

## HADĪTH SCHOLARS' EFFORTS IN FACING FABRICATION OF HADĪTH

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### ABSTRACT

*Since the demise of the Prophet Muhammad ﷺ, the Companions and the following generations paid great attention to preserving the Dīn. These efforts started with the compilation of the Qur'ān during the reign of Abu Bakr رضي الله عنه. Later, more efforts were exerted across generations in the compilation of the Sunnah of the Prophet Muhammad ﷺ to preserve it from mistakes and lies. False reports were made and related to the Prophet Muhammad ﷺ for several reasons; however, scholars exerted efforts to stop the dissemination of those fabrications by writing compilations about fabricators' names, fabricated ḥadīths, and common unauthentic ḥadīths. Furthermore, scholars developed rules and methodologies to identify fabricated ḥadīths and to scrutinize the text and chain of narrators of ḥadīths. In this paper, some of these efforts are highlighted, some examples of the books written for this purpose are mentioned, and some of the rules stated by these scholars are listed. This study was made using library research and content descriptive analysis methods for the information obtained from published books and papers. The study has shown that tremendous efforts were made to resist fabrications and to expose fabricators since the third century AH, and these efforts resulted in extensive and comprehensive compilations about fabricators and fabricated ḥadīths as well as the development of other fields of Islamic sciences such as 'ilmu al-Jarḥi wat-Ta'dīl and 'ilmu at-Tārīkh. These efforts should be brought to light in our contemporary time in which some voices claim once again that the Sunnah of the Prophet Muhammad ﷺ is not authentic or cannot be considered as a reliable source of law.*

**KEYWORDS:** ḥadīths, Sunnah, fabrications, Prophetic traditions, scholars' efforts, criticism.

## 1. INTRODUCTION

*Wadʿ* lexically means to put something down, to leave it, or to fabricate it. Technically, as a terminology in the ḥadīth sciences, *wadʿ* means to falsely and intentionally ascribe sayings, acts, approvals, or descriptions to the Prophet Muhammad ﷺ (Al-ʿAnzī, 2021). Fabrication is prohibited and a major sin in Islam. It also guarantees a seat in the Fire for the fabricator. Abū Hurayrah ؓ narrated that the Prophet Muhammad ﷺ said: *“Whoever lies upon me intentionally, then let him take his seat in the Fire”*<sup>1</sup>. The scholars of ḥadīth agreed about the prohibition of narrating fabricated ḥadīths if the narrator is aware of the fabrication, except in the case of exposing the fabrication of the ḥadīth. This ruling is general, whether the fabricated ḥadīth belongs to the category of the Islamic rulings (*aḥkām*), stories (*qaṣāṣ*), or virtues of deeds (*at-targhīb*) (Al-ʿAnzī, 2021). Samurah ibn Jundub ؓ narrated that the Prophet Muhammad ﷺ said: *“Whoever narrates a ḥadīth from me, and he knows that it is a lie, he is one of the liars”*<sup>2</sup>.

The fabrication of ḥadīth started in the first century AH after the murder of ʿUthmān ؓ, but spread widely in the second century, after the era of the Companions (*Ṣaḥābah*) and the first generation of Followers (*Tābiʿīn*). Any fabrication during the first century could be easily detected due to the large number of the memorizers and the scholars of ḥadīth during that time. Reasons for fabrication included attempts to harm the Islamic faith, political disputes, disputes between the different schools of Islamic creed (*ʿaqīdah*), disputes between the different schools of Islamic jurisprudence (*fiqh*), bias and fanaticism towards a race, tribe, language, or a city; attempts to please Caliphs and rulers of states, telling stories and exhortations especially for providing incentives (*targhīb*) and apprehension (*tarhīb*), and for personal motives (Al-Ḥayyāwī, 1413 AH; Al-Maṭʿanī, 1999; Ghaffār, 1404 AH).

Due to the aforementioned reasons, the field of ḥadīth criticism was developed by early scholars to distinguish authentic from unauthentic and forged ḥadīths. The term authentic means a ḥadīth that is attributed to the Prophet Muhammad ﷺ, and hence, it can be used in all aspects of Sharīʿah. Duderija (2009) discussed the concept of an authentic ḥadīth and presented a chronological analysis of the development of ḥadīth literature. If the ḥadīth is unauthentic, scholars debated on the extent of using such ḥadīths. In that perspective, Brown (2011) studied the opinions of ḥadīth

<sup>1</sup>Sahih Al-Bukhari, 1291; and Sahih Muslim, 3.

<sup>2</sup>Musnad Ahmad, 18184 (30/121, 122) from the way of Al-Mughīrah ibn Shuʿbah, and the grade is authentic/Sahīh.

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scholars on the use of unauthentic and fabricated ḥadīths from the third century (AH) to the contemporary era.

Ḥadīth critics have developed rules and standards for ḥadīth criticism. Abul ‘Abbās (2017) studied the early ḥadīth criticism standards as established by Imām ash-Shāfi‘ī (d. 204 AH) and Imām Muslim (d. 261 AH) in their writings and highlighted the common points and the minor differences in their principles. Another debate was made about ḥadīth criticism: is it mainly concerned with the chain of narration (*isnād*) or is the text (*matn*) also included? In response to that, Brown (2008, 2012) paid great attention to *matn* criticism in his research. He focused on the works of the third and fourth centuries (AH) to prove that early critics did both *matn* and *isnād* criticism. Also, Al-‘Alwānī (2017) discussed *matn* and *isnād* criticism and presented 19 criteria for *matn* criticism. This paper discusses further important signs of fabrication in *matn* and *isnād* and provides an analytical discourse and descriptive analysis of the efforts made by scholars in protecting the *Sunnah* from the forged ḥadīths through secondary research. This paper provides the reader with a summary of the scholars’ efforts that is brief in size but comprehensive in scope, which may help in understanding that the authenticity of *Sunnah* must not be doubted. The paper proves that fabrication is a fact that the scholars acknowledged, but also proves that they tackled it in several ways.

The remaining parts of this paper are organized as follows: the second section represents a literature review; the third section elucidates the research methodology; the fourth section discusses the efforts of scholars in facing the fabricated ḥadīths and provides examples of their methodologies, their books, and the rules and guidelines they formulated to identify the fabricated narrations; and the final section provides a summary of the paper’s main points and future recommendations.

## **2. LITERATURE REVIEW**

Every so often one of the sources or sciences of the *Dīn* is attacked, whether it is Qur’ān, ḥadīth, or *fiqh* and *uṣūl* (Aouidad, 2021). However, the ḥadīth corpus has had the biggest share of these attacks. Ḥāfiẓ (2007) mentioned several quotes from contemporaries who question the authenticity of the *Sunnah* and claim that it cannot be a source of law or a reference because it includes fabricated narrations, it is narrated by meaning, it is not preserved nor did the Prophet Muhammad ﷺ want it to be preserved, and because the scholars did not exert enough effort to make the *Sunnah* a source of a certain knowledge (*‘ilm yaqīnī*) instead of a speculative knowledge (*‘ilm ḡannī*).

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Many studies in literature discussed the scholars' efforts in responding to these claims and in facing fabrications, which this paper aims to review and summarize. For example, Al-Ghaūrī (2016) discussed in his paper "Fabrication of the Prophet's tradition" the fabrication, its inception and causes, and the response of the scholars to fabrication as well as the books written for this purpose. He also summarized the guidelines to identify signs of fabrication in ḥadīth that were presented by Imām Ibn al-Qayyim (1970) in his book "*The Towering Lighthouse*".

Later in 2017, Al-Ghaūrī added to the previous topics in his book "*The Fabricated Hadīth*" the types of fabricators and expanded the guidelines to include guidelines in *sanad* and others in *matn*. He classified the guidelines in identifying the signs of fabrication into three categories: 1) specific guidelines 2) general guidelines and 3) maxims. He also presented the terms used by scholars of ḥadīth to identify a fabricated narration or a fabricator. Furthermore, he listed popular books that are full of fabricated ḥadīths.

Mazīd (2011) discussed the scholars' efforts from two perspectives:

- 1) in exposing the weak and fabricated narrations.
- 2) in defending the Sunnah in the past and in contemporary times by listing the claims against the Sunnah and their refutations. Under the first topic, he listed the methodology of the scholars and listed the books written by them about:
  - 1- Narrators who are accused of narrating the ḥadīth with a gap in the chain after the *Tābi'ī* (i.e., *irsāl*).
  - 2- Those who are accused of concealing defects (i.e., *tadlīs*).
  - 3- Others who are weak or abandoned.
  - 4- *'Ilal* (hidden defects).
  - 5- The fabricated ḥadīths.

He also mentioned some signs of fabrication in *sanad* and in *matn*.

Fabricated ḥadīths were used in *tafsīr* to give strength to some opinions and relate them directly to the Qur'ān. Eren (1998) discussed the effect of fabrication of ḥadīth on *tafsīr*. He stated that fabrication existed mainly in *tafsīr* by narration (*ma'athūr*) as compared to the *tafsīr* by opinion (*r'ay*). He noted that fabricated ḥadīths were used in the books of *tafsīr* in the following sections: 1- virtues of sūrahs, 2- causes of revelations, 3- Qur'ānic stories, 4- Qur'ānic recitations (*qirā'āt*), and 5- in *'aqidah*-related matters.

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Al-Laknawī (1984) comprehensively discussed the types of fabricators and weak narrators based on their knowledge and their reasons. Then, he mentioned some of the commonly narrated stories that are based on forged ḥadīths. He organized his book by topics that are supported by fabricated narrations stating the position of scholars on them, what they agreed upon and what were disputed.

One of the extensive studies that were made on the issue of fabrication is the three-volume book of Fallātah (1981) named: “*The Fabrication in Ḥadīth*”. He discussed the terms that indicate fabrication, causes of fabrication, evidences of fabrication, rulings related to fabricators and fabrications, fabrication in *sanad* and fabrication in *matn*, names of fabricators, and the efforts made by scholars in resisting fabrication. This paper summarizes and discusses the main outcomes of the aforementioned studies in section four.

### **3. METHODOLOGY**

This study was made using library research and content descriptive analysis methods for the information obtained from published books and papers about fabrication of ḥadīth. The paper aims to summarize and list the efforts in the form of clear points and tables that show the methodology of the scholars as well as the results of their efforts in facing the fabricated and unauthentic ḥadīths.

### **4. DISCUSSION**

#### **4.1 SCHOLARS’ EFFORTS IN PROTECTING THE *SUNNAH* FROM WEAK AND FABRICATED ḤADĪTHS**

Scholars of ḥadīth exerted great efforts in resisting the fabrication of ḥadīth. Fallātah and Ḥāfiẓ classified these efforts into two types: preventive and curative efforts. Protective efforts include questioning about *sanad* and criticizing narrators. The curative efforts include compilation of the fabricated ḥadīths and criticizing their *sanad* and *matn*; exposing the fabricators; compilation of the liars and fabricators in books; and compilation of ḥadīths in general (Fallātah, 1981; Ḥāfiẓ, 2007).

Al-Ghaūrī summarized the efforts as follows: verifying the narration of ḥadīth and investigating about its narrators; travelling to seek knowledge of ḥadīth; gathering the fabricated ḥadīths and conducting a critical appraisal of their *sanad* and *matn*; exposing the fabricators and their behavior; compiling the ḥadīths; and developing the sciences of ḥadīth. Furthermore, scholars put precise conditions and guidelines to detect the fabricated ḥadīths, even by barely looking at the *sanad* without the *matn*. Lastly, they compiled books about the fabricated ḥadīths (Al-Ghaūrī, 2016).

