

Challenges and Opportunities of Islamic Financial Institutions in Sri Lanka: With Special Reference to Ampara District

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Abstract

Nowadays, we hear about the resistance of Islamic finance to latest global financial crisis and about the continuous growth of Islamic financial institutions. Islamic banking is very popular and contains a prominent position in the financial sector of Sri Lanka but it is necessary to look the factors of its adoptability for its growth in Muslim and non-Muslim communities in Sri Lanka. The aim of this research is to find out the opportunities and challenges of Islamic banking in Sri Lanka and main challenges which are currently faced by Islamic banking in Sri Lanka. A qualitative study was carried out which involved structured questionnaire with two different groups of people such as the banking authorities and the customers of Islamic banking and conventional banking. The questionnaire was used as a research tool to measure of the fundamentals of Islamic banking, basic understanding to Muslim community, information system and the growth opportunities related to products and market development as well as opportunities and challenges in the way of Islamic banking in Sri Lanka. The research findings show that more challenges are facing by Islamic financial institutions other than the opportunities in Sri Lanka for development and growth of Islamic financial system because Muslim community is keen to take financial products and they are willing to spend their lives according to their religion. There is need to educate the Muslim community toward Islamic financial products; service providers need to improve the information system within the communities and Islamic banking institution is needed to work hard for survival and compete with conventional banking system in the sector of banking. Finally, it is concluded that Islamic banking has some challenges and opportunities in Sri Lanka but with increasing experience, with corporation of Muslim community and with proper guidance of Islamic scholars Islamic banking can be easily turned these challenges and opportunities as a key success.

Keywords: Financial institutions, Challenges, Opportunities, Islamic banking

Introduction

Sri Lanka's modern financial sector has undergone significant reforms since the early 1990s, notably to reduce the government's role as a direct financial provider. The attempt to open Islamic financial operations in Sri Lanka started in 1997; it had spread with the origination of financial institution. Today it is running with permission of Central Bank of

Sri Lanka (CBSL) in 2005-12-10, the schedule II of banking act no.30 of 1988 was amended and the permission for running Islamic financing institution in Sri Lanka was given (Annual Report of Central Bank, 2005).

Islamic banking is very popular and contains a prominent position in the financial sector of the Sri Lanka but it is necessary to look the factors of its adoptability for its growth in Muslim and non-Muslim communities in the Sri Lanka. There is also a burgeoning stock exchange. The government is taking steps to strengthen the institutional and regulatory framework for financial services. A remarkable recent evolution is the reform and reorganization of the Central Bank of Sri Lanka (CBSL).

Currently, more than 15 foreign banks have set up branches in the island nation. What is more significant is that some of these branches have been established for more than 100 years. Sri Lanka also has more than 10 local banks, including two that are state-owned (Bank of Ceylon and People's Bank). Sri Lanka is one of the few non-Islamic countries to have legislation for the Islamic banking sector. Following amendments to the Banking Act No 30 of 1988 in March 2005, there is now adequate flexibility for conventional banks to establish Islamic banking windows and launch Islamic financial products. However, efforts in strategic marketing communication to promote and raise awareness of these products are still in the infancy stage.

Research Question

The majority of the literature related to Islamic finance in the world is country related. They only examine the role of Islamic finance in a respective country according to its Muslim population. I would like to gather all these studies and give a comprehensive overview of opportunities and challenges that Islamic financial institutions (IFIs) face in Sri Lanka, The Case study of Ampara District. In the course of my research on Islamic finance, I found that Sri Lanka is the multi religious country in the Asia that has benefitted from the growth of this market. One of the reasons, which have been explained by many researchers, is the large Muslim population in country. While countries like USA, Germany, France and Spain all have relatively large Muslim population, the Islamic banking is just at the introduction stage. One problem here is non-compatibility of Islamic banking with the established financial order of these countries. The other is the limited effort of these countries to encourage the introduction of Islamic finance. The above mentioned led the researcher to following problem statement:

What are the measures IFIs must make, in order for Islamic finance to thrive and prosper in the Ampara district not only for Muslim but also non-Muslim consumers?

