

ASSESSING THE CHANGE OF CONVENTIONAL BANKING TO ISLAMIC BANKING

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ABSTRACT

Due to the differences between conventional and Islamic banks, switching from conventional to Islamic banking entails major modifications. Actually, the lack of a thorough structure for the conversion process is causing conventional banks to face a number of challenges. Compliance with shari'ah, conversion resistance, human resources, Islamic financial products, and rules and laws are a few notable barriers. This essay explores the idea of conversion while highlighting the difficulties and barriers encountered throughout the transition to Islamic finance. As a result, this article highlighted some crucial elements that can compromise the conversion process's success. This research outlined the problems from the literature related with the conversion process and the driving forces behind conventional banks' conversion to Islamic banks in order to explore important barrier elements. The primary goal of this research is to better understand the factors that affect the conversion of conventional banks to Islamic banks and the driving forces behind this process. According to the report, the conversion procedure should be viewed as a comprehensive process including every element of the financial and economic system.

Keywords: Conventional banks, Interest based bank, Islamic banks, Driving forces, GCC.

INTRODUCTION

Background

In Muslim nations, particularly those in the Gulf Cooperation Council (GCC), the trend of converting conventional banks (CBs) to Islamic banking systems has been gaining popularity. However, due to structural differences, transitioning from conventional to Islamic banking involves major modifications. The lack of a thorough structure for this conversion process presents CBs with significant challenges.

Problem statement

A major obstacle is the lack of a comprehensive structure for the process of converting regular banks to Islamic banks. Additionally, there is a dearth of information on the variables affecting conversion process performance, which makes it difficult for conventional banks to convert to Islamic banks.

Research questions

1. What are the factors that influence the success of the conversion process from conventional banks to Islamic banks, and what are the motivations for this process?
2. What are the major obstacles that conventional banks face when converting to Islamic banking, and how can these obstacles be overcome?
3. What are the key components of a successful conversion process from conventional banking to Islamic banking, and what steps can be taken to ensure that the process is effective?

Research objective

The objective of this study is to investigate the factors that influence the success of the conversion process from conventional banks to Islamic banks and the motivations for this process.

Importance of the study

This project provides a thorough overview of the literature on the conversion process to Islamic banking and sheds light on certain key elements that may undermine the conversion process's success Ahmad, W. (2008) Aziz, M. R. A., Johari, F., & Abdalla, M. A. (2015). As a helpful checklist for Islamic banking academics and leaders in their effort to assess the conversion process from conventional banks to Islamic banking, it also offers suggestions for overcoming these barriers.

Scope of the study

This study takes into account the transition from conventional banks to fully functional Islamic banks. The Shariah board of accounting and auditing organization for Islamic financial institutions (AAOIFI) Al-Rabia, S. (2012) Hassan Al-Tamimi, H. A has approved its adherence to certain standards and regulations.

Organization of article

The background, problem statement, research question, research purpose, importance of the study, scope of the study, and key terms are all presented in the introduction to this article. A review of the literature on conversion motivations is presented in section two. The conversion tendencies in various nations are explained in section three. The study's weaknesses are listed in section 4 Canning, J., & Found, P. A. (2015). Section five concludes with suggestions and a summary of the study.

Islamic banks differ from normal banks in that they follow shari'ah compliance regulations and standards Majid, M. Z. A., & Ghazal, R. (2012). This distinctive quality boosts client confidence and draws customers to use Islamic banks. According to Mohd. Zamil (2014) Al-Salem, F. H. (2009), shari'ah principles exclusively control Islamic banking and finance. As a result, it is anticipated that all activities carried out by Islamic banks adhere to these regulations

with the ultimate purpose of advancing shari'ah goals (maqasid al-shar'ih) Ashraf, S. H., & Giashi, A. A. (2011). Devout muslims who want to conduct banking transactions that adhere to shari'ah laws must fulfil this important criteria. By emphasizing that the main distinction between islamic banks and conventional banks is the former's rigorous commitment to islamic rules, kahf (2004) provides support for this claim.

Islamic banks have a noteworthy weakness in the delayed development of financial products, which makes it difficult to innovate shari'ah-compliant goods and services Al-Omar, F. A., & Iqbal, M. (1999). This restriction on islamic banking products is thought to be a key barrier that conventional banks as well as islamic banks must overcome in order to offer or convert to islamic banking goods and services (mustafa, 2006) Alani, F. S., & Yaacob, H. (2012). The global development of shari'ah- compliant banking products has advanced significantly, although the system is still in its infancy. Although pls modes like mudaraba and musharaka are included in the theoretical framework of islamic banks, these products are rarely used in actual operations (karbhari et al., 2004) Arshad, M., Aslam, S., Razi, A, et al. (2011).