Mazīd discussed these efforts as well in several points (Mazīd, 2011). The following list include the main efforts:

- 1- Scholars of ḥadīth compiled the accepted ḥadīths in books such as the six books of the Prophetic tradition, *al-Muwatta'a*, *Ṣaḥīḥ Ibn Hibbān* and *Ṣaḥīḥ Ibn Khuzaymah*, *Sunan al-Dārimī*, *Musnad Aḥmad*, *al-Mustadrak* by *al-Ḥākim*, and *al-Muntaqa* by Ibn Jārūd, etc.
- 2- They studied the narrators of ḥadīth, analyzed and conducted critical appraisals of them, and developed *'ilmu al-Jarḥi wat-Ta'dīl* (the science of criticism of ḥadīth narrators). Examples of books written in this field include: *Tahdhīb al-Kamāl fī Asmā' ar-Rijāl* by Al-Ḥāfiẓ Jamāl al-Dīn al-Mizzī (d. 742 AH) and *Tahdhīb at-Tahdhīb* by Ibn Hajar al-'Asqalānī (d. 852 AH).
- 3- The traditionalists paid particular attention to *isnād*. They would not accept a ḥadīth unless the entire chain of narration was clean and free of a single untrustworthy narrator.
- 4- Scholars of ḥadīth also paid a lot of attention regarding transmitting the ḥadīth and memorizing it. They would track any minor issues, count them, and discuss them in detail.
- 5- They developed rules and conditions for the acceptance of ḥadīth in *'ilmu ar-Riwāyah* and *'ilmu ad-Dirāyah*. An example of the former is the long travels made by the scholars of ḥadīth to check the authenticity of ḥadīth. Examples for *'ilmu ad-Dirāyah* include the development of *'ilmu at-Tārīkh* (e.g., books about the history of narrators like: *Tārīkh al-Bukhārī* by al-Bukhārī, *Tārīkh Baghdād* by al-Khaṭīb al-Baghdādī); the development of *'ilmu al-Jarḥi wat-Ta'dīl*; and the development of the conditions of transmission and narration of ḥadīth to check the continuity and authenticity of narrations.
- 6- Scholars also exerted huge efforts in *matn* criticism. They compared ḥadīths with Qur'ān, authentic *Sunnah*, deduction analogy (*qiyās*), and by checking their rationality.

#### 4.2 SCHOLARS' EFFORTS IN IDENTIFYING THE FABRICATED ḤADĪTHS

The scholars further analyzed the fabricated ḥadīths and tracked them in different ways. These efforts resulted in the development of signs and indicators of fabrication in ḥadīth. These signs can be classified as signs in *matn* and signs in *sanad*. The signs of fabrication in *sanad* includes:

- 1- A fabricator acknowledges that he fabricated ḥadīth(s).
- 2- A narrator is commonly known as a liar to the scholars of *'ilmu al-Jarḥi wat-Ta'dīl*.
- 3- A narrator narrates from a *shaykh* that he did not meet, or was born after his death using explicit forms of hearing such as *ḥaddathanā*, *akhbaranā*, *sami'tu...* etc.
- 4- A narrator mentions a ḥadīth from a *shaykh*; however, this ḥadīth is not mentioned in any of the books of the *shaykh*, or narrated by any of his trustworthy students.

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A fabrication is evident due to his circumstance or due to a certain incident that happened to him (Mazīd, 2011; Al-Ghaūrī, 2017).

Fabrication can also be detected by the *matn*. The signs of fabrication in *matn* are either related to the style or the meaning. With respect to the style, the most important sign is the weak wording of a ḥadīth. The signs concerning the meaning of the *matn* include:

- 1- An explicit disagreement with Qur'ān, authentic *Sunnah*, or consensus of scholars (*ijmā'*).
- 2- A disagreement with realities and rationalities.
- 3- A disagreement with historical facts.
- 4- A great reward for a simple deed or huge threat for a simple mistake or heedlessness.
- 5- A narration of an important story that took place in front of a great number of *Ṣaḥābah*; however, their action was against it, as if all of them had decided to conceal it.
- 6- A narration that is full of fantasies or silly information.
- 7- A narration that does not sound like the speech of prophets, or sounds like a physician's prescription rather than a ḥadīth (Mazīd, 2011; Al-'Anzī, 2021; Al-Maṭ'anī, 1999).

#### **4.3 COMPILATIONS OF THE FABRICATED ḤADĪTHS AND FABRICATORS**

One of the most important efforts of the ḥadīth scholars in facing the fabrication of ḥadīth was by listing the names of the fabricators in different generations. Hence, the next generations of scholars can identify these liars if they encounter them in any *sanad*. The following are some of the books written to expose the fabricators and weak narrators of ḥadīth. Al-Ghaūrī mentioned 19 books in his study (Al-Ghaūrī, 2017). Few examples are listed in Table 1.

Table 1. Examples of compilations about the fabricators of ḥadīth

Book Name	Author
Al-Ḍu‘afā’	‘Alī ibn al-Madīnī (d. 234 AH)
Tamyīz thiqāt al-muḥaddithīn wa ḍu‘afā’ihim wa asmā’ihim wa kunāhum	Ibn al-Barqī (d. 249 AH)
Kitāb al-ḍu‘afā’ al-ṣaghīr, (and al-kabīr)	Imām al-Bukhārī (d. 256 AH)
Al-Ḍu‘afā’	Al-Jūzajānī (d. 259 AH)
Al-Ḍu‘afā’ wal-matrūkūn	Abū Zur‘ah ar-Rāzī (d. 264 AH)
Al-Ḍu‘afā’ wal-matrūkūn	Imām an-Nasā’ī (d. 303 AH)
Ma‘rifatu al-majrūhīn mina al-muḥaddithīna wal-ḍu‘afā’ wal-matrūkīn	Ibn Ḥibbān (d. 354 AH)
Kitāb al-ḍu‘afā’ wal-matrūkīn	Al-Dāraqutnī (d. 385 AH)
Al-Ḍu‘afā’ wal-matrūkūn	Ibn al-Jawzī (d. 597 AH)
Lisān al-mīzān	Ibn Ḥajar al-‘Asqalānī (d. 852 AH)

Source: The Author

It is noteworthy to mention that Fallātah (1981) in his comprehensive work of “*Fabrication in Hadīth*” had listed all names of fabricators in an alphabetical order, and he divided them into three groups:

- 1- narrators that are agreed upon as fabricators.
- 2- narrators that are disagreed upon as fabricators.
- 3- narrators that are accused of lying and have narrations in one or more of the six canonical books of ḥadīth.

The scholars did not write only about the fabricators of ḥadīths; they also gathered the fabricated ḥadīths in separate compilations. Al-Ghaurī and Mazīd mentioned more than 20 books in each of their studies (Al-Ghaurī, 2017; Mazīd, 2011). Table 2 below includes only some examples.



Table 2. Examples of compilations about the fabricated ḥadīths

Book Name	Author	Remarks
Tadhkirat al-mawḍū'āt	Muḥammad ibn Ṭāhir al-Maqdisī (d. 507 AH)	Includes 1139 ḥadīths
Al-Mawḍū'āt min al-'aḥādīth al-marfū'āt	Al-Jaūraqānī (d. 543 AH)	771 ḥadīths, 270 are fabricated or <i>munkar</i>
Al-Mawḍū'āt	Ibn al-Jawzī (d. 597 AH)	1847 fabricated ḥadīths
Al-Mughnī 'an al-ḥifẓi wāḥidat	'Umar al-Maūṣilī (d. 623 AH)	He compiled the topics that have no single authentic ḥadīth
Al-Durr al-multaqāṭ wa al-mawḍū'āt	Al-Ḥasan al-Ṣaghānī (d. 650 AH)	145 fabricated ḥadīths in Al-Durr, then added another 93 fabricated ḥadīths in al-mawḍū'āt
Mukhtaṣar al-'abāṭil wāḥidat	Al-Ḥāfiẓ al-Dhahabī (d. 748 AH)	A combined and an abridged version of Al-Jaūraqānī's and Ibn al-Jawzī's books.
Al-Manār al-munīf fī al-ṣaḥīḥ wāḥidat	Ibn al-Qayyim al-Jawzīyyah (d. 751 AH)	Includes 347 fabricated ḥadīths.
Al-L'ālī' al-maṣnū'ah fī al-'aḥādīth al-mawḍū'ah	Al-Suyūṭī (d. 911 AH)	The best book in this field, it gathered most of the fabricated ḥadīths and added more that were overlooked, and organized the book in chapters and sections.
Al-Maṣnū' fī ma'rifat al-ḥadīth al-mawḍū'	Al-Mullā 'Alī Qārī (d. 1014 AH)	Includes 417 fabricated ḥadīths.

Source: The Author

The scholars exerted significant efforts in filtering the *Sunnah* from any possible fabrications. Consequently, An-Nawawī (d. 676 AH) and Ibn as-Ṣalāḥ (d. 642 AH) said all the narrations of a fabricator of a single ḥadīth are rejected, even if he repented and became a righteous Muslim later in his life. This shows to what extent the scholars of ḥadīth took precautions and paid great attention to the issue of fabrication (Al-Ghaūrī, 2016).

Moreover, the scholars made compilations about the ḥadīths that are widespread among people. Some of these ḥadīths were fabricated; therefore, the scholars put efforts to filter these ḥadīths and


make Muslims aware of all of the fabricated narrations. Al-Ghaūrī listed 12 books in his book that were compiled solely for this purpose (Al-Ghaūrī, 2017). Table 3 shows some examples of these books.

Table 3. Examples of compilations about the common ḥadīths that have fabrications

Book Name	Author
Aḥādīth al-quṣṣās	Ibn Taymiyyah (d. 728 AH)
Al-L'ālī' al-manthūrah fī al-'aḥādīth al-mashūrah	Az-Zarkashī (d. 794 AH)
Al-Maqāsid al-ḥasanah fī bayān kathīr min al-'aḥādīth al-mushtahirah 'ala al-'alsinah	As-Sakhāwī (d. 902 AH)
Al-Ghammāz 'ala al-lammāz fī al-'aḥādīth al-mushtahirah	Abū al-Ḥasan al-Samhūdī (d. 911 AH)
Al-Durur al-muntathirah fī al-'aḥādīth al-mushtahirah	Al-Suyūfī (d. 911 AH)
Al-Shadharah fī al-'aḥādīth al-mushtahirah	Ibn Ṭulūn al-Dimashqī (d. 953 AH)
Al-Mawḍū'āt al-kubra	Al-Mullā 'Alī Qārī (d. 1014 AH)

Source: The Author

Lastly, the scholars developed specific rules and regulations (*dawābiṭ*) to help students of ḥadīth and the general Muslims to easily identify fabricated ḥadīths. Ibn al-Qayyim listed many of his *dawābiṭ* in his book “Al-Manār al-Munīf” (Ibn al-Qayyim, 1970). The following are just some examples (Al-Qārī, 1986):

- All ḥadīths about virtues of praying on certain days (Sunday, wednesday etc.) are fabricated.
- All ḥadīths regarding the prevention of raising hands in prayer are fabricated.
- All ḥadīths include “al-ḥumairā’” are fabricated.
- All ḥadīths that slander Mu‘āwiyah  or the Umayyads are fabricated.
- All ḥadīths mention that a certain city is a city of Paradise, or a city of fire are fabricated.
- All ḥadīths about the rock in Al-Aqṣa are fabricated.
- All ḥadīths about Al-Khiḍr and that he is still alive are fabricated.
- All ḥadīths about ‘aql (intellect) are fabricated.

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- All ḥadīths about *adhkār* on every limb of *wuḍū'* are fabricated.
  - All ḥadīths that say “*īmān* does not increase nor decrease” are fabricated.
  - All ḥadīths that praise al-Manṣūr as-Saffāḥ and ar-Rashīd (Abbasid caliphs) are fabricated.
  - All ḥadīths that praise celibacy are fabricated.
  - All ḥadīths about the virtues of certain flowers are fabricated.
  - All ḥadīths about certain dates in the future are fabricated.
  - All ḥadīths that slander Abyssinia, Sudan, and Turks are fabricated.
  - All ḥadīths about pigeons are fabricated.
  - All ḥadīths that slander children are fabricated.

## 5. CONCLUSION

This paper discusses the efforts of ḥadīth scholars in facing the fabrication of ḥadīth. Fabrication is defined, its ruling is mentioned, and the reasons for fabrication are briefly presented. Scholars exerted huge efforts in protecting the *Sunnah* and classifying the ḥadīths. Many of these efforts are summarized. Among these efforts were the compilation of the books of ḥadīth and scrutinizing the authenticity of ḥadīths by questioning about the *isnād* and criticizing the *matn*. Furthermore, the scholars tracked the fabricators of ḥadīth and their fabrications. Several books were compiled since the third century after Hijrah and until recent times to list and expose the fabricators as well as the fabricated ḥadīths. Moreover, scholars developed rules and guidelines to help in identifying the fabricated and invented narrations. A few of these guidelines are listed. This paper focused on some of the early works of ḥadīth scholars; in the future, the works of the contemporary scholars in defending the *Sunnah* and facing the claims of the modernists and Orientalists need to be discussed.

