk sharing (financial transactions need to reflect a symmetrical risk/return distribution each participant to the transaction may face); (2) materiality (financial transaction is directly or indirectly linked to a real economic transaction); (3) no exploitation (financial transaction should not lead to the exploitation of any party involved in the transaction); and (4) no financing of sinful activities (for instance, production of alcoholic beverages). Therefore, the argument that IBF offer different alternative to conventional finance is not supported as there is no difference between IBF and conventional banks (Khan, 2010).

If in reality, the operation of IB is not much difference with CB, the intended objective of promoting social justice and equality and the alleviation of poverty in the society would not be achieved if the funds are not circulated to the group of people who deserve them.

In terms of IBF financing, the social dimension is limited to zakat and other charitable activities such as waqaf, hibah, and sadaqah, which, ignore economic development and social justice. Even though the IBF industry has been growing worldwide, the lives of Muslim people have not shown much improvement.

Since the earliest days, it was clear that Islamic banks should not be driven by profit maximization, but by the provision of socio-economic benefits to their communities (Warde, 2000, p. 153). In reality, Islamic banks tend to focus on profit maximization as their main objective, which is consistent with the objective of conventional banks. Theoretically, the objective and the foundation of the establishment of IBs are totally different with the objective of the establishment of its conventional counterparts.

Maqasid al-Shariah and the Protection of Wealth

Islamic banks should abide by the objectives of the Shariah (maqasid al-shariah). According to shari'ah ruling, there are five dimensions of public welfare (maslahah) in the Muslim societies that must be protected: faith, life, intellect, prosperity, and property (Khairul Mukminin, 2018).

Laldin and Furqani (2012: 4) define Maqasid al-Shariah as follows:

> "…all the goals and objectives of Islam as a system of life that constitutes standards and criteria, values and guidance based on divine revelation (*wahi*) to be applied in practical life to solve human problems and guide the direction of human life."

Maqasid and maslahah principles must not and cannot contradict Al Qur'an and Hadith since both are the core from which other principles and rules are derived. In the current situation, however, the interpretation of maslahah is derived from the practical approach and reasoning only, but not from Al Quran and Hadith. As a consequence, the interpretation of maslahah and maqasid has been manipulated to justify the actions and norms by some IFIs (Sabirzyanov and Hashim, 2015).

The main objective of Shariah in terms of the *mal* (wealth) is the legal protection of fund. How the fund should be invested is only a secondary objective. Islamic banks, however, has put priority on profit maximization. Even though there are various profitable investments, Islamic banks should place highest priority to the protection of depositors' wealth rather than investing to gain higher profit. Islamic banks are advisable not to get involved in normal profit or maximizing its sources of fund into financial gain. It has also been argued that Islamic banks have also given less attention to the society wellbeing as a whole (Khairul Mukminin, 2019). A critical study on the performance of IFIs shows that there is a deviation between the realities of IFIs and the objectives of Islamic economics. Instead of providing benefits to the society, Islamic banking and finance has been earning high profitability (Sabirzyanov and Hashim, 2015).

In term of profit from the Shariah viewpoint, the right of Allah must be given supremacy, the right of human-being will come after all other commitments have been fulfilled. Maqasid al-Shariah is a complete conception of preference without imposing difficulties on benefits. IB could preserve the value of wealth and the other higher-values in the long run through the safeguarding of maqasid al Shariah whereby protection should be given the highest priority followed by establishment and nurture (Khairul Mukminin, 2018).

Shariah Compliance Defined

Shariah compliance means adherence and conformity with Shariah principles. In the case of Islamic financial transactions, all the transactions must comply and conform with Islamic law and rules of commercial transactions. The sources of Islamic laws include the primary sources: Al Quran and Hadith and the secondary sources such as ijma' and qiyas (Engku Rabiah Adawiah, 2013).