Objective of the research

The aim of this research is to find out the opportunities and challenges of Islamic banking in the Sri Lanka and main challenges which are currently faced by Islamic banking in the Sri Lanka generally and Ampara district especially. I divided the research questions in three different areas such as basic understanding of Islamic banking in community and in banking sector because without basic understanding it is difficult to develop this financial system, whether there is any opportunity for growth and development in the Ampara district and which kind of challenges is faced by Islamic banking. This area will cover the basic and fundamentals of Islamic banking.

Literature Review

Islamic finance is one of the most rapidly growing segment of the global financial system. It is based on ethical principal in the line with Islamic religious law. Despite its low share of financial market, Islamic finance has been one of this sector's faster growing components over the decade and has gained further momentum in the wake of the financial crisis.

Islamic Finance might be defined exactly as methods of undertaking banking and financial transactions that are in conformity with the precepts of Islamic law (Hassan & Lewis, 2007). This is common system whereby Muslim & non-muslim may benefit. As Islamic Finance is based on the Shari'ah, it has great guidelines which are common to all mankind irrespective of religion, colour, ethnicity or country. The Qur'an restates this fact as "This day I have perfected your religion for you, completed My favour upon you and have chosen for you Islam as your religion (The Holy Qur'an, Chapter.5:3). Vatican's official newspaper Osservatore Romano said in an article in its issue of March 3, 2009 "The ethical principles on which Islamic finance is based may bring banks closer to their clients and to the true spirit which should mark every financial service." The modern Islamic banking practices can be traced back from four decades ago. However, in fact many principles of Islamic banking system have been generally accepted all over the world for centuries fairly than decades. (www.islamicbanking.com). Islamic banking system is existed in Muslim society in different methods according to the era. Actually Islamic banking system has ability to fulfill the society requirements in decent way.

Islamic banking is fastest growing sector with its variety in different segments and field. It provides to Muslims as well as they are minority ethnically. In addition, it is a broad standard: non-Muslim individuals and communities that look for ethical financial solutions have also been fascinated to Islamic banking. It is clear from banking practice that Islamic banking is evenly well liked in all communities (www.hsbcamanah.com). The majority of these principles are based on simple morality and regular sense, which form the bases of many religions, including Islam. The Holy Quran absolutely mentions about prohibition of Ribah.

"Oh! ye who believe!, Eat no Ribah (usury) doubled and multiplied but fear Allah that you may be successful" (3:130). "The Messenger of Allah Prophet Muhammad (PBUH) cursed the one who takes Ribah, the one who gives (pays) Ribah, the one who records the Ribah transaction and the two witnesses thereof He said, they are all equally guilty" (Sahih Muslim). Not only in Islam, has even some other major religions including Christianity forbidden the interest. Moreover, some world's influence people warned regarding the interest. One of the important quotes is said by Thomas Jefferson third president of USA "Banking establishments are more dangerous than standing armies" (Jefferson, 1779).

An Islamic bank is an intermediary and trustee of other people's money with the difference that it shares profit and loss with its depositors. In practice the most Islamic banks have an organizational set-up very coordinated and similar to their conventional counterpart banks (Dar and Presley, 2000). "Islamic banking is remarkably profitable because, although its underlying funding mechanism is the same as conventional banking, its default experience is better, and its charges higher and less transparent" (Cook, 2006).