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## **THE CONCEPT OF HARMONIZATION AND UNIFICATION OF THE LAW IN MALAYSIA: AN ISLAMIC APPRAISAL**

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### **ABSTRACT**

*Harmonization and unification of laws is an important topic for all Muslim countries irrespective of the governmental jurisdictions they follow due to the plurality of laws applied therein. Accordingly, this study considers the possibility of harmonizing Islamic law and common law in certain jurisdictions and studying what is the best choice to be applied in different cases, whether harmonization or unification. This paper aims to study both concepts and their application in Malaysia and the EU as an example for greater understanding of these concepts. The main finding of this paper is that harmonization has been applied successfully to harmonizing Islamic law and other legal issues in Malaysia, unlike unification.*

**KEYWORDS:** Harmonization, Unification, Islamic law, Malaysia, The EU.

## **1. INTRODUCTION**

Comparative law has experienced a remarkable upsurge of interest and action after the conclusion of World War II and it is commonly acknowledged that comparative law is a significant element of legal education nowadays. Therefore, the study of differences and similarities between the laws of different countries has become more beneficial with some concepts of comparative laws, such as harmonization and unification of laws (Fox, 1991).

Harmonization and unification of laws are the means of processing laws to change the relationship between two laws to bring them into a state of compatibility; unification replaces them by a single law while harmonization retains their individuality. Therefore, the harmonization and unification of laws share significant similarities but there are some instances where they vary with each other. However, they deal with each other when it comes to the issue of development and advancing the laws of different jurisdictions or different legal families (Waller, 1993).

Thus, this effort aims to discover the differences between harmonization and unification of laws, in order to achieve better understanding of the concepts and their role in developing and advancing various laws, with a specific focus on Islamic law.

## **2. REVIEW OF LITERATURE**

### **2.1 Harmonization of Laws**

The idea of harmonization is that it is a process to bring different components in harmony, which in general creates a relationship between different components. Thus, it essentially implies bringing the relationship to accordance and consonance. Therefore, harmonization of laws was defined by Kamba as “designed to achieve an approximation or co-ordination of different legal systems or provisions by eliminating the main differences and making minimum requirements or standards” (Kamba, 1974, p. 501). Hence, it is not the same as unification; it is only the convergence of norms or the coordination of policies. Furthermore, practically speaking, the harmonization of laws is an attempt to alter the connection between at least two laws in order to bring them into a state of compatibility (Kamali, 2007, p. 392), but it retains the individuality of such laws while they are combined to each other. As a result, Martin Boodman said that “harmonization is a process in which diverse elements are combined or adapted to each other so as to form a coherent whole” (Boodman, 1997).

The concept of harmonization of laws arises generally in issues of comparative law and particularly in matters connected with inter-jurisdictional and private transactions. This is

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applicable to both general as well as specific areas of the law in different countries or states within a particular country in order to facilitate transactions either for residents or citizens. Harmonization is similarly superfluous to the internal analysis and development of the laws of a particular jurisdiction or legal domain within a jurisdiction. As seen recently, the comparative analysis of private law rules is the main concern of comparative law. The movement for the unification of laws in comparative law postulates a view to eliminate the diversity of laws in international or inter-jurisdictional transactions, as much as possible. Harmonization requires a minimum connection among subjected laws. Thus, Goldring describes the process of harmonization as “one under which the effects of the type of transaction in one legal system are brought as close as possible to the effect of a similar transaction under the laws of other countries”. It can be concluded that it is a process in which different laws are made simple to be understood and applied for easy compliance (Kamba, 1974, p. 501).

Indeed, in terms of the harmonization of the Sharī‘ah and other legal systems, the areas of *‘aqīdah* (Islamic creed) and *‘ibādah* (worship) are outside the purview of harmonization because they are not covered by statutory law or *ijtihād* (striving to understand the *shar‘ī* ruling on the basis of *shar‘ī* evidence). Harmonization of Islamic law [of] civil transactions (*mu‘āmalāt*) and other legal systems, on the other hand, is feasible. As a result, *mu‘āmalāt*, such as contracts and finance in which new interpretations may be permitted, law, and *ijtihād* are viable and have the potential to promote social-economic progress. Certain aspects of the Islamic law were brought into harmony with civil law e.g., the Sharī‘ah aspect for partnership such as *sharikah*, *mudārabah* and finance such as *ijārah* which have been subjected to new procedures for better management of transactions in Islamic banks and financial institutions.

Harmonization of Islamic law and another law means the process of articulating and selecting (*takhayyur*) the relevant parts of the two major legal systems and piecing them (*talfīq*- a method of *usūl al-fiqh* to reconciling two points of view) in order to arrive at formulae that are both coherent and unified. As a result, Sharī‘ah harmonization is largely concerned with existing law, rather than introducing new laws. Its methodological methods, which will be outlined below, are with selecting (*takhayyur*) and piecing together (*talfīq*) important elements of the Sharī‘ah and civil law in order to integrate them into coherent and unified formulae. Both *takhayyur* and *talfīq* are common *usūl al-fiqh* techniques that can be grouped together under the larger notion of *siyāsah shar‘iyyah*, or Sharī‘ah-based policy (Barlinti, 2011).

On the other hand, harmonization is impossible between two radically opposed perspectives, such as Sharī‘ah and civil law's conflicting views on banking interest (*ribā*), one prohibitive and the other favorable. It is impossible to have an Islamic bank that does not use *ribā* or a normal bank



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that does not use interest. The concept of *caveat emptor* in common law vs the option of the flaw (*khiyār al-‘ayb- the ability to put the contract into effect or to cancel it if a defect is discovered*) in Sharī‘ah law is another example of *mu‘āmalāt* dispute that is not necessarily linked to Islamic finance. The former allows the seller to avoid disclosing any existing faults in the item of sale to the buyer, whereas the latter does not (Kamali, 2007, p. 399). Moreover, harmonization of Islamic laws and other laws such as common laws do not imply that these two systems should be combined without regard for Islamic law norms. The harmonization process here refers to the use of common law concepts that are not in conflict with Islamic law but must be consistent with the principles of Islamic law (Kamali, 2007).

Malaysia is a country having both Islamic and common law traditions, and the phrase "focused harmonization of laws" refers to the blending of Islamic and common law traditions. It is interesting to note that the issue of harmonization arose since the negotiation leading to the formation of Malaysia in 1963. With different historical, racial and cultural backgrounds the harmonization procedure was carried out by amending the existing legislation (Bari, 2005, p. 21). The best example of the harmonization between Islamic laws and Common laws is what it has done to Malaysia, during the last four decades, of the harmonization of Islamic Banking and Common Laws (Barlinti, 2011). In the context of Islamic banking, harmonization of Islamic and common law does not imply that these two systems be combined without regard for Sharī‘ah principles. The application of common law principles that are not in contradiction with Islamic law is referred to as the harmonization process (Rahman, 2007). It means that current laws, such as common law principles in contract law, might be merged with Sharī‘ah principles to enhance the legal infrastructure for Islamic banking (Tajuddin & Abd Rahman, 2021). The Islamic Banking Act of 1983, as well as Section 124 of the Banking and Financial Institutions Act of 1989, do not provide a clear framework for Islamic banking. In general, any type of business can be part of an Islamic financial institution. *‘uqūd tamlīk* (contracts of ownership), *‘uqūd sharākah* (contract of partnership), *‘uqūd tawthīq* (contracts of guarantee), *‘uqūd itlāq* (general contracts), *‘uqūd taqyīd* (contracts of restriction), *‘uqūd isqāt* (contract of waiver), and *‘uqūd hifẓ* (contracts of deposit) are just some of the Sharī‘ah principles that can be offered to the market. (al-Nasir & al-Basl, 1999, p. 41).

In addition, the Contracts Act 1950, the Sale of Goods Act 1957, the Companies Act 1965, and the Hire Purchase Act 1967, as well as a slew of other key procedural statutes, have explicit provisions. As an example, we may look at the implementation of the housing project under *bay‘ bithaman ājil*'s products. According to Sharī‘ah norms, the parties must provide options and meet the contract's pillars. Customers must be provided appropriate alternatives such as *khiyār al-majlis*

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and *khiyār al-‘ayb*. In the meanwhile, Islamic financial organizations must adhere to the norms of common law enshrined in the Contracts Act of 1950 (Yaacob & Maamor, 2019).

It is important to note that the harmonization technique for implementing Islamic banking simply cannot be employed without adhering to particular Islamic requirements. In this regard, harmonization could not be applied to things that are forbidden in Islam, ethical considerations should not be jeopardized, Qurānic and Sunnah rulings should not be changed, no harmonization should be allowed to make forbidden things permissible and vice versa, and no universal Islamic principles should be violated to justify equality in transactions. In carrying out this harmonization process, the ideas of Sharī‘ah objectives (*maqāsid Sharī‘ah*), public interest (*maslaḥah*), blocking the means to evil (*sadd al-dharā‘i’*), and other principles may be used (Sale, 2020).

## **2.2 Law Unification**

“Unification signifies the process whereby two or more different legal provisions or systems are supplanted by a single provision or system: it creates an identity of legal provisions or systems” (Kamali, 2007, p. 392) The unification of laws may be described as a process by which conflicting rules from two or more legal systems are replaced by a single norm that applies to a legal transaction. The reason to unify the laws is voluntary or imposed by adoption of a judicial institution of one of the countries by the other country in order to achieve a legal and economic importance (Rosett, 1992).

A good example of unification of laws is the European Union (EU). Subsequently, it is an attempt to replace two or more legal systems with one single system. A complicated and secure legal framework is formed by the symbolic interplay of national law, international agreements, and European Union Acts. Divergent contracting laws across member states increases barriers to internal market exploitation and leads to competition distortion (Belikova, 2019). Due to a lack of knowledge of the legal principles that apply to business relationships and the inability to evaluate risks, the unification of international private law standards is insufficient to facilitate cross-border trade. The project of unifying substantive international commercial laws necessarily depends on a technocratic legal process. The process has its own political economy with predictable and unattractive implications for what is produced.

International unification instruments display a strong tendency either to compromise legal entity or to advance the agenda of interested groups. In both the two cases, the offer is not an obvious gain as compared to rules produced through the national legislative process. In fact, we have no reason to expect the instrument to achieve substantial improvements in the law, if we may disregard what the interested groups get out of their adoption. The unification project of the past century has served as a useful means for promoting comparative research and scholarship and depends on our

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understanding of the institutions. The traditional method of achieving uniformity between different countries has not succeeded in the field of private law. The apparent reason is that a treaty can only come when being in an agreement of the contracting States and will only get in to force, after an approval by the State in which the treaty is to apply. Experience has proved that it is very difficult to reach uniformity particularly in the field of private law (Belikova, 2019).

The unification of laws is considered to be the least practical process when applied to the Islamic legal system to be in accordance with other legal systems. This can be explained through the understanding of the Unification of Laws principle as it replaces different rules with a single rule that must be followed by both or all parties. Unlike Harmonization of Laws, unification does not retain the individuality of such laws. So, in the case of the unification of Islamic finance and conventional finance, there are many opposing legal positions between the Sharī'ah and other systems, and such unification cannot be condoned between these opposing legal positions. For example, prohibiting *ribā* in Sharī'ah and permitting interest in civil law, any attempt to unify them will be practically unrealistic. On other hand, the harmonization between Islamic finance and conventional finance is more suitable since it focuses on common principles and retaining the individuality of the different laws. Practically, by harmonizing both finances, conventional banking will continue using interest while Islamic banking will replace it by another Islamic concept because an Islamic bank that practices *ribā* and a normal bank that does not practice interest are incompatible (Kamali, 2007).

### **3. RESEARCH METHODOLOGY**

This study is conducted based on two research approaches. A content review analysis is a primary methodology applied to analyze both qualitative and textual data. In addition, certain comparative techniques are utilized in evaluating both concepts of harmonization and unification, with the goal of identifying their theoretical nature and implementation in Malaysian and EU legislation. Both primary and secondary data sources in this context have been analyzed. As original sources, a large body of literature and references has been studied on the notions of harmonization and unification. In addition, a critical Islamic viewpoint is added to the notion of harmony and unification.