REVIEW LITERATURE

Introduction

This article's literature analysis offers a thorough summary of the elements affecting the effectiveness of the transition from conventional banks to Islamic banks Rahman, N. M. N. A., & Shahid, S. (2009). It emphasizes the difficulties and barriers encountered throughout the conversion process as well as the reasons driving conventional banks to convert to Islamic banks

Overview

The essay analyses earlier research on conversion reasons and offers suggestions for removing barriers. From the literature, which included research articles, previous survey results, and notions, the researchers drew an outline of the problems associated with the conversion process. The study's primary goal is to look at the elements that affect the conversion of conventional banks to Islamic banks and the reasons for this conversion.

Theory Review

The article makes use of a number of theoretical ideas, including Shari'ah compliance, resistance to change, human resources, and rules and laws, but it does not clearly link to any one theory

Details about Dependent Variable

The article "Assessing the change of Conventional Banking to Islamic Banking" discusses the factors that influence the success of the conversion process from conventional banks to Islamic banks. The dependent variable in this study is the success of the conversion process, which is measured based on whether or not the conventional bank is able to fully convert to the Islamic banking model. The authors do not provide a specific operationalization or measurement of success, but it can be inferred that success is achieved when a conventional bank is able to comply with Shariah principles and offer Islamic financial products. The study aims to investigate the factors that influence this success, including Shariah compliance, resistance to conversion, human resources, Islamic financial products, and regulations and legislations. The authors also explore the motivations for conversion, which can be considered another dependent variable, and include factors such as increased profitability of Islamic banking products, maintenance of existing customers, and attraction of new customers Al-Atyat, Y. (2007)..

Main Variables

The primary independent variables in this study include the reasons for and barriers to conversion, such as

1. Adherence to Shari'ah,
2. opposition to conversion,
3. human resources,
4. Islamic financial products,
5. Laws and regulations.
6. Success in the conversion procedure is the dependent variable.

Theoretical Framework

We propose that the conversion procedure be seen as a whole process including all elements of the financial and economic system. The format for financial statements recommended by AAOIFI in general and Shari'ah standard number 6 (conversion standard) in particular should be used by conventional banks that want to convert to Islamic banks.

Hypothesis Development

Based on our findings, two possible hypotheses that can be developed are Hypothesis 1: Conventional banks are motivated to convert to Islamic banking primarily due to the potential for increased profitability and compliance with Shariah principles.

Hypothesis 2: The conversion process from conventional banks to Islamic banks is hindered by obstacles such as the lack of a comprehensive framework, resistance to conversion, challenges related to Shariah compliance, human resource issues, and regulatory and legislative barriers.

Conclusion of Literature Review

In order to evaluate the process of switching from conventional banks to Islamic banks, academics and leaders in Islamic banking can use the literature study in this article, which offers a thorough and integrative critical literature assessment. The study's primary goal is to look at the elements that affect the conversion of conventional banks to Islamic banks and the reasons for this conversion.

METHODOLOGY

Introduction of Methodology

The methodology section of the research outlines the overall approach and procedures used to conduct the study. It provides a detailed explanation of the research design, data collection methods, sampling technique, data analysis techniques, and ethical considerations.

Research Design

The research design refers to the overall plan or strategy adopted to address the research objectives. In this study, the research design used is ratio analysis (t-test) on the data extracted from the bank Scope database of five banks operating in the Gulf Cooperation Council (GCC) countries.

Research Area

The research area refers to the geographical location or specific context in which the study was conducted. In this case, the research area is the Gulf Cooperation Council (GCC) countries.

Research Approach

The research approach refers to the general perspective or methodological stance adopted to carry out the research. The approach used in this study is quantitative, as it involves the analysis of numerical data obtained from the bank Scope database.

Sampling Design

The sampling design refers to the procedure used to select the sample for the study. The specific details of the sampling design are not mentioned in the provided content of the research.