“Sri Lanka is the only South Asian country that has dual banking in the region, providing the momentum to the Islamic financial industry not only within the country but also within the region. Sri Lanka will be one of the top Islamic finance players globally within next 15 years. The number of Shari’ah-complaint companies during the past 15 years increased from 10 companies to 35 companies at present, which is significant for an industry that has less than 10 percent of Muslim population in the country” said by Ariff Sultan (Ideal Rating Regional Director-Asia)

This statement is proved by the following statistics; Islamic financial market has an estimated market of around Rs.300 billion and with the operation of a fully fledged bank, current four commercial licensed banks, four finance companies and other institutions. Sri Lanka’s total deposit base is nearly Rs.35 billion and total loan base is Rs.24.8 billion (www.dailynews.lk/business). All the researches regarding Islamic financial institutions, scholarly articles and books have contributed to this literature review accordingly. These studies mostly are carried out based on challenges of the Islamic financial institution. A few of them are related to the challenges and opportunities. But, the all reviewed literatures did not try to penetrate the challenges and opportunities of Islamic financial institutions in Sri Lanka. Therefore, this research aims to fulfill the research gap existing in the academic field.

Methodology

There is main research model namely; descriptive analysis approach has used for this study. The data was collected from two different perspective such as banking authority perspective and customer perspective by issuing the structured questionnaire. The collected data were entered in SPSS 16.0 version. The following analyses were conducted for relevant descriptive statistics (Frequency distribution, bar charts, graphs and crosstabs). The following important questions were included in the questionnaire, which were distributed among the banking professionals.

- What is Islamic banking?
- What is the difference between Islamic banking and conventional banking?
- How are you treating the interest and profit sharing factors under Islamic banking system?
- What are you offering other than conventional banking to retain the customers?
- What is the role of Islamic banking for the development and growth of Sri Lankan economy in Ampara District?
- Do you face any challenges and opportunities in this region?

The following important questions were included in the questionnaire, which were distributed among the customers.

- What do you mean by Islamic banking?
- If so, what is the difference between Islamic and conventional banking?
- How do you feel the interest and profit sharing factors under Islamic banking system?
- What are you expecting from the Islamic banking other than conventional banking?

- What is the role of Islamic banking for the development and growth of Sri Lankan economy in the Ampara district?
- Are you satisfied with the work of Islamic banking? If not why is that?

This research was carried out based on Ampara district in Sri Lanka because growing population of Muslims community is playing positive role for the Sri Lankan economy. Actually most of the Muslims want to spend their lives according to their faith. In this research it was examined that what were the opportunities and problems facing by Islamic financial institutions in Ampara district. Therefore, this study has used the qualitative method for evaluating and analyzing the situation of Islamic financial institutions in the study area consequently.

The study location was fifty respondents from five banks and their selected fifteen branches which are providing Islamic banking service in Ampara district such as Amana PLC, Bank of Ceylon (An Noor), HNB (Al Najah), Commercial bank (Al Adalah) and Lanka Orix Finance (Al Falah).

Table:1 Sample structure

Bank	Professionals	Account Holders
Amana PLC	15	17
Bank of Ceylon (An-Noor)	10	10
HNB (Al-Najah)	8	9
Commercial Bank (Al-Adalah)	7	6
LOF (Al-Falah)	10	8
Total	50	50

Source: Survey data

Sample size out of fifteen bank branches fifty bank professionals (Manager, Assistant manager, Executive officers, etc) were interviewed and their answer collected through by issuing the questionnaire.

Random sampling of professionals of each institution was interviewed to record their opinion about the challenges and opportunities. Finding of the study were consulted with the available literature and executives of the banks to confirm their reliability and acceptability. For the collection of primary data the study has used the method of structured questionnaire. The plan was issued the two different sample groups.

Discussion and Findings

The background data and other information collected about the sample would be presented in this chapter. As mentioned in previous chapter the sample was taken from 50 Islamic financial institutions' professionals (Manager, Assistant Manager, Executive officer, etc...) and selected 50 individuals who are holding accounts in Islamic banks as well as conventional banks by random sampling method. Even though the title was Islamic

financial Institution but the sampling was taken from the Islamic banking because of the Islamic financial institution mostly considered as Islamic banks. The following data was analyzed based on customer perspective.