### **4. RESULTS AND DISCUSSION**

The scope for harmonization can be understood and analyzed by the following points which show how harmonization and unification are important at the international level. Custom, commercial practice, legislative actions or their equivalents, judicial practice, and the work of legal writers are all used to achieve unification and harmonization. Comparative law is an unavoidable requirement in every situation of unification or harmonization. It is critical to have a full grasp of the numerous

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systems that are being unified or harmonized. Comparative legal studies and research are required not only for the goal of evaluating if unification or harmonization is feasible, desirable, or helpful, but also for deciding whether it is feasible, desired, or useful. The development of a unified or harmonized legal framework is only the first step. To achieve this goal, it is important to provide as much uniformity as possible in terms of interpretation and implementation throughout the many jurisdictions that have adopted the law.

Levels at which legal unification or harmonization is possible: At times, harmonization and unification of legislation have taken place at the national level, while at other times, they have taken place at the international level. As a result, there are certain levels of legal harmonization that are occurring. Some argue that there are essential components, ideas, conceptions, and institutions shared by all civilized legal systems, which might be determined via comparative law. However, only a few areas of international law, such as commercial law, maritime law, space law, and broadcasting law, are possible and desirable.

Harmonization, on the other hand, has a greater chance because, although it removes or reduces main legal impediments, it allows for some variance in minor details. Due to the closeness of history and culture, states in the same geographical area may have very similar legal death systems. The tight connection formed among the regional nations makes the necessity for unification or harmonization more imperative such as in Scandinavian countries and the European Union, for example.

Despite the close similarities between the three concepts there still exist differences between harmonization, unification and convergence of laws which have been seen above. Highlighting some differences includes: Both imply a deliberate negotiated process aimed at producing a legislative or other conventional act. Harmonization directs a change of rules, standards, or processes in order to avoid conflicts and bring equivalence, while unification is a common set of rules that is applied for all interest jurisdictions (Cruz, 1999, p. 21).

Harmonization is the process of bringing various legal systems or laws closer together or coordinating them by removing major discrepancies and establishing minimal criteria or standards.” (Kamba, 1974, p. 501). Furthermore, it retains the individuality of different legal systems or provisions. On the other hand, unification is the uniform law that is designed to be adopted by the State and it is considered as a substitution of two or more legal systems with one system, so it does not retain the individuality of both legal systems and provisions. Therefore, harmonization makes the dissimilarity of legal rules more identical or reduces it which will be achieved within the same legal family; while unification focuses on combining the legal system and substituting it with common legal rulings.

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In terms of the Sharī‘ah and other legal systems harmonization, ‘*aqīdah* and ‘*ibādāt* are beyond the purview of harmonization because they are not covered by statutory law or *ijtihād*. Harmonization of Islamic law (*mu‘āmalāt*) and other legal systems, on the other hand, is feasible. So civil transactions (*mu‘āmalāt*), such as contracts and money in which new interpretations may be permitted, law, and *ijtihād* are possible and have the potential to promote socio-economic progress. Harmonization of the Islamic law and another law means the process of articulating and selecting (*takhayyur*) the relevant parts of the two major legal systems and piecing them (*talfīq*) together with a view to arriving at coherent and unified formulas. Therefore, harmonization of the Sharī‘ah is primarily concerned with the law as it exists, less so with proposing new legislations. Its methodological tools (to be articulated below), are concerned with the selection (*takhayyur*) of the relevant parts of the Sharī‘ah and other laws and putting them together (*talfīq*) in order to make them intelligible and unified formulae. Both *takhayyur* and *talfīq* are common *usūl al-fiqh* techniques that can be grouped together under the larger notion of *siyāsah shar‘iyyah*, or Sharī‘ah-based policy.

Harmonization, on the contrary, is difficult between two profoundly opposing perspectives, such as the Sharī‘ah and civil law’s opposing views on banking interests (*ribā*), one of which is prohibited and the other permitted. It is difficult to have either an Islamic or a conventional bank that does not employ *ribā*. The finest example of harmonization of Islamic law and other laws is what Malaysia has accomplished over the previous four decades in terms of Islamic banking and common law harmonization. The unification of laws, on the other hand, is seen as the least realistic approach for achieving compliance between the Islamic legal system and other legal systems. The reason for this is that unification of laws substitutes many rules with a single rule that both or all parties must observe. Unlike harmonization of laws, unification does not retain the individuality of such laws. So, in the case of the unification of Islamic finance and conventional finance, there are many opposing legal positions between the Sharī‘ah and the other systems, and such unification cannot be condoned between these opposing legal positions. For example, prohibiting *ribā* in the Sharī‘ah and permitting interest in civil law, any attempt to unify them will be practically unrealistic. On other hand, the harmonization between Islamic finance and conventional finance is more suitable since it focuses on the common principles and retaining the individuality of the different laws. Practically, by the harmonization of the finance in both laws, conventional banking will continue using interest while Islamic banking will fix it with a suitable Islamic concept because one cannot have an Islamic bank that practices *ribā* or a conventional bank that does not practice interest.

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In conclusion, it may be deduced from the above discussion that there are various findings that we can draw, which are as follows:

1. Law Harmonization is the process of making two laws applied at the same time and in the same area.
2. The procedure of implementing one law by eliminating or creating new legislation is known as the Unification of the law.
3. Islamic law is the legislative part of Islam as a religion; as a result, one of the most fundamental tasks of Muslims as followers of Islam is to implement Islamic law.
4. Al-Qurān, sunnah, *ijmā'*, and *ijtihad* are the sources of Islamic law. Each of these resources has a distinct level of obligation; whilst the laws of the Qurān must be followed at all times, the rules of *ijtihad* can be amended based on the area or era.
5. Islamic jurisprudence has used this approach of harmonization under the name of (*talfiq*).
6. The influence of colonialism on the laws in Islamic countries is quite apparent and widespread.
7. Due to the obvious influence of colonialism or the diversity of religious groups in society, certain Islamic countries have had difficulty enforcing Islamic law.
8. Using the harmonization approach to apply Islamic law in a community with several religious groups, while retaining the peremptory norms of Islamic law and altering the *ijtihad* rules, might be a viable option.
9. Malaysia has a long history of reconciling Islamic and common law, particularly in the area of Islamic finance.
10. The European Union (EU) is a superb example of legal unification.
11. When it comes to the Islamic legal system, the unification of laws is thought to be the least realistic approach.

## **5. CONCLUSION**

The harmonization of the law is an attempt to apply two different laws at the same time without any conflict between them. Unification of the laws is the case when there are two laws that need to be applied, in the case of unification, there are three solutions:

1. First: To apply the first law and delete the second law.
2. Second: To apply the second law and delete the first law.

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3. Last: To delete both laws and create a new law.

Harmonization can be applied to harmonization between Islamic law and other law families because Islam encourages all Muslims to get wisdom from wherever the source lies. Unification of the law cannot be applied in Islamic law because Islam as a religion believes that Islamic law is compulsory to be applied in all Muslim life aspects. Harmonization could be used in harmonizing Islamic law with non-Islamic law, but the unification of the laws cannot be used in most Islamic laws. It can be generally understood from the above discussion that the harmonization and unification of laws share significant similarities but there are some instances where they vary with each other. The main difference is that harmonization and unification alike imply a deliberate negotiated process aimed at producing legislative or other conventional acts. Besides, unification led to the replacement of different laws by one single law, whereas harmonization of laws is only a process of bringing harmony; so, it retains the individuality of such laws. This feature of harmonization enables it to hold a wide range in the case of bringing accordance between the Islamic legal system and other legal systems. However, the concepts have co-existed with each other when it comes to the issue of development and advancing the laws of different jurisdictions or different legal families.

The impact of colonialism on the law on Islamic countries is very clear. Therefore, it is recommended to use harmonization of the law to keep the Islamic identity of the law in Muslim countries especially as most of the constitutions of Islamic countries recognize Islamic law as the main source of law. It is recommended to conduct more studies in different scopes of the law in the light of the harmonization approach to do detailed studies.

There are various suggestions that may be addressed in future contributions which include the following:

1. Understanding the degree of laws in terms of mandatory is one of the principles that should be followed while employing harmonization and unification of laws with Islamic law.
2. More research by Islamic scholars is needed to elucidate the Islamic rules that are under *ijtihad* and which can be altered to assist legislators.
3. The approach of harmonization and unification of laws can be applied within the Islamic laws to choose the best school of jurisprudence (*madh'hab*) to be applied.
4. There are some Islamic countries that ignore some Islamic rules as an impact of colonialism which led to a conflict between society and the States; by harmonizing Islamic law and the other legal systems, this conflict may be resolved.

5. More research is needed in the fields of Islamic banking and finance in order to develop Islamic banking that can function and compete in the international banking system.

More research is needed in the domain of unifying Islamic countries' laws as a first step toward achieving complete unity.



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## STABILITY OF ISLAMIC BANKS: EVIDENCE FROM NIGERIA

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### ABSTRACT

*This research studies the stability of Islamic banking through a closer observation of Jaiz Bank Nigeria. The study covers a period of seven (7) years (covering 2012 to 2018). Z-score has been used as a proxy for Bank Stability (SB) in order to derive the values of SB. Bank data as well as descriptive statistics were used. An analysis of the impact of macro-economic variables (Inflation and  $\Delta$ GDP) on the Return on Assets (ROA) of Jaiz Bank as well as the ROA of some five conventional banks in Nigeria selected for the purpose of comparison. The SB figures of these banks were also compared to verify the most stable, over this period of seven years. The use of tables was employed to make data readable at a glance. This study found that Jaiz Bank is consistent with theoretical studies which expect a positive correlation of profitability with  $\Delta$ GDP and a negative correlation with a rise in inflation and vice-versa. The conventional banks on the other hand were not consistent. Some of the banks behaved in a similar manner to Jaiz Bank at some point while some others had no clear pattern. However, the bank stability derived by SB(K) and SB(ROA) indicated that, conventional banks are more stable while SB(CAR) figures shows that Jaiz Bank is second, only to Access Bank and Jaiz Bank maintained smaller Stdv figures indicating a much smaller variation in the figures and therefore more stability.*

**KEYWORDS:** Islamic Banking, Z-score, Banking Stability (SB), Capital Asset Ratio (CAR), Return on Assets (ROA), Conventional Banking, Risk.

## **1. INTRODUCTION**

Bank Stability (SB) is the ability of the bank to be solvent and remain viable in difficult economic conditions by means of capital reserves. Usually, instability results from two factors: microeconomic factor, where the financial institution depends heavily on debt. The second factor is the macroeconomic factor which is due to high inflation and over leveraging. According to Minsky (1995) during periods of economic boom investments in speculative activities tend to increase and such investments are financed through debt. This causes a rise in interest rates. A persistent rise in interest rates weakens the financial system. Thus, detachment from the real financial system is the major reason for instability in the financial market. This has put Islamic finance under the spotlight in the world economy since the occurrence of the world economic crisis of (2007-8).

There have been numerous research studies since the 1980's on Islamic finance. Most of them were theoretical in nature; however, more recent research focuses on empirical studies. According to MI (2021), Islamic financial systems in 2017, grew at the rate of 8.3% worldwide at the total figure of \$2.05trillion against the previous year's (2016) figure of \$1.88trillion. The banking sector accounts for 71% of the total Islamic Finance figures. The other two sectors being Takaful (insurance) and Sukuk (Islamic bonds) account for the remaining 39%. In 2018, the sector expanded by 2% and this implies a retardation in the growth rate. In 2019, there was a growth rate of 14% with the figure reaching USD 1.99 Trillion. In 2020, the global growth rate was estimated at 7.61% showing a fall in the growth rate due to the effects of the pandemic (Covid 19). There was high volatility in the first and second quarters of the year-2021. This caused Islamic financial institutions to pay more attention towards protecting their capital base not bothering about expansion.