Population and Sample Size

The population refers to the entire group of interest from which the sample is drawn, while the sample size refers to the number of participants or units included in the study. The details regarding the population and sample size are not provided in the given content

Unit of Analysis

The unit of analysis refers to the level of aggregation or the specific entities that are the focus of the study. In this research, the unit of analysis is the converted banks in the Gulf Cooperation Council (GCC) countries.

Data Collection and Procedure

The data collection and procedure section explains how the data was collected for the study. The specific details of the data collection method and procedure are not mentioned in the given content.

Questionnaire Development

The questionnaire development refers to the process of designing and constructing the questionnaire used to collect data from participants. The details regarding the questionnaire development are not provided in the given content.

Item Generation

Item generation refers to the process of generating the specific questions or items included in the questionnaire. The content does not provide information about the number of questions or the specific items included in the questionnaire

Variables

Variables are the concepts or phenomena that are measured or observed in the study. The content does not provide specific details about the variables examined in the research.

Validity

Validity refers to the extent to which a research study measures what it intends to measure. The content does not provide information about the validity of the research measures.

Research Instruments

Research instruments refer to the tools or techniques used to collect data in the study. The specific research instruments or techniques used in this research are not mentioned in the provided content.

Data Analysis

The data analysis section explains the statistical or analytical methods used to analyze the collected data. The specific details of the data analysis techniques are not mentioned in the given content.

Data Error

The data error section discusses the potential errors or limitations associated with the collected data. The content does not provide information about data errors or limitations.

Ethical Consideration

The ethical consideration section addresses the ethical issues and safeguards taken to ensure the rights and well-being of the participants. The content does not provide information about the ethical considerations of the study.

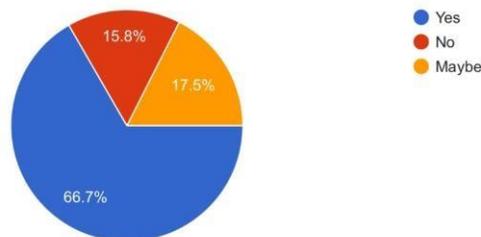
Conclusion

The conclusion section of the methodology summarizes the overall approach and procedures used in the study. However, the content does not provide a specific conclusion for the methodology section.

RESULTS AND DISCUSSION

During the questionnaire in which 57 people participated, it was asked whether the person is well-versed in Islamic Banking and finance or not. The percentages 66.7% said yes, and 17.5% said maybe. In us, the rest of the participants, who accounted for 15.8%, they answered with no, as shown in fig 1

Do you know what Islamic banking is ?
57 responses



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Figure 1
QUESTION 1 RESPONSE

Another question was posed to the participants asking how long have you been hearing about Islamic banking? 54.4% of the participants responded that they hear about it from a long time, followed by 33.3% who said Moderate, and 12.3% of the respondents said that the just hear about it short time ago, as shown in fig 2.

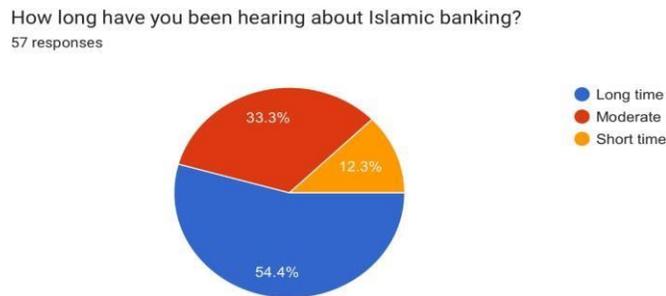


Figure 2
QUESTION 2 RESPONSE

The primary difference between Islamic banking and conventional banking that participants were questioned about, and the vast majority (61.4%) responded with the correct answer which is the use of interest, while 29.8% of the participants said that it is investment with non-permissible industries and 7%% answered that it is securitization of assets , as shown in fig 3.

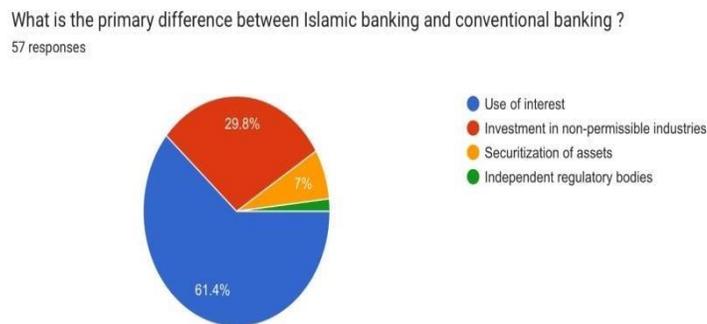


Figure 3
QUESTION 3 RESPONSE

CONCLUSION

In conclusion, the research titled "Assessing the change of Conventional Banking to Islamic Banking." explores the impact of the conversion process on the operations of Islamic banks. The study focuses on five banks operating in the Gulf Cooperation Council (GCC) countries and employs ratio analysis (t-test) as the analytical method.