Among the 50 respondents 20% of them were non Muslims and 80% of them were Muslims which was shown as figure 4.2

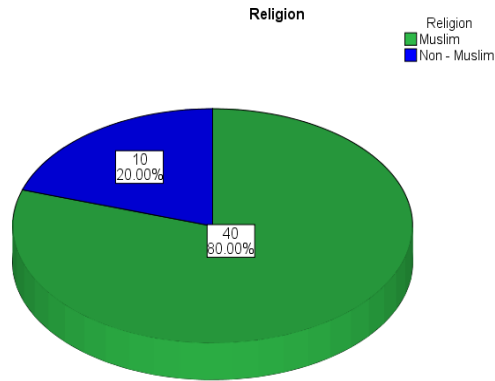


Figure: 1 Religions
Source: Survey data

The respondents maintaining account details are shown as below pie chart.

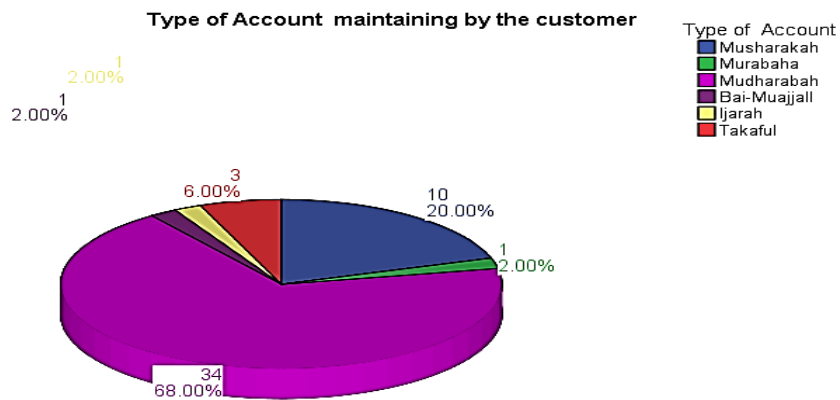


Figure: 2 Type of Account
Source: Survey data

68% of the respondents are maintaining Mudharakah and 20% of the respondents are maintaining Musharakah. Most of the respondents were think that as conventional banks have the simplified banking system.

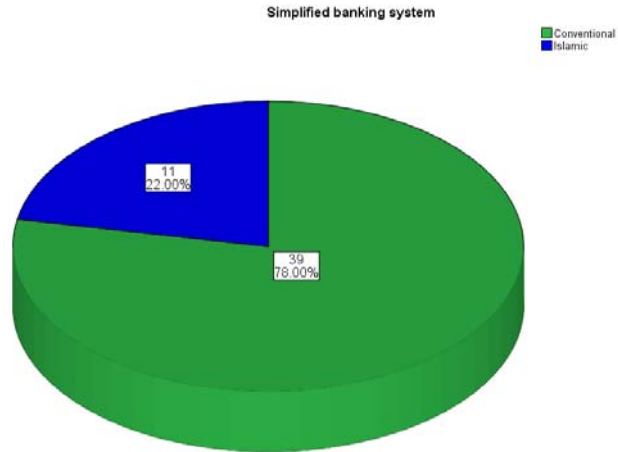


Figure: 3 Simplified banking
Source: Survey data

54% of the total respondents did not have enough idea about the Islamic banking products; it is shown by the below bar chart. 56% of the customers were not satisfied with the current Islamic banking system and 44% of the respondents satisfied with the current system.