The promulgation of Banks and other Financial Institutions Decree (BOFID) 24 and 25 in 1991 sets pace to the momentum of Islamic banking (Daud et al., 2011). The bank to first establish an Islamic window was Habib Bank in 2001, then Stanbic Bank in 2008 and Intercontinental Bank in 2010. In 2011, Jaiz Bank began operation as a regional bank in northern Nigeria and subsequently became a full-fledged bank in 2016. As the stability of Islamic banking had already been under discussion long before the world economic crisis, empirical research began to appear after the occurrence of the economic crisis. Some research studies conclude that Islamic banks are more resilient to economics crises compared to conventional banks (Abdul-Majid et al., 2010; Hasan & Dridi, 2010; Miah & Sharmeen, 2015; Odeduntan et al., 2016; Pradiknas & Faturohman, 2015; Srairi, 2010). However, most previous research focused on developed Islamic bank markets such

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as Malaysia, Saudi Arabia, and Bahrain to mention a few. As per the author's knowledge no study has been reported in the developing markets of Nigeria to investigate its Islamic banking stability. Furthermore, results from the developed markets may not fully represent developing markets in different environments and economies.

Therefore, this research aims at exploring the stability of Islamic banking in Nigeria through a study of Jaiz Bank from 2012 to 2018. A comparison will also be made of Jaiz Bank and some five conventional commercial banks to ascertain stability. The rest of the paper is organized in the following order: the second section contains the literature review, the third section is the methodology, where the formulae employed to calculate the Z-score which represents the bank stability are discussed. The fourth is analysis and data description where five conventional banks are compared with the Islamic bank (Jaiz Bank). The fifth section is about the impact of macro-economic variables on ROA of the banks. The result of the research is discussed in the sixth section and the final section summarizes and concludes the paper, showing the important points and possible impacts of Islamic banking on the economy.

## **2. REVIEW OF LITERATURE**

The stability of banks has been the focus of attention all the time in world economic policies, but it caught the special attention of economists after the global economic crisis that took place in 2007. During the crisis, banks across the world witnessed a series of failures which led to their collapse. Researchers such as Bilgin et al. (2017); Dietrich and Wanzenried (2011) reported a huge impact of the crisis on the profitability of banks around the world. The funding structure of the banks was reported among the main reasons behind the crisis, as banks based on wholesale funding were affected more than the banks with depository funding. Banks in general suffered losses following the economic crises, but Islamic banks showed stronger resilience during the global financial crisis (DW, 2009).

The stability of banks is associated with proper functioning of the financial system (Belouafi et al., 2015), and both micro as well as macro-economic approaches explain the reasons behind the occurrence of instability in banks (IMF, 2004). Excessive risk, banking efficiency, banking concentration, size of the banking sector, government effectiveness, political stability, regulatory quality, investor protection, corruption control, and unemployment levels are reported among the significant determinants of banking stability. Supporters of Islamic banking report factors like share of equity in financing, market indiscipline, interest rate, investment in unreal assets among the main causes of instability in banks (Belouafi et al., 2015; Chapra, 2008; Minsky, 1995). Risk sharing principle and asset diversity make Islamic banks more resistant to adverse shocks

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(Boumediene & Caby, 2009). There is a host of empirical evidence specific to the stability of Islamic banks in the available literature.

Hasan and Dridi (2010) analyzed the impact of financial crisis on Islamic and conventional banks, using data from eight countries, Bahrain, Jordan, Kuwait, Malaysia, Qatar, Saudi Arabia, Turkey and the United Arab Emirates, for a total of 120 banks. They tested the effects of crisis on profitability, credit growth and asset growth. Their results showed that Islamic banks had stronger resistance during the early stage of the crisis. Odeduntan et al. (2016) observed that Islamic banks have the potential of absorbing shocks and are not likely to experience financial problems in the immediate term, provided their liquidity ratios are regularly kept under check. Beltratti and Stulz (2012) investigated [the reason] why some banks performed better and [others] poorly during the 2007 and 2008 global financial crisis, using a global sample, they found that better performing banks had fewer leverage and lower returns before the crisis. Positive correlation has been reported between profitability and bank stability. Bashir (2003) noted that many regulators believe that return on assets is the best measure of bank efficiency. According to Jahn and Kick (2012) a safe and sound system ensures the optimal allocation of capital resource, and regulators therefore, aim to prevent costly banking system crisis and their associated diverse feedback effects on the real economy.

### **3. RESEARCH METHODOLOGY**

As Jaiz Bank is the only full-fledged Islamic bank with a national presence in Nigeria, this research tests its stability and performance using appropriate tools (Z-Score and Financial Ratios). Results are compared with five top conventional banks operating in the country- First Bank, GTBank, Eco Bank, Zenith and Access Bank. Z-score and ratio analysis is performed using income statements of the banks from 2012 to 2018. The study tests the following hypothesis:

H0: Islamic banking is not stable in Nigeria.

H1: Islamic banking is very stable in Nigeria.

The Z-Score has been used by researchers over the years to find the stability of the banking sector (Belouafi et al., 2015). More than 55% of the studies on the stability of the financial system used the Z-Score stability indicator (Ozili, 2018, 2019). Z-Score is a popular measure of testing the soundness of a bank. It has an inverse relationship with the probability of bank insolvency. The higher the Z-score the more stable is the bank. A lower Z-score would indicate high insolvency risk. Regardless of the characteristics that govern the bank, Z-score remains a good measure as it tests the insolvency risk objectively using the bank data. The study employs Z-Score using three different approaches.

Z-Score is expressed as:

$$1. \quad Z = \frac{(\mu ROA + Equity/Asset)}{SROA}$$

Adopted from Houston et al. (2010); Laeven and Levine (2009).

$$2. \quad Z = \frac{ROA (Current Period) + Equity/Asset}{SROA}$$

Adopted from Beck and Laeven (2006); Hesse and Martin (2007).

$$3. \quad Z = \frac{\mu ROA + CAR}{SROA}$$

Adopted from Uhde and Heimeshoff (2009).

Where:

Z= Stability of the Bank (SB).

$\mu$ = the Average performance of banks assets (ROA).

K= Equity as a percentage of total assets (CAR).

$\delta$  =the standard deviation of ROA as a proxy of the volatility of returns.

Stability of bank= f(Macro economic factors, bank variables specified and financial structure).

Thus, we have 3 research equations

$$SB(K) = c + \Delta GDP + CAR + INFL + ROA + DP + BC + NPL + EFF + e$$

$$SB(CAR) = c + \Delta GDP + CAR + INFL + ROA + DP + BC + NPL + EFF + e$$

$$SB(ROA) = c + \Delta GDP + CAR + INFL + ROA + DP + BC + NPL + EFF + e$$

Where:

SB= Stability of the bank.

C = Constant.

$\Delta GDP$ = The state of the economy measured as a change in real economy i.e., gross domestic product.

CAR=Capital Adequate Ratio (of the bank).

INFL= Inflation rate.

ROA= Profitability of the bank measured as Returns on Assets.

DP= Depth of financial system.

BN= Banking Concentration.

NPL= Ratio of Non-Performing Loan to gross loan (in this case, the ratio of non-performing investment to gross investment –*Mudarib*).

EFF= Efficiency of the bank measured as a cost of income ratio.

e =error term.

Table 1 below, gives the various definition of variables.

Table 1. Definition of variables

Definition of Variables		
SB	Bank Stability	$Z = \frac{\mu + k}{\sigma}$
C	Constant Variables	Those that can't be measured
$\Delta$ GDP	Change in per capital income	-
CAR	Capital Adequacy Ratio	$\frac{Tier1capital + Tier\ 2Capital}{Risk\ Weighted\ Asset}$
INFL	Inflation rate	-
ROA	Return on Assets	$ROA = \frac{Profits}{Total\ Assets}$
DP	Depth of Financial System	Size of the Institution in the industry
BC	Bank Concentration	Level of Bank's Concentration
NPL	Ratio of Non-Performing Loan	It has an inverse relationship with stability
EFF	Bank's Efficiency	$Eff = \frac{Cost}{Income}$

Source: The Author



## 4. ANALYSIS

### 4.1 Descriptive

Table 2, reports the statistics of Jaiz Bank compared to other conventional banks over the period under study (2012 to 2018). The monetary figures of assets, equity, liabilities, return on equity and profits are all in billions in the local currency (Naira). It is observable that the assets of Jaiz Bank have continued to increase rapidly over this period of seven years. The bank began operation with assets worth N14billion and by 2018, its assets had grown to over N100billion.

Table 2. Jaiz Bank Data and other Six Banks Compared

Bank		2012	2013	2014	2015	2016	2017	2018
Jaiz Bank	Assets	14114813 000	33915651 000	44427942 000	52639244 000	66053824 000	87312609 000	1.08426 E+11
	Equity	10101866 000	10965994 000	11228685 000	11407407 000	13143784 000	13679148 000	131091 62000
	ROA	-0.052	-0.022	0.016	0.017	0.005	0.006	0.009
	CAR	77.0	71.0	63.0	-	27.0	33.0	21.0
		27706750 00	32465770 00	34908710 00	33323750 00	22510000 00	37770380 00	389141 2000
First Bank	Assets	37217600 0	35070900 0	42304700 0	45974700 0	48608700 0	57984200 0	584944 000
	Equity							
	ROA	0.026	0.018	0.022	0.011	0.022	-	-
	CAR	0.19	0.17	0.16	0.17	0.18	-	-
GT Bank	Assets	16203172 23	19043657 95	21266083 12	22776292 24	26133400 74	28249289 85	271252 1494
	Equity	28654000 0	32964700 0	34402189 9	40560834 8	47691785 3	58434436 1	511842 259
	ROA	0.053	0.045	0.042	0.041	0.049	0.057	0.062
	CAR	-	-	-	0.18	0.20	0.25	0.22
Zenith Bank	Assets	24368860 00	28786930 00	34238190 00	98784000 00	42837360 00	49554450 00	483365 8000
	Equity	43800300 0	47262200 0	51270700 0	54694600 0	61635300 0	70752500 0	675032 000
	ROA	0.041	0.033	0.027	0.010	0.028	0.031	0.034
	CAR	-	0.26	0.19	0.22	0.20	-	-

Source: Collected from Banks' Yearly Statements of Account.

## 4.2 Model

Z-score measures the disparity of variables from the default value. A high Z-Score indicates low risk, because it implies larger disparity from the insolvency risk. The reverse is the case, where a low Z-Score would imply high risk. The bank's stability figures calculated are represented by Z1, Z2, and Z3 represent the SB (K), SB (CAR) and SB (ROA) respectively.

Table 3 shows the bank stability figures across the seven years under study. For Jaiz Bank, the values of SB (K) and SB (ROA) are very close with very little and insignificant variations. Both are 28 in 2012 and end with 4 in 2018. While the SB (CAR) were larger at 30.7 but are regressed over the years till it has reached 8.4, in 2018.

Table 3. SB Figures of the Seven Banks Over the years Studied

	SB(K)	28.6	12.9	10.1	8.7	7.9	6.3	4.8
<b>Jaiz Bank</b>	SB(CAR)	30.7	28.3	25.2	0.0	10.8	13.2	8.4
	SB(ROA)	28.5	12.9	10.1	8.7	8.0	6.3	4.7
<b>First Bank</b>	SB(K)	12.67	10.17	11.14	12.41	20.31	14.44	14.14
	SB(CAR)	17.55	15.76	14.85	16.85	16.73	-	-
	SB(ROA)	12.6	10.2	11.4	13.0	20.3	-	-
<b>GT Bank</b>	SB(K)	23.0	22.5	21.0	23.1	23.7	26.9	24.5
	SB(CAR)	-	-	-	23.6	25.7	32.8	28.1
	SB(ROA)	3.0	22.5	21.0	23.1	23.7	26.7	24.5
<b>Zenith Bank</b>	SB(K)	18.5	16.9	15.5	5.7	14.8	14.7	14.4
	SB(CAR)	-	26.8	19.6	22.7	20.6	-	-
	SB(ROA)	28.6	16.9	15.5	5.7	14.8	14.7	14.4
<b>Eco Bank</b>	SB(K)	-	-	13.52	13.22	15.07	18.03	-
	SB(CAR)	-	-	-	-	-	-	-
	SB(ROA)	-	-	13.52	13.22	15.55	18.04	-
<b>Access Bank</b>	SB(K)	34.20	33.84	36.44	28.45	28.45	37.98	28.52
	SB(CAR)	56.47	46.21	-	-	51.34	46.21	43.64
	SB(ROA)	-	33.8	36.4	28.5	28.4	38.0	28.5

Source: The Author

Access Bank has the largest figures of SB (K) and SB (ROA), showing the least risk of insolvency compared to other six banks. However, its Standard deviation values are quite large. This implies wide disparity of the SB values over the years from the mean. Consequently, there is a great deal of fluctuation in its SB (K) and SB (ROA). GT Bank comes second in line. Yet, it has more consistency in the SB (K) and SB (ROA) values as indicated by the Standard deviation figures which are quite low, indicating very small disparities from the mean values. Zenith Bank and Eco Bank come third, with both banks having very close figures though Eco Bank has lower Stdv than Zenith Bank. Next is First Bank with lower SB (K) and SB (ROA) figures and high Stdv. However, Jaiz Bank is the least stable bank by this measure of SB (K) and SB (ROA). Its Stdv figures are also very large, second only to Access Bank.