The concept of Shariah compliance has been misunderstood as a slightest fulfillment of the minimum legal requirement set by Islamic jurisprudence. Instead, Shari'ah compliance means to cultivate Islamic finance in the Islamic spirit and value system and achieve the ideals and purpose of Islam in the financial sphere (Laldin and Furqani, 2013a). Maqasid al Shariah is considered as the grand framework that provides guidelines and directions for ensuring the realization of *maslahah* (benefit) and the prevention of *mafsadah* (harm) in all financial contracts (Laldin and Furqani, 2012).

Realizing both objectives (profit maximization vs Shariah compliance) is not a simple job for the branch managers as in Malaysia, both types of products, Islamic and conventional are offered under the same branch. When this happens, it is clear that, there is a mix of halal and haram transactions. Even though, in some banks, there is a separation between the branches that offer Islamic and conventional products, it is still questionable whether their day to day operations are consistent with the Islamic rulings. It is not much as an issue as the products they are offering are Shariah compliant, as this is only a **micro** issue and IB has been focusing on Shariah compliant products (as opposed to Shariah-based products) since its inception. The issue is whether the day to day practices are Shariah compliant. In other words, is the day to day operations of the Islamic subsidiaries consistent with the **macro** level of Maqasid al Shariah? In reality, achieving the macro level of Shariah compliant is more difficult than realizing Shariah compliant at the micro level.

The maqasid of wealth circulation is a macro goal of the Shariah, while the maqasid of fair and transparent financial practices are related to micro goals of the Shariah in transactional instruments and mechanisms. As discussed in the earlier section, IB role is to circulate wealth from the rich (the surplus sector) to the poor or the part of the society that need the funds (the deficit sector) so that efficient wealth circulation in the society could be realized. However, this goal could hardly be achieved if IBs are not practicing of what they are supposed to do, instead they act like conventional banks. If IBs are not much different from CBs, then the main objective of the establishment of the IBs would remain as a theory only.

Islamic Banks: Theory vs Reality

In theory, Islamic banking is a subset of Islamic economic system which aims at achieving just, fair, and balance society that has been engraved in Maqasid al Shariah (see for instance, Ahmad, 1972; Chapra, 1985, 2000; and Siddiqi, 1981). The purpose of prohibitions of interest, gambling, and excessive risk taking is to promote a level playing field to protect the interest of the society and to promote social harmony (Dusuki and Bouheraoua, 2011).

In reality, however, Islamic banking is a subset of conventional parent bank and the conventional parent banks are the subset of the capitalist economic system (please refer to Figure 1). Figure 1 depicts the structure of Islamic bank in reality where IB is a subsidiary (or a subset) of a bigger conventional bank. This conceptual framework is developed based on the arguments presented in the earlier sections. This is a common case in Malaysia and Pakistan where the Islamic banks are normally subsidiaries of conventional parent bank. Both the conventional parent bank and the Islamic subsidiary are part (subsets) of the capitalist economy. According to Figure 1, the CEO/Chairperson and board of directors of the parent conventional banks are the parties who could influence the decisions made by the CEO/Chairperson and the board of directors of the Islamic subsidiary. The Shariah board members are responsible in providing advice on Shariah issues and they may have direct contact with the board of directors of the Islamic subsidiary. On the other hand, the Shariah board may not have direct contact with the general managers and the branch managers of the Islamic subsidiary. Given their role as advisors to the BOD of Islamic subsidiary, the Shariah board members may not have power in the decision making process. The managers may have more power than the Shariah board in decision making process (please refer to, for instance, Ullah et al. (2016)).