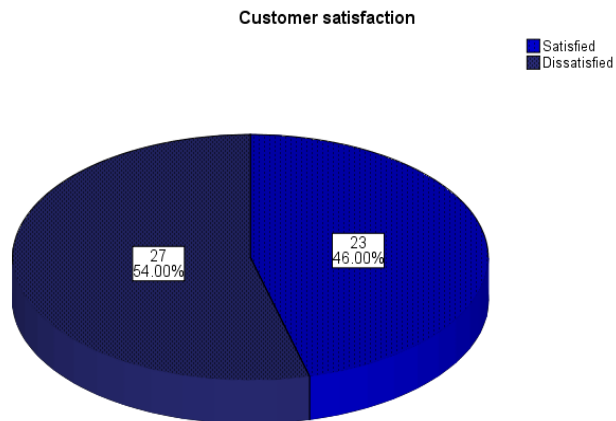


Figure: 5 Customer satisfactions
Source: Survey data

The below table depicted that among the 23 satisfied customers 7 of them were non-Muslims and 16 customers were Muslims.

Data presentation based on banking professional perspective

The bank professionals strongly believed that around 86% of their customers were satisfied with the current Islamic banking services and products and 14% of their customers were not satisfied with their current system.



Figure: 6 Customer satisfactions.

Source: Survey data

From the survey the following challenges were identified by the researcher and around 83% bank professional felt that lack of Shari'ah knowledge and awareness to customer was the significant challenge face by the Islamic banks.

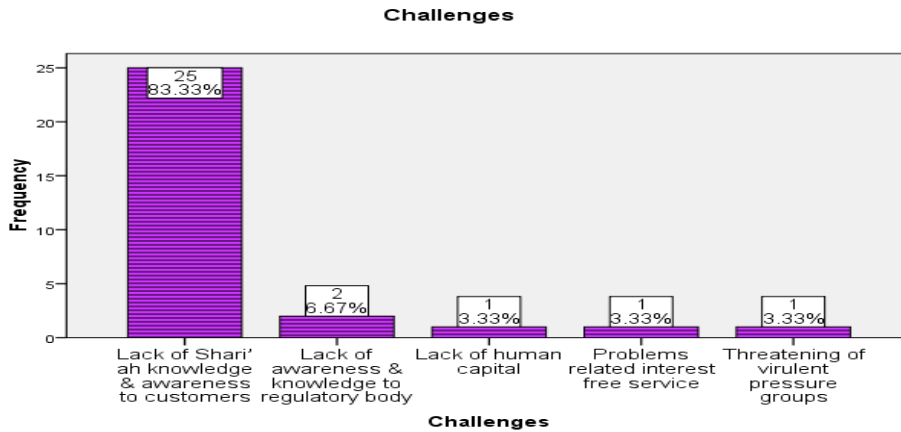


Figure: 7 Challenges

Source: Survey data

From the survey the following opportunities were identified by the researcher and around 83% bank professional felt that lack of Shari'ah knowledge and awareness to customer was the significant challenge face by the Islamic banks.

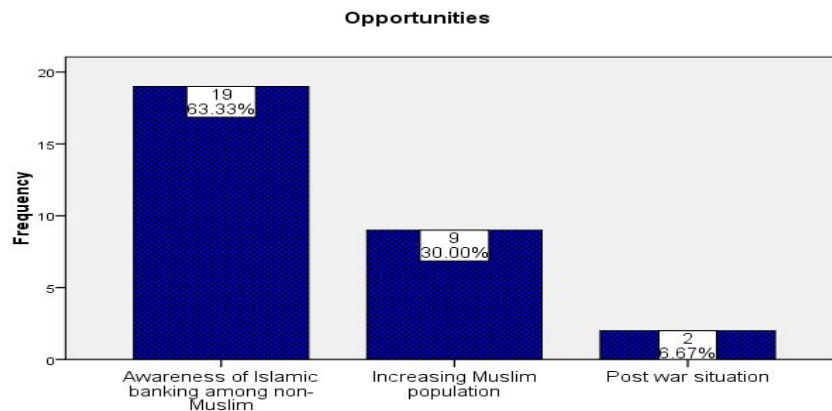


Figure: 8 Opportunities

Source: Survey data

Challenges facing by the Islamic Financial Institution in Ampara district

Sri Lanka as a non-Muslim country Islamic banking industry is gaining numerous success yet facing some challenges. It has a long way to go. Most of the Sri Lankan Muslims do not understand what Islamic banking actually is. CBSL act as financial advisor to the government because of the regulation and supervision of Islamic banking is done by conventional banking rules. Bankers and customers have lack of knowledge about Shari'ah compliant products.