On the contrary, the SB (CAR) shows a very different result. This measure puts Jaiz Bank at an advantage because it has very large CAR ratios since Islamic banks are based on real assets. By this measure, Jaiz Bank is second to Access Bank. Yet Jaiz Bank has a smaller Stdv figure which implies smaller disparities from the mean value. Jaiz Bank is however, at par with GTBank. While Jaiz Bank has a mean value of (16.65), GTBank has a mean value of (15.75) but GTBank has a smaller Stdv (3.93) as against (8.04) for Jaiz Bank. Meaning that the disparity of SB (CAR) figures from the mean is smaller in GTBank. Table 4 shows the descriptive statistics of all five conventional banks in comparison with Jaiz Bank (Islamic bank).

Table 4. Descriptive Statistics Table

Bank	Bank Stability	Median	Minimum	Maximum	Mean	Stdv
<b>Jaiz Bank</b>	SB(K)	8.7	4.8	28.6	11.32	8.04
	SB(CAR)	13.2	8.0	30.7	16.65	11.5
	SB(ROA)	8.7	4.7	28.5	11.30	8.04
<b>First Bank</b>	SB(K)	12.67	11.14	20.31	13.73	3.26
	SB(CAR)	16.73	14.85	17.55	9.75	8.01
	SB(ROA)	12.6	10.2	20.3	13.5	4.0
<b>GT Bank</b>	SB(K)	23.1	21.0	26.9	23.5	1.82
	SB(CAR)	24.7	23.6	32.8	15.75	3.92
	SB(ROA)	23.7	3.0	26.7	23.5	1.8
<b>Zenith Bank</b>	SB(K)	14.8	5.7	18.5	4.4	4.1
	SB(CAR)	20.1	19.6	26.8	12.8	12.2

	SB(ROA)	14.8	5.7	28.6	14.4	4.0
	SB(K)	14.3	13.22	18.03	16.55	2.20
<b>Eco Bank</b>	SB(CAR)	-	-	-	-	-
	SB(ROA)	14.5	13.22	18.04	14.95	2.21
	SB(K)	33.84	28.45	37.98	28.4	13.08
<b>Access Bank</b>	SB(CAR)	46.21	43.64	56.47	34.8	24.2
	SB(ROA)	33.8	28.4	38.0	27.7	12.5

Source: The Author

The descriptive statistics for SB(K) and SB(ROA) figures of Jaiz Bank are very close like the SB figures. The Mean and Median are 11.32 and 8.7 respectively, while the minimum is 4.8, the maximum is 28. The Stdv is 8.04 which indicates a wide disparity. The SB(CAR)'s descriptive statistics on the other hand are: 11.3 for Mean, 8.7 for Median, 8.0 for Minimum and 30.7 for Maximum. The Stdv is 11.5 which shows a wider disparity of figures. In the case of First Bank, the descriptive statistics are: for SB(K) and SB(ROA) Mean 13.73, Median 12.6, Minimum 14.8, Maximum 20.3 and an Stdv figure of 3.3 indicating a small disparity in the figures. The SB (CAR)'s descriptive statistics for First Bank on the other hand are: Mean 9.8, Median 16.7, with an Stdv of 8.0; which is very much larger than the SB(K) and SB(CAR) Stdv. Therefore, First Bank shows more stability by SB(K) and SB(CAR) measure relative to the SB(CAR) measure.

GTBank has a mean value of 23 and a median of 23 with an Stdv of 1.8 for SB(K) and SB(ROA). The values for Mean and Median here are both the same with a very low Stdv. Therefore, it correctly indicates a very small disparity. On the other hand, the Mean and Median of SB(CAR) are 15.7 and 24.7 respectively with an Stdv of 3.9. The disparity of SB(CAR) figures are larger for GTBank though it is also small. Eco Bank has 16.5 and 14.3 for Mean and Median respectively, with respect to SB(K) and SB(ROA) and a Stdv of 2.2. This shows low disparity. The SB(CAR) values could not be calculated due to lack of data and consequently, the descriptive data. Access Bank's Mean and Median for SB(K) and SB(ROA) are 28.4 and 33.84 respectively with Stdv 13.1, while the SB(CAR) has 34.8 and 46.2 as Mean and Median figures respectively. The Stdv 24.2 is quite large, which shows a very wide disparity.

#### 4.3 The Impact of Macro Economic Variables on ROA of Banks

Macro-economic variables are expected to affect the stability of banks in the country. It is expected, that a rise in GDP of the country should have a positive impact on the stability of the bank, while the rise in the rate of inflation is expected to affect the bank stability negatively. This

is not always the case, as high inflation rates may have a positive impact on conventional banks. Table 5 shows how the banks' ROA changes in response to the macro-economic variables.

Table 5. Seven years' bank data from conventional banks and macroeconomic variable

<b>Bank</b>		<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2017</b>	<b>2018</b>
<b>Jaiz Bank</b>	ROA	-0.052	-0.022	0.016	0.017	0.005	0.006	0.009
<b>First Bank</b>	ROA	0.026	0.022	0.022	0.011	0.014	0.006	0.006
<b>Eco Bank</b>	ROA	0.014	0.002	0.014	0.020	0.004	0.005	-
<b>Gtbank</b>	ROA	0.053	.045	0.042	0.041	0.049	0.057	0.062
<b>Zenith Bank</b>	ROA	0.039	0.030	0.026	0.026	0.027	0.032	0.039
<b>Access Bank</b>	ROA	0.022	0.020	0.020	0.025	0.020	0.015	0.029
<b>Macroecono</b>	GDP	4.3	5.4	6.1	4.8	5.0	5.3	5.5
<b>mic variable</b>	INFL	9.3	6.6	6.3	7.0	11.4	10.7	9.5

Source: Author's work (ROA: Return on Assets, GDP: Gross Domestic Product, INFL: Inflation).

The ROA of Jaiz Bank fluctuated a lot. It began with a negative number, and that is expected because the bank had just begun operation. However, it grew and by the third year 2014, the number became positive and above one (1.6%). The year 2014 was the bank's break-even year. The economy had improved and GDP was (6.1%) at its peak. With a relatively lower rate of inflation of (6.3%). As inflation rose in 2015, and GDP dropped, there was a significant drop in the ROA. This continued to drop and fluctuate between 2016 and 2018. Therefore, Jaiz Bank's ROA behaved as expected. It rose with a rise in GDP and a fall in inflation, and vice-versa.

In the case of First Bank, ROA was at 2.6% in 2012 and this is the highest in the period studied. The GDP was low (4.3%) and inflation was high (9.3%), the ROA of First Bank continued to fall until it reached (1.1%) in 2015 and rose slightly in 2016(1.4%), then fell again to (0.6%) in both 2017 and 2018. Although GDP was at its peak in 2014, it did not have any positive impact on the bank.

Eco Bank's ROA in 2012 was 1.4% while inflation was at (9.3%) and GDP was (4.3%). In 2013, the rise in GDP (5.4%) accompanied by inflation (6.6%) did not have any positive effect on ROA (0.2%) of Eco Bank as it only fell further. However, an increase in the ROA (1.4%) occurred in 2014 with a rise in GDP (6.1%) and a fall in inflation (6.6%). ROA fell drastically in 2016 and 2017. Thus, Eco Bank's ROA fluctuated greatly.

GTBank had a relatively high ROA (13.1%) in 2012 during high inflation (9.3%) and low GDP (4.3%). In 2013, GDP increased to 5.1% with an inflation rate of (6.6%). This caused a slight fall in the bank's ROA. In 2014, there was a further decrease in the inflation rate (6.3%) with a rise in GDP (6.1%), causing a further decrease in the bank's ROA. However, from 2016 to 2018, ROA

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continued to rise slightly and steadily. In the first three years, it is observable that GTBank had a positive correlation with inflation and a negative correlation with GDP but the reverse occurred in the second half.

From 2012 through 2016, Zenith Bank's ROA had a positive correlation with inflation, but by 2017 2018 the reverse occurred. Access Bank had an ROA that was similar to that of Eco Bank. It fluctuated greatly, not having a clear pattern. According to Bourke (1989) "Some studies have shown a positive relationship between profitability and inflation", and this was the case with some conventional banks, as high inflation rates encourage lending and hence, higher profits. Therefore, some conventional banks showed higher profits during high inflations although there are inconsistencies in this.

## **5. RESULTS AND DISCUSSION**

Jaiz Bank's assets grew by 86% from 14billion Naira in 2012 at the inception of the bank to 100billion Naira in 2018. Though the ROA of the bank began with a negative number (-0.052) which was expected, it grew and became positive over time though it remained low till 2018 (0.009). Jaiz Bank has not been as profitable as the conventional banks (Jaiz Bank, 2012). Though the ROA of Jaiz Bank was the least compared to the conventional banks, its CAR remained the highest and was above the minimum requirement (of 10% to 15%) all through the years studied. It began with 77% in 2012 and continued to regress till it reached 21% in 2018. The SB(K) for most of the banks were very close and it was an unfavorable measure of SB for Jaiz Bank due to very poor profit rate while most of the conventional banks did quite well. On the other hand, measuring SB through CAR put Jaiz Bank at an advantage. By the measure of SB(CAR), Jaiz Bank was the second most stable bank after Access Bank. Jaiz Bank would slide upward when Stdv values are considered, as the Stdv of Jaiz Bank was smaller than those of Access Bank and this indicated smaller disparity of figures, thus more stability. Looking at the impact of macro-economic variables on the ROA, Jaiz Bank remains predictable as it responds according to theoretical evidence (i.e., a positive correlation between ROA and a rise in the change in the GDP and a fall in inflation and vice-versa). Therefore, the research concludes that a healthy economy will cause Islamic banking to grow and develop, and Islamic banking will in turn boost economic growth and development.

## **6. CONCLUSION**

The stability of a bank is extremely vital to the survival of any bank and no doubt a matter of concern to both the management and the customers of the bank. This very factor has caused Islamic banks to be in the spotlight in recent years around the world. Bank stability is measured by a number of factors, which includes bank variables, return on assets (ROA) as it responds to

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macro-economic variables as well as institutional factors. All things being equal, Jaiz Bank is expected to have stability and resist economic shocks if it adheres to the Shari'ah law since it espouses ethical values.

According to the findings of this research, Jaiz Bank would be expected to do well and be more buoyant in a healthier economy. This is because Islamic banks deal with real assets and as such have more protective strategies. For this reason, we find that the SB(CAR) values were quite high and by this measure, Jaiz Bank was second to Access Bank in terms of stability among all the six banks compared yet with a smaller Stdv value compared to that of Access Bank. This implies that the SB(CAR) figures over the years are closer to the mean. Thus, there is more consistency implying more stability.

However, SB(K) and SB(ROA) are quite low and Jaiz Bank by this measure is the least stable. Consequently, profit making is quite challenging to Jaiz Bank due to the unhealthy economy. According to Abduh and Omar (2012), "the relationship between Islamic banking development and economic growth is bidirectional, meaning that Islamic banking encourages economic growth just as economic growth would stimulate Islamic bank development".

It is noteworthy, that Z-score does not take account of the fact that Islamic banks have other protective measures due to their restrictions to real assets. The profit and loss sharing transactions allow Islamic banks to shift some risks to investors. This reduces the overall financial risks.

It is noteworthy here, that all five conventional commercial banks compared are decades older than Jaiz Bank. Consequently, they have better expertise, bank concentration, larger market share, and stronger legal backing (as legal backing for Islamic banking is quite recent and still ongoing). All these have given the conventional banks a competitive advantage, while Jaiz Bank is expected to improve in a healthier economy and become more stable as it deals in real assets.