The findings of the study indicate that the conversion from conventional to Islamic banking has resulted in improvements in the performance and financial position of the converted banks. There have been significant increases in assets, deposits, equity, and net income. However, it is worth noting that the profitability, efficiency, asset quality, liquidity, and risk indicators of the converted banks did not show significant improvement Al-Rabia, S. (1989).

The dichotomy between the positive effects on certain aspects and the lack of improvement in others could be attributed to the management's inability to effectively utilize the banks' funds to align performance with the growth in assets and income. This highlights the importance of considering the conversion method and the competencies of the banks' management prior to the conversion process.

The research also discusses different conversion approaches, namely full-fledged conversion, partial transformation, and gradual transformation. Each approach has its advantages and disadvantages, and the choice of method can significantly impact the success of the conversion process.

The motivations behind bank conversion vary, including profitability, cultural and religious beliefs, and political factors. Islamic banks have demonstrated profitability, and attracting new customers who prefer Shariah-compliant products has been a common motivation. Additionally, the religious prohibition of *riba* (interest) and the belief that engaging in *riba* is a sin have influenced banks to convert to Islamic banking Khatun, M. (2013). Political considerations have also played a role in some instances.

Overall, the research highlights the importance of addressing the lack of a comprehensive framework for the conversion process in the Islamic finance industry. It provides insights into the effect of conversion on Islamic banks and offers recommendations for overcoming obstacles and improving the conversion process.

FINDINGS

The research study's findings about the Islamic financial system and traditional banking can be summed up as follows: The study attempted to contrast Islamic banking with traditional banking in terms of profitability, efficiency, and liquidity. Significant disparities between the two types of banking in terms of the variables under research were discovered through the analysis of

secondary data from banks in each sector. The survey also discovered that, between 2013 and 2017, return on assets had a stronger impact on customer trust in Islamic banks than in conventional banks. The study also looked at critical elements crucial to the development of Islamic banking.

RECOMMENDATIONS

On the basis of the study's findings, the following suggestions can be made:

1. Islamic banks should emphasize the value of client trust while focusing on utilising their comparative advantage of not charging interest.
2. To meet the growing demand for interest-free banking, conventional banks can look into the introduction of Islamic banking products.
3. By enacting supportive legislation and frameworks, regulators and policymakers should foster a climate that is favourable for the expansion of Islamic banking.

FUTURE RESEARCH

Future studies in this field could go more deeply into particular topics including risk management, consumer preferences, and the effect of Islamic banking on economic growth. The effectiveness of Islamic banking in various nations and locations can be further explored, here are some potential areas for future research in this field

1. In-depth analysis of the obstacles faced by conventional banks during the conversion process to Islamic banking and strategies to overcome them.
2. Examination of the impact of regulatory frameworks and legislations on the conversion process and the performance of Islamic banks.
3. Comparative studies between countries or regions that have experienced successful conversions to Islamic banking and those that have not, to identify key factors influencing the success of the conversion process.
4. Investigation of the role of human resources development and training programs in facilitating the conversion process and ensuring the competence of staff in Islamic banking operations.
5. Exploration of the motivations and preferences of customers in choosing Islamic banking products and services, and their impact on the growth and sustainability of Islamic banks.
6. Analysis of the financial performance and profitability of converted Islamic banks compared to their conventional counterparts.
7. Evaluation of the effectiveness of Shari'ah standards and guidelines, such as those provided by AAOIFI, in facilitating the conversion process and ensuring compliance with Islamic principles.
8. Examination of the challenges and opportunities for Islamic banking in non-Muslim majority countries and the potential for conversions in those contexts.

9. Investigation of the role of technology and digitalization in facilitating the conversion process and enhancing the efficiency of Islamic banking operations.
10. Longitudinal studies tracking the progress and development of converted Islamic banks over time to assess their sustainability and long-term impact.
11. These are just a few potential avenues for future research based on the topic of conversion from conventional banks to Islamic banks.

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