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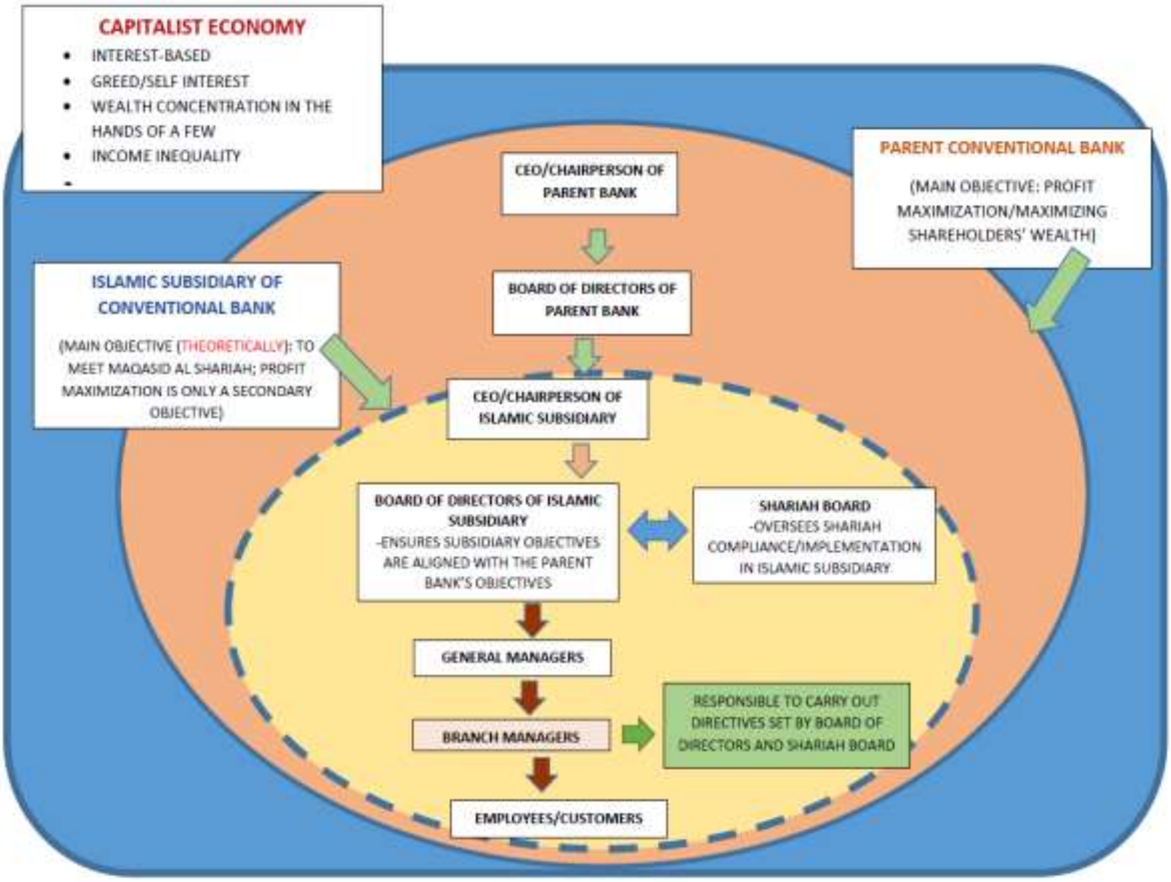

Figure 1 Current Setting of Islamic Banking in the Capitalist Economy

Challenges in Realizing Maqasid al Shariah in Islamic Banks

The chief motivating factor to choose an Islamic bank is the avoidance of interest and Shari'a compliance (Bley and Kuehn, 2004; Haque *et al.* 2009; Hanif *et al.*, 2012). However, Shariah compliance has been one of the biggest obstacles to Islamic banks. In this section, challenges of realizing Maqasid al Shariah will be discussed. The main challenges include the lack understanding of the staff and managers of Islamic banks of the main objectives of the establishment of Islamic banks.

The willingness of customers to pay premium price for Shariah compliant products and services contributes to the high profitability in Islamic banking business (Lee and Ullah, 2008, 2011). However, meeting Shariah objectives have become one of the biggest challenges to Islamic banks. Ullah (2014) discovers the lack of Shari'ah compliance in Islamic banks in Bangladesh and there is a severe Shari'ah violation especially in activities related to investment. This is due to the lack of knowledge and seriousness in Shariah compliance, lack of due care in Shariah audit and lack of competency and experience of the Shariah supervisory board members.