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## POTENTIAL APPLICATION OF BAY' AS-SALĀM CONTRACT IN ISLAMIC BANKING IN INDONESIA

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### ABSTRACT

*Islamic banking in Indonesia has developed and grown tremendously in recent times. This is proved with the launch of various products, however they have not yet applied a form of Islamic forward contract bay' as-salam as a mode of financing due to it being more susceptible to risks than the other Islamic commercial contracts used by Islamic banks in Indonesia. This research attempts to analyze some factors as to why bay' as-salam does not seem attractive to the Islamic banks to implement, then to explore the theoretical possibility of its future application as well as to propose a working model. Due attention will be paid to comparison between bay' as-salām and the future of contract applications in the Islamic finance industry. The methodology approached is focused on library research and conducting interviews with Islamic bank officers. The study proposes a bay' as-salam model based on wakālah contract to be applied in Islamic banks in Indonesia.*

**KEYWORDS:** *bay' as-salam*, Islamic financing, *wakālah* contract, Islamic banking, risk factors, Indonesia.

## 1. INTRODUCTION

The Islamic financial industry globally has shown fairly rapid development in recent times. Based on data from the IFSB Financial Stability Report in 2016, the assets of the world's Shari'ah-compliant financial industry have grown from about USD150 billion in the 1990s to about USD2 trillion by the end of 2015 and are projected to reach \$ 6.5 trillion in the year 2020. Indonesia, the most populous Muslim country in the world, has huge potential for Islamic finance (87.19% of Indonesia's population of 237 million are Muslims). Although still relatively small on a national scale, the industrial development in Indonesia's Shari'ah-compliant financial sector has shown significant development in the global arena.

The Indonesian Islamic financial assets (excluding Islamic stocks) have reached IDR889.28 trillion or approximately US\$66.18 billion, and the available data shows that the Islamic banking sector has 41.04% or IDR365.65 trillion or US\$27.21 billion (GIFR, 2017). This rapid growth of Islamic banking should be accompanied by the development of products and various contracts in accordance with Islamic principles. This development is expected to meet the needs of customer transactions. One of the important issues faced by Islamic banking is the problem of financing products that are still dominated by *Murābahah*, *Mushārah* and *Mudārah*, while another contract such as *bay' as-salam* that could be implemented is neglected.

With the addition of the term "Islamic" to banking, Islamic banking is expected to be unique with the integration of greater moral and Islamic values compared to other conventional institutions. The objective is not solely to maximize profit but also to achieve socio-economic development and the alleviation of poverty.

Since *bay' as-salam* is rarely implemented in Islamic banking in Indonesia, it is critical to examine the risk-taking behavior of contracting parties. Several factors may lead to banks being reluctant to employ *bay' as-salam*. Perhaps it is a lack of understanding on the part of banking practitioners with regards to the application of the contract, as financial literacy does not reach every level within the community, besides several risks inherent in the contract itself. Therefore, regarding the aim of Islamic finance, Az-Zuhaili, (1997) mentioned that Islamic Financial Institutions (IFIs) are not profit making, but work towards the endorsement of social goals of socio-economic development and the alleviation of poverty (Salihu et al., 2011). The implementation of *bay' as-salam* contract is believed to expand the role of Islamic banking, therefore, this study aims to identify factors obstructing the practice of *bay' as-salam* in Islamic banks in Indonesia. Following this, strategies for designing the *bay' as-salam* model will be proposed for the development of the Islamic banking industry. Once these factors are identified, the next step is to find solutions that

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make this mode of financing applicable to products, bankable and marketable, to be applied in the Islamic banking industry.

## 2. LITERATURE REVIEW

### 2.1 Overview of *Bay' As-salām*

*Bay' as-salam* can be defined as: A sales transaction in which the buyer will give the payment in advance for the goods that will be delivered by the seller at a future date specified in the contract. The Shāfi'īs and Hanbalīs defined it thus: A forward contract over described merchandise sold as a deferred liability on one party, in exchange for a price that is received during the contract session. The opinion of Mālikīs is: It is a sale in which the capital sum (price) is paid in advance, and the object of sale is deferred to a specified term" ( Az-Zuhailī, 1997).

If the price is a tangible (e.g., currency) it must also be delivered during the contract session. This is to avoid the selling debt and such deferment would fall under the prohibition of the Messenger of Allāh ﷺ of "trading one deferred item for another". This condition is agreed upon by the Hanafīs, Shāfi'īs, and Hanbalīs. However, Imām Mālik stipulated that deferment of receiving the price is permissible for three days or less, even if this deferment is stipulated as a condition of the contract.

A hadīth narrated by Al-Bukhārī and Muslim clarifies that the Messenger of Allāh ﷺ came to Madīnah and found its inhabitants entering *as-salam* contracts (with the price paid in advance) over fruit produce for a period of one, two or three years in advance. He ﷺ said: "*Whosoever makes buying and selling by way of salaf (as-salam), he should buy and sell with a specified weight and measure up to the time limit*<sup>3</sup>." However, there are four elements which must be fulfilled, namely:

1. buyer (*al musllam 'ilayh*)
2. seller (*al musllem*)
3. transaction objects/goods (*musllam fīhi*)
4. agreement of offer and acceptance (*sīghat ījāb wa qabūl*) ( Az-Zuhailī, 1997).

Furthermore, it is said: "Whosoever engages in *as-salam* contract, let him specify a volume or weight for the object of sale, and a definitive term of deferment." Thus, jurists of all schools of Islamic jurisprudence considered the forward sale of tangible commodities (measured by weight, volume, length/size, or number of homogeneous units), with full prepayment of the price, to be a valid contract (El-Gamal, 2006). It is well known that there is a consensus among all scholars

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<sup>3</sup> Al-Bukhārī, Hadith (no.2239) and Muslim (no.4094)

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regarding the permissibility of *bay' as-salam* to help needy farmers with their agricultural produce and to feed their families up until the time of harvest ('Uthmānī, 2002; ISRA, 2011).

According to Muneeza et al. (2011) the *as-salam* contract conditions can be classified into:

1. The buyer should fully pay the price of goods in cash at the time of the contract to avoid sale of debt against debt since it is not allowed in Islam.
2. Everything must be clearly stated in the contract, this includes the quality and quantity of the products. This is aimed at avoiding the resultant uncertainty (*gharar*).
3. The time and place of delivery must be agreed upon by both parties, but if there is any change in these it can be revised again by mutual agreement.
4. Only commodities which can be measured precisely by their quality and quantity can be involved in *as-salam* contract. For example, precious stones cannot be sold on the basis of *bay' as-salam* because usually every piece is different from the other either in its quality or in its size or weight and their exact specification is not generally possible.
5. The subject of *as-salam* contract must be available at the time of delivery.
6. In terms of the subject of *as-salam* that must be delivered on the spot such as gold, silver, wheat and others items of interest (*ribawi*) cannot be implemented in *as-salam* contract.

According to the Sharī'ah point of view, the selling or buying of non-existent objects is forbidden due to uncertainty (*gharar*) but there are some exceptions such as *as-salam* and *al-istiṣnā'* which are permitted in Islam. So, forward contract is acceptable according to the Sharī'ah principles if they adhere to the contract of *as-salam* and *al-istiṣnā'*.

## 2.2 Factors hindering the implementation of *bay' as-salam* sale in Islamic banks

According to research conducted by Ayub (2013) there are certain risks attached to the *bay' as-salam* such as counterparty and delivery risk, price risk, marketing risk, asset-holding risk and early termination chances. However, he argued that these risks can be solved by improving the management of assets. Putri and Dewi (2011) have pointed to three problems in conjunction with the implementation of *bay' as-salam* in Indonesia by BPRS or Islamic Rural Bank which are: unavailability of sufficient business models, insufficient risk management and the perception of bankers that this contract is unprofitable. The result is still not ideally appropriated with Islamic teachings. Nonetheless they suggested performing some adjustment by referring to the fatwa concerning this matter.

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Furthermore, Kaleem and Wajid (2009), explored the possibility of *as-salam* contract in the agriculture sector of Pakistan. They concluded that this financing scheme is fully viable in assisting poor farmers in Pakistan as it is acceptable with regard to the operation of the modern banking system. Even so, the application of the *as-salam* contract should be implemented wisely to avoid large scale default. They recommended to the banks that the proposed *bay' as-salam* scheme should carefully select the farmers; only eligible farmers who have a good reputation can be accepted to make the contract, and banks must control the contract effectively to reduce operational costs, and lastly to appoint middlemen as partners or agents.

Besides that, Muneeza et al. (2011) in their exploratory study stated that *as-salam* is a risky contract compared to other commercial contracts. However, an appropriate *as-salam* model could assist poor farmers in the country, which will automatically promote the development of the economy in Indonesia. Therefore, the *bay' as-salam* condition gives mutual benefit among the parties involved, where the seller gets some money in advance for his insufficient budget for production and the buyer can obtain a special price which is usually at a lower rate than the market value (Kaleem & Ahmad, 2016). Looking at the previous studies mentioned above, *bay' as-salam* contract is one of the Islamic financing instruments that brings a lot of risk, since selling the product faces market uncertainty which affects the price volatility thus making this contract relatively risky.

### **3. METHODOLOGY**

A qualitative research methodology based on two approaches was employed to meet the objectives of this study. A content review analysis based on past literature was adopted for the sake of identifying common factors preventing the application of *bay' as-salam* in the Islamic banking industry in general and in Indonesia in particular. Based upon this, several issues were highlighted then posed to experts working in the banking industry. Beneficiaries represented by Indonesian farmers were interviewed as well in order to discover obstacles confronting them if this specified contract was applied.

### **4. DISCUSSION**

#### **4.1 Inhibiting Factors**

Previous studies indicated a number of inhibiting factors confronting the application of *bay' as-salam* in the Indonesian Islamic banking industry. Such a study was conducted by Ascarya and Yumanita (2006), in which they examined several factors caused by the lack of profit and sharing (PLS) in Indonesia's Islamic banks using the Analytic Network Process (ANP) methodology. They placed these into four aspects, namely: Islamic bank internalities, customers, regulations, and the Government. It was taken into consideration that some of them may occur in the area of *bay'*

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*as-salam* contract which is not implemented yet by Islamic banks in Indonesia (Ascarya, 2009). They are as follows:

#### 4.1.1 Avoiding risks

The quality and quantity of the agricultural sector is highly dependent on the season and weather as well as fluctuating prices of agricultural commodities, hence this sector is considered risky for banks. Therefore, due to these reasons banks do not engage in the *bay' as-salam* contract.

#### 4.1.2 Regulations

Regulations have the greatest contribution in the development of Islamic banking in Indonesia, thus the implementation of *bay' as-salam* needs a special policy to support it.

#### 4.1.3 Low comfort level

Contracts in Islamic banks are still dominated by *murābahah*, *mushārahah*, etc. and as far as banks are concerned, they are more comfortable with these contracts. Thus, in financing to the agriculture sector, banks perceived it was not necessary to utilize *bay' as-salam* as other contracts were already accommodated by banking operations. Therefore, they did not establish *bay' as-salām* as one of the tools of Islamic financing.

Banks (including Islamic banks) will always naturally play safely in managing funds to the counterparty because *murābahah* is a system that gives more returns, it is easier to apply, and is less risky. The alternative is *bay' as-salam*, which is not easily carried out into practice by Islamic banks.

#### 4.1.4 Profit/business oriented

It is difficult to say that Islamic banks give more space to social benefit-oriented transactions; maximizing profits will always be a priority. Thus, banks pay the greatest attention to the business sector which is more profitable and provides fixed results. Therefore, the uncertainty of *as-salam* financing in the agriculture sector will be a major factor for banks to exercise prudence in involving this contract.

#### 4.1.5 Limited channeling

Most farmers live in villages or rural areas which are not the areas where most banks are located, since they are concentrated in urban areas. It is thus difficult to obtain funds for farmers in the banking environment. Transportation costs and the costs of administrative or legal documents incurred by the farmers could make them prefer the option of alternative financing which appears more straightforward, such as money lenders who impose interest.



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#### 4.1.6 Long term financing

*As-salam* financing in the agriculture sector requires a long period of harvest. This fact obviously poses a risk for banks, since banks are business institutions that are also obliged to submit a return for the results on a regular basis over the term of the existing deposits. For instance, bank deposit types that usually have a one-month period must refund the original amount plus profit sharing to their customers every month. Therefore, banks should be able to generate returns in a short time, so the solution is to place the fund into a profitable transaction, for example into *murābahah*, which will give returns within a certain time. This is one of the factors affecting why banks are reluctant to get involved in *bay' as-salam* financing in matters of placing funds in long-term financing.