1. Lack of Shari'ah knowledge:

Initially Muslim and non-Muslim bankers trained in conventional banking were engaged into Islamic banks. They were conveyed in their banking knowledge and expertise, but were inhibited by the fact that their knowledge of FiqhulMuamalah was minimal. They therefore had to discover the new rules. This need was fulfilled largely by Shari'ahscholars who provided them the religious backing and the conceptual framework to work in and agreed to sit in their newly constituted SSBs. Today many Islamic bankers are extremely opposed to taking risks and taking Islamic banking forward to what it really should be. Hence, there is an urgent need for training Islamic bankers in the Shari'ahaspects transactions (Marikkar, 2006).

Most of the Muslims and few non-Muslims deal with Islamic banks to take its benefits. They do not have more knowledge and understanding about the Islamic Commercial Ethics or Islamic principles regarding the business dealings and transactions. Most of the customers having the perception of that their banking transaction equal to conventional banking system. Their activities are only occurring equal to Shari'ahrules and regulations. There is another barrier for the better understanding of Islamic banking transaction or

modern Islamic banking products, which includes the latest Shari'ah compliant developments transactions. These are simply discussed and practiced at higher level only or people those who read and understand the global language English, they do understand since they have the access to various publications regarding the Islamic banking products and other information

2. Lack of Human Capital:

One of the major obstacles for the development of the Islamic banking industry, at present in Sri Lanka is the scarcity of trained and qualified human resources. They are the main factors for any successful ventures where they are always trained human resources add value to the industry. Trained labor forces are minimum dues to lack of educated Muslim population in Sri Lanka (Hajara, 2011).

3. Lack of women employees:

Many of the Islamic financial institutions that are in operation in Ampara District have full of male employees and do not have adequate female representation as employees in their institutions to cater to the needs of women in the area. Therefore, these institutions have hard times in appealing to the women's needs in terms of banking services, such as savings, investment, current account, leasing, insurance, etc. And other challenges are as follows;

- Threatening of virulent pressure groups
- Threatening campaign of other traditional banks
- Increasing numbers of competitive banks

Opportunities facing by the Islamic Financial Institution in Ampara district

The strong performance of the Islamic financial Institutions after war situation the financial crisis has full-fledged the interest of investment community, consumers and intermediaries investors around the Sri Lanka and is increasingly gaining ground in western countries. Majority of the conventional banks have opened Islamic financing windows in the Ampara district. Despite the regulatory hurdles presented by operating in a non-Muslim financial environment Islamic financial Institutions have experienced double digit growth also in this region. The growth of Islamic finance partly reflects demand from Muslim minority communities residing in this area, but also non-Muslim population of this region is increasingly using Islamic financial Institutions as a viable alternative to the Conventional financial institutions.

Post war situations

The end of the three decade civil conflict Sri Lanka banking industry is growing rapidly in East part of the region. The peaceful situation drives the people to trade, marketing and business thoughts. Due to the peaceful environment number of banks undertake their financial procedures through Islamic financial organizations especially in the eastern province Ampara District. Most of the business person and merchants are Muslims. And also they eager to do all their money transactions through the Islamic financing institutions. Because of the post war situations creates huge opportunities to continue the affairs successfully in this era.

Increasing Muslim population

Recent decades of the population of Muslims has been dramatically increased in Ampara district. The needs and wants of the community are going to the highest situation in the Ampara district. According to the population density and the expectation of the people number of Islamic financial institutions were founded and also they have been experiencing a successful path.