Given the stiff competitive environment where Islamic banks have to compete with conventional banks in terms of product innovation, the easy solution is to rely on lenient Shariah board so that Islamic banks can compete with conventional banks in the lucrative market faster. The hard way is to improve management and introduce differentiated products (based on the profit and loss sharing (PLS)) (Warde, 2000, p. 153). As evident from the above literature, many Islamic banks choose the first solution. As a result, Shariah compliance, which is the backbone of Islamic banking, has to take a back seat.

Among the main challenges facing IBs in realizing Maqasid al Shariah are (1) divergent objectives of Islamic subsidiaries and their parent conventional banks; (2) profit maximization objective of Islamic banks; and (3) the role of the branch managers. These issues will be discussed in greater detail in the subsequent sections.

Divergent Objectives of Islamic Subsidiaries and Their Parent Conventional Banks

Business objectives are based on capitalist economy as proposed by Adam Smith in his book "The Wealth of Nations". Under capitalist system, individuals are not restricted to make profits and allowed to pursue their self-interest. Built on Adam Smith's capitalist economy, the main objectives of a firm are profit maximization and increase market share. In other words, the main objective of a firm is to maximize the wealth of the shareholders who contribute capital to the firm and they expect profits in return for their investment. Shareholders appointed managers, who are the agents, to ensure the day to day operations of the firms are in line with the objectives of the firm.

The objectives of conventional banks are in line with an economic theory as proposed by Friedman (1970). As Friedman (1970) argues: the corporate executive or the manager is hired by the owners of the business and they have direct responsibility toward the owner of the business, who is their employer. They have the responsibility to carry out the business to maximize the profits for the company while conforming to the basic rules of the society (as required by the law or ethics). In line with Friedman's (1970) theory, the primary objective of the parent conventional bank is to maximize the shareholders' wealth.

On the other hand, the primary objective of establishing Islamic bank is to comply with Shariah rulings and provide benefit to society as a whole (Warde, 2000) and to protect the interest of the public (attaining maslahah[1]). In other words, the establishment of Islamic banks is religious based, while profit making is only the secondary objective of Islamic banks. The commercial aspects of Islamic banks are complementary to the religious and Shariah-based substance (Engku Rabiah Adawiah, 2013). Therefore, there are divergent objectives between the parent conventional bank and its Islamic subsidiary.

In Islamic banks, it is expected that the objectives of the managers and the Shariah board to be consistent. In other words, the main objective of both parties is too meet the requirement laid out in the Maqasid al Shariah. However, empirical evidence has shown otherwise. For instance,

[1] For detailed discussion on maslahah, please refer to Dusuki and Abdullah (2007), Lahsasna (2013) and Laldin and Furqani (2012).

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in a study by Ullah et al (2016), the following dimensions have been used to check the consistency between the objectives of the managers and Shariah board: social welfare, ethical investments, fairness and justice, philanthropy, unity principle, profiteering, secured investment and conventional reciprocity. Based on the interview results, they found that managers place moderate relevance and importance to social welfare, fairness and justice, philanthropy and unity principle. On the other hand, the Shariah board place high importance on these areas as their main objective is to earn the will of God. In terms of profit making, managers believe that profit maximization is the main reason for the establishment of Islamic banks and they are willing to forgone fairness and justice to gain high profit. In terms of secured investment, managers prefer financial instruments that are convenient, secured and provide fixed return on investments. The managers do not prefer profit sharing instruments such mudarabah and musharakah as these instruments are risky and provide uncertainty in the return on investment. To be able to compete with the conventional banks, managers of Islamic banks choose to offer products that are similar to conventional banks to meet customers' need. Shariah scholars argue that managers even ask them to find ways to make all conventional products Shariah compliant. Since the managers have more power in decision making compared to Shariah scholars, the former use several coercive strategies to influence the latter to accept minimum Shariah compliance level on matters related to Shariah.