#### 4.1.7 High cost

This mode of financing also requires high operating costs as the banks need to ensure returns by conducting a survey prior to making the contract, the cost of controlling and monitoring during the process, transportation or delivery costs and most importantly, recovering the cost if the harvest fails and so on.

#### 4.1.8 The bankability of farmers

In the eyes of the banks, farmers are not bankable because small farmers do not have good working knowledge of accounting and reporting of agricultural activity. In addition, the legal aspect is also the reason that small farmers are not bankable which includes the inability of farmers to show business licenses as well as provide additional collateral which is held by the banks to cover the financing risk.

### **4.2 The Bank's Preference of *Bay' As-salam* and Justification**

Despite the consensus among Muslim jurists on the permissibility of *bay' as-salam* and its potential as a mode of financing, none of the Islamic banks in Indonesia are currently applying it in their operations. Therefore, this section will seek to find out why Islamic banks are reluctant to implement *bay' as-salam* as a mode of financing for their customers. Furthermore, it will attempt to investigate the obstacles and challenges that are hindering its implementation by the Islamic banks in Indonesia.

#### 4.2.1 Regulations

According to our interviewees the main impediment to the application of *bay' as-salam* as a mode of financing by Islamic banks in Indonesia are the regulations that restrain the Islamic banks from getting involved in direct trading. However, the application of *bay' as-salam* necessitates the

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involvement of the bank into direct trading where it buys a commodity from the farmer and then sells it with profit to commodity traders or manufacturers who use it as raw materials. Since the bank is not in need of the commodity, it has no other choice.

This confirms the finds of previous studies such as Ascarya (2009), which stressed the importance of proper regulations in the development of Islamic Finance. The Islamic banking system cannot flourish without appropriate rules and regulations in place. Therefore, it is vital to revise and amend the existing regulations in order to allow Islamic banks to provide financing through *bay' as-salam* for those in need of it to realize their potential and increase their welfare.

#### 4.2.2 Counterparty Risk

Risk is one of the factors mentioned by our interviewees as a major challenge for the implementation of *bay' as-salam* by the Islamic banks in Indonesia. Counterparty risk refers to the possibility that one of the parties to the transaction could default (Bacha, 2017). *Bay' as-salam's* similarity to the forward contract makes it susceptible to the counterparty risk that is found in the forward contract. However, Bacha (1999) points out that counter party risk in the *as-salam* contract is one sided, since the buyer (bank) has to pay the price in full to the seller (farmer) at the time of affecting the sale. The seller (farmer) will not be exposed to the counterparty risk, because he has already received the payment in full at the signing of the contract which is one of the conditions of *bay' as-salam* as pointed out earlier.

Nevertheless, the buyer (bank) will still be exposed to the counterparty risk since there is a possibility that the seller (farmer) might fail to deliver the commodity as specified in the contract. Furthermore, there is the risk that he may not recover the money he paid when he was entering the contract. This makes *as-salam* even riskier for the buyer (bank) than the forward contract. Therefore, *bay' as-salam* is not appealing to Islamic banks which are often driven by the objective of maximizing profit and minimizing risk.

#### 4.2.3 Commodity Price Risk

In addition to the counterparty risk, there is a commodity price risk involved in *bay' as-salam*. Our interviewees asserted that the bank will be exposed to losses if the price of the commodity falls at the time of delivery. Since the bank does not intend to hold possession of the commodity it will have to sell it at the prevalent price, thus incurring some losses. However, this could be resolved by resorting to parallel *as-salam* where the bank enters into another *as-salam* contract with a third party for the same commodity that it is going to acquire from the first contract, to be delivered at the same time or this risk can be mitigated through indulging in Takaful service for the crop.

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Takaful would compensate the farmer financially in case of any damage to the crop (Ehsan & Shahzad, 2015).

#### 4.2.4 High Cost

Another obstacle raised by our interviewees is the high cost of implementing *bay' as-salam*, where the bank would incur various costs through the process of the *as-salam* contract:

- Before entering into the *as-salam* contract the bank has to assess the creditworthiness and honesty of the farmer. This investigation requires resources which may be higher than the assessment of conventional customers who have a record of taking up loans or have a stable income.
- After the agreement with the farmer on the *as-salam* contract, the bank must find another party who is interested in buying the commodity upon its delivery from the farmer since the bank is not in need of the commodity. Thus, it will bear further costs in the process.
- However, if the bank does not find a buyer for the commodity upon its delivery from the farmer it will incur the cost of storage of the commodity which may in some cases be very high.

### 4.3 Comparison between *Bay' as-salam* and Forward contract

Forward contracts are basic financial risk management tools that could be used for hedging against price fluctuations and reducing risk. It is the closest derivative contract to *bay' as-salam*; there are striking similarities between the two contracts. Despite these similarities there are differences between the forward contracts and *bay' as-salam* as well. Hence this section seeks to explore the similarities and differences between the two contracts.

*Bay' as-salam* is considered the Islamic version of the forward contract. *Bay' as-salam* is defined as: “a sale whereby the seller undertakes to supply some specific goods to the buyer at a future date in exchange of an advanced price fully paid on the spot” (Uṣmānī, 2002, p.186). Whereas a forward contract is: “An agreement between two parties to deliver and make payment for a designated commodity or service at a designated future date” (Paul et al., 1976).

Both the contracts are agreements on the future delivery of a specified commodity on a specified future date. Furthermore, they are over-the-counter negotiated instruments; their prices, quantities and maturities are determined through a negotiation between the parties involved. However, there is one major difference between the two contracts. In *bay' as-salam*, the buyer has to pay the full price of the commodity to the seller upon entering into the contract of *as-salam*. Failing to do so would render the contract null and void. This condition is unanimously agreed upon by the Muslim jurists although Imām Mālik allows two to three days of concession (Paul et al., 1976).

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On the other hand, the buyer in a forward contract is not required to pay the full amount at the time of affecting the sale. With the exception of prepaid forward which involves paying today to receive the asset in the future (McDonald, 2003, p. 120), the buyer has to pay the full price only upon delivery in standard forward contracts. This is the reason why the conventional forward contract is considered un-Islamic, since both the delivery of goods and payment is being made at a future date, hence violating one of the conditions of *bay' as-salam*. Furthermore, failing to uphold this condition makes the forward contract tantamount to sale of a debt against a debt, which was prohibited by the Prophet ﷺ.

In addition to this, *bay' as-salam* differs from forward contracts in that its underlying asset has to meet certain criteria. The Shari'ah has put certain conditions on the underlying assets which are not necessary in forward contracts. For instance, *as-salam* cannot be affected with respect to things which have to be delivered on the spot, such as the exchange of gold for silver, as the Shari'ah requires the simultaneous delivery of the two commodities. Failing to do so would be tantamount to usury (*ribā*), whereas the underlying asset in forward contracts can be currency for currency (Ringgit for Dollars), gold for currency or any other financial asset. Therefore, the underlying assets in *bay' as-salam* are more restricted than forward contracts, making it less flexible.

## 5. CONCLUSION

The *bay' as-salam* contract in Islamic commercial law is of the important methods of investment in Islam because the aim of the contract is to finance farmers in a production level, and *as-salam* can play an important role in economic development. It encourages the demand for agricultural goods to be stabilized and at the same time grants benefits to the farmers. Currently, *as-salam* is not practiced as a mode of finance in Indonesia because of many reasons such as counter party risk, high cost, commodity price risk and regulation risk.

Therefore, to mitigate all these risks that banks might face if they implement the *as-salam* contract, these are the policy recommendations:

1. Banks should initially sign selected contracts under *bay' as-salam* as caution is needed in the presence of existing debts of the farmers due to a multi-pronged obligation to serve the debts. This to mitigate the counter party risk. In other words, banks should finance only potentially suitable farmers.
2. The reputation of the farmer should play a vital role in the whole finance decision. Guarantees of future delivery should be awarded to potential suitable farmers and the farmers should have to provide the guarantor a guarantee in the case of defaults.

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3. Banks may appoint middlemen as their agents or partners. This arrangement can play two important roles: to reduce the operational risk to the bank in the case of default delivery, and to transfer the risk to a third party.
  4. Quick and efficient decision making will be critical for the success of such a contract due to the farmers having a specific time frame to produce their commodities.
  5. Continuous monitoring and information sharing with the middlemen in previous defaults can play an important role in building trust and cost-efficient working relationships.
  6. Sale of substandard seeds, fertilizers and other inputs should be strictly curtailed, otherwise if the crop fails, banks will not even be able to recover their original investments until the next harvest.
  7. The initial starting point from the Bank Central of Indonesia is essential. This is because when there are proper regulations and guidelines to follow, the Islamic Bank will have a greater comfort level as there is a guarantee from the regulator.

To support all these given recommendations, these are the proposed models for *as-salam* financing under Islamic banking. The first model where there is no third party or middle man involved in the process. The product innovated here is a hybrid of *as-salam* using a *wakālah* contract. These are the processes:

1. The bank opens and advertises to farmers to apply for *as-salam* assistance facility.
2. Farmers apply for the facility.
3. The bank chooses farmers by looking at their background information.
4. The bank enters into *as-salam* agreement with the farmer.
5. The bank pays the money in full.
6. The bank enters into an independent contract of agency with the farmer, appointing him as a bank agent to sell the products.
7. The farmer finds customers to sell the products and enters a promise with them.
8. The farmer delivers the product constructively to the bank and as an appointed agent of the bank, the farmer will immediately sell the products to the consumers. Owing to unforeseen calamities, if the farmer fails to produce the amount agreed, he should buy it from the market and supply it.

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9. The farmer gives the sales money to the bank and bank pays a wage to the farmer for his work.

What happens in this scheme is that the bank will introduce a facility in which they will invite farmers who need assistance to produce agricultural products to apply for bank assistance. The bank would be the buyer of the products using *as-salam*. The farmers have to give details of the farm size and the products they intend to produce.

The amount, quality, and the date of delivery shall be specified in the documents. Two guarantors must also be stated in the documents who are willing to indemnify if anything goes wrong and at the same time the availability of the product which they intend to grow must also be specified. So, the bank would examine all the applications made by the farmers and will choose the most profitable products, and they will also look at the capability of producing such a product within the period specified. The guarantors would be checked, then the bank will choose the farmers to which it is ready to give *as-salam* assistance.

The following model is when the third party comes into the picture when an Islamic bank opens an independent subsidiary as their agent which deals with farmers on behalf of the bank. The bank provides direct finance to the farmers only against the recommendations of its subsidiary, and when the farmers furnish the required guarantees. On the hand, it is the responsibility of the subsidiary to provide technical advice, monitoring and collecting the crop from farmers. The subsidiary may also arrange crop inputs for the farmers. Once the crop is received, the subsidiary is responsible for selling it in the market and sharing the profit with the bank as per the agreement.

Farmers also mentioned some possible problems regarding the appointment of middlemen as agents, such as they will:

- Give less profits.
- Consider their own benefits.
- Take high service charges against the facility provided.
- Give preference to their own relatives.
- Delay payment.
- Offer smaller amounts in cash.
- Offer lesser rates for the crop than the market.

Although farmers do not seem satisfied with a third party in the picture, but the banks are in agreement with this model as they want to transfer the risks to the third party.

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## IMPACT OF CUSTOMER RELATIONSHIP MANAGEMENT ON ISLAMIC BANKS AND TAKAFUL COMPANIES: A CASE STUDY OF PAKISTAN

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### ABSTRACT

*In today's business environment, which is dominated by the social customer ecosystem, Customer Relationship Management (CRM) is critical for maintaining successful customer relations and sustainable growth of businesses. Although Islamic Financial institutions (IFIs) of Pakistan do recognize the importance of CRM and work on implementing its principles, they struggle to take the lead over conventional financial institutions with regards to overall market share. Therefore, this paper is an investigative study that pinpoints CRM factors which hinder local IFIs in dominating the current financial industry of Pakistan. The paper attempts to study the extent of CRM application on ground-level in various Islamic banks and Takaful companies, especially during COVID-19 times in the year 2020, when it is essential to sustain strong customer