Awareness of Islamic banking among non Muslim

Awareness among the non Muslims in the Ampara district in the Islamic financial system is in good level. Not only the Muslims but also the non Muslims are interested in those systems. As noted by Dr. Weeremanthir the Islamic banking systems are attracting the non Muslims by the work of Shari'ah. They eager to get to know about it and like to keep in connected with the Islamic financial institutions. They strongly believe that there is no gambling in the Islamic banking industry. They consider the Islamic financial institutions will decrease the stress from interest (Hameed Abdul Karim).

Growth of religious thoughts

Aftermath of the tsunami in Sri Lanka lot of people turn on their path towards the religious base they concern all of their activities and efforts should be the Islamic religious boundary so they seek for a chance to obtain their financial matters as Halal. In this era Islamic financing institutions pick up a mass level of preference.

Literate population of Ampara district

The highly literate population of Ampara district is also an indictable opportunity to the Islamic financial institution. Scholars who are diplomatic in the financial field often try to serve their community through successful and innovative means as per their wish assist to found Islamic financing institutions. Investment friendly regulations of the Islamic financial institutions prop up business confidence and developed secured transactions. Such of these services play most important and peaceable conditions.

Infrastructure developments:

Rapid infrastructure developments are attracted the investors look at favorably. The nation is that identified as Islamic state and other, willing to invest more in the east and north. Recent statics states that Eastern part of the nation has a big economic growth and also high infrastructure facilities. New development projects tend new employment opportunities in all the sectors. This is giving a flow on open investment.

Conclusions and Recommendations

Islamic banking is a very young concept. Yet it has already been implemented as the only system in some Muslim countries; there are Islamic banks in many Muslim countries and a few in non-Muslim countries as well. Despite the successful acceptance there are problems. These problems are mainly in the area of financing. Such a system will offer an effective banking system where Islamic banking is obligatory and a powerful alternative to conventional banking where both co-exist. Additionally, such a system will have no problem in obtaining authorization to operate in non-Muslim countries.

Finally, it is concluded that Islamic banking has some challenges and opportunities in Sri Lanka but with increasing experience, with corporation of Muslim community and with

proper guidance of Islamic scholars Islamic banking can be easily turned these challenges and opportunities as a key success.

The following are some recommendations that can be of significant use to the Islamic banks operating in Ampara district, if applied or followed in a proper manner.

- Since the Islamic banks in Ampara district are devoid of women employees in their banks that hamper the presence of Muslim women for their financial dealings, it is highly recommended to recruit women employees to attract Muslim women in the area.
- Islamic banks are strongly recommended to reach out to the popular level/village level to enlighten them on the significance of Islamic banking sectors.
- More accomplished and qualified individuals equipped with Islamic banking concepts, theories, and practices should be employed in the institutions.
- Maintain close relationship with firms, schools, departments and authorities to promote the product.
- Advices or suggestions can be sought from the expert in Islamic banking not only in the local level, but in the foreign level as well.
- Efficiency and effectiveness should be expedited in the banks so that the customers, mostly Muslims, may transfer their accounts and dealings from the conventional banks to Islamic banks.
- Awareness programs should be done to the Ulama and mosque trustee in the area by the Islamic banks about product and the Shari'ah banking system.
- Introduce and implement the on line services in the Islamic banking sector to beat the conventional banking competitive advantage.
- Establish and invest in corporate social responsibility related projects to attract new customers.
- Have to maintain a collaborative relation with other banking networks

The research attempted to describe the challenges and opportunities of Islamic financial institutions in Sri Lanka into customer perspective as well as banking professional perspective. Future researches may find these variables and find the relationship with some dependent variables such as financial performance, business success and etc.

The particular research was conducted in Ampara district by considering the available Islamic banking institutions only such as Amana PLC, Bank of Ceylon (An Noor), HNB (Al Najah), Commercial bank (Al Adalah) and Lanka Orix Finance (Al Falah). Since sample size is less there is a generalizable issue in the conclusion part. It is better to spread out the geographical research area as island wide and we can improve the findings and conclusion.

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