In the case of a subsidiary of a parent conventional bank, the board of directors of the Islamic subsidiary are not independent as they have to follow directives set by the board of directors of the conventional parent bank (please refer to Figure 1). The directives will then be passed down to the branch managers of the Islamic subsidiary. At the same time, the branch managers also have to abide by the Shariah rulings passed by the Shariah authority and observed by the Shariah board of the Islamic subsidiary. As discussed above, there are divergent objectives between the parent bank's and the Islamic subsidiary's objectives, as the former is based on capitalist economy (non-Islamic) and the latter is based on Maqasid al Shariah. As a result, to ensure convergence between the parent bank's and the Islamic subsidiary's objectives, only minimal Shariah compliance would be realized by the Islamic subsidiary.

If the parent bank is conventional in nature and the subsidiary is Islamic, how could the macro Maqasid to promote competition between both types of banks be realized as the Islamic bank is the subsidiary of the parent conventional bank? Of course, the subsidiaries would not be competing with their parent banks. Instead of competing or be different from the conventional banks, Islamic banks eventually mimic conventional banks' products and practices. This is against of what Islamic banks supposed to be as argued by Dusuki and Abdullah (2014) where Islamic banks should compete with conventional banks. Therefore, Islamic banks must re-align their objective with the objective of Shariah.

Profit Maximization Objective of Islamic Banks

The main challenge faced by conventional banks in the process of conversion to Islamic banks is the compliance to the Shariah principles (Shafii, Shahimi, and Said, 2016). It has been argued that the operations of Islamic banks are similar to that of the conventional banks, except that the former has to comply to Shariah rulings (Haniff, 2011; 2014). Under the current setting, Islamic finance tries to tap profitability and efficiency from its conventional counterpart through the modification of the external structure. Modification of this type is not sufficient without changing anything in substance since the objectives of capitalist system are maintained. For instance, the present Islamic financial products are modified from their conventional counterparts to meet Islamic legal requirements (Laldin & Furqani, 2013b, p. 32-33).

According to Al-Atyat (2007) and Al-Atyat and Hakeem (2010), as cited in Ahmed and Hussainey (2015), the main reason for converting from conventional to Islamic banks is to tap on the profitability from Islamic banking as many studies have proven that Islamic banks are more profitable than their conventional counterparts (see for instance, studies by Khediri, Charfeddine, & Youssef (2015), Ramlan & Adnan (2016)). This is also consistent with the motivation of the managers to enter into Islamic banking industry is to tap on the profitability from the industry and not to meet the Shariah objectives from holistic business model (Ullah et al., 2016).

A study conducted on Islamic banks practices suggest that wealth maximisation, shariah rulings (fatwa), competitive environment, minimal risk management methods in Islamic banking triggered Islamic banks to embrace debt based financing. Islamic banks defend their practices by adopting Islamic rulings from shariah scholars in order to make them shariah compliant but not shariah based. The study concludes that Islamic bank policies and practices have diverted from the theory of Islamic banking and Islamic principles. Islamic banks' focus has been concentrated on profit maximization instead of welfare to the society (Ahmed, Akhtar, Ahmed, & Aziz, 2017).

Al-Omar and Iqbal (1999) has raised the issue on the genuineness of the operations of large multinational banks in Islamic banking industry. Their participation in Islamic banking industry is purely commercial to tap on the profitability of the Islamic banking business. Another concern is on whether conventional banks are following Shariah rulings strictly and abide by the Islamic banking rulings. It has been argued that the main factors that influence traditional bank conversion into Islamic banks are risk and profitability (Al-Alani and Yaacob, 2012).

Previous studies, as cited in Shafii, Shahimi and Saaid (2016), have proven that the environment where Islamic banks are operating side by side with conventional banks is not fully supportive for Islamic banks to completely comply to Shariah principles as these banks are based on conventional economic system (see for instance studies by Al-Oqool (2011); Al-Atyat (2007); Al-Martan (2005); Al-Omar & Iqbal, (1999); and al-Rabiaa (1989)).
Moreover, studies in the literature highlighted many challenges and barriers to a successful CB conversion into an Islamic bank model. Majority of studies (e.g., Alani & Yaacob, 2012; Al-Oqool, 2011; Al-Atyat, 2007; Al-Martan, 1999) evidenced that human resources, regulations and legislation, shari'ah compliance and Islamic banking products are the major barriers that affect the CBs conversion to Islamic banks.

Role of the Managers

According to Azid, Asutay, and Burki (2007), there are two main responsibilities of the managers in a firm. They are (1) maximizing the profit of shareholders and (2) protecting the interest of the stakeholders. Stakeholders not only include employees, customers, and suppliers but also society and the environment. Therefore, the second role is consistent with maqasid of Shariah where the activities should be beneficial to the ummah as a whole (it should cover human life and human wellbeing).

Given the state of Islamic banks which is built as a subsidiary and part of the bigger conventional entity, the managers are stuck in the middle between following the directives from the top management/board of directors or conforming with Shariah rulings as passed by the Shariah board as the main requirement as an Islamic entity.

In an Islamic subsidiary of conventional bank, the branch manager is the person who is responsible to put in place the directives set by the board of directors. At the same time, he/she must also abide by the Shariah rulings passed by the Shariah board. Since the main objective of the parent conventional bank is profit maximization (consistent with capitalist economic system) while the main objective (theoretically) of the Islamic subsidiary is to meet Shariah objectives, the manager is stuck in the middle in meeting both objectives. Since the Islamic bank is only a subsidiary of parent conventional bank, the objectives of both entities have to be converged. Thus, it has to be profit maximization.

Another main issue is the background of the managers themselves. It has been argued widely in the literature that managers of Islamic banks lack Shariah knowledge and exposure as they may come from the conventional background. The implementation of Shariah rulings needs to go through tough times if the persons who are supposed to abide by the rulings do not have clear understanding of Shariah principles.

Conclusion and Recommendations

Islamic banking and finance had been founded nearly four decades ago. However, until today, there has been many unresolved issues and the emergence of new issues that goes hand in hand with the development of Islamic finance. One of the main reasons for the unresolved issues is due to the fact that there is no clear separation between Islamic banking and conventional banking as both banking systems coexist in the same economy. Even though Malaysia is known as an Islamic banking and financial hub, there are only two full-fledged Islamic banks; Bank Islam and Bank Muammalat that exist. The rest of the Islamic banks are Islamic subsidiaries of large conventional banks.

The establishment of Islamic subsidiaries of conventional parent banks have raised many unresolved issues. This could mainly due to the divergent objectives between the parent conventional banks and their Islamic subsidiaries. The main objective of the conventional parent bank is profit maximization (maximizing the shareholders' wealth) while the main objective of the Islamic subsidiary is to comply with Shariah rulings (profit motive is only secondary). The managers who are supposed to implement and abide by the Shariah rulings have also need to follow the directives from top management that comes from the conventional parent bank. In addition, the Islamic subsidiaries are operating under the same branches with their conventional parent banks. The staff who is performing duties for conventional parent has also need to perform the duties for Islamic subsidiaries. Under such situation, conflict of interest could hardly be avoided.

Given the fact that most Islamic banks in Malaysia are subsidiaries of conventional banks and the existence of conflict of interest among the managers and staff in performing their conventional and Islamic banking tasks, the best solution could be to train the managers and staff by giving them in depth exposure and knowledge of both Islamic banking and Islamic teaching. The knowledge of Islamic economics is also important as it is based on spiritual focus, generosity, cooperation and moral leadership and training as proposed by Zaman (2015). Such knowledge could make the staff realize the importance of separating their tasks either for Islamic or conventional bank because there should exist clear distinctions between Islamic and conventional bank duties.

In conclusion, minimum Shariah compliance is not sufficient in achieving Maqasid al-Shariah. The Islamic spirit should be built in the heart of the managers and staff of Islamic banks (sincerity, honesty, truthfulness) in achieving the objectives of Islamic banks. If the managers and staff are equipped with a strong Islamic spirit and consistently aiming in achieving maximum Shariah compliance, the objective of the establishment of Islamic bank in meeting social goals including social justice, alleviation of poverty and prevention of exploitation could finally be realized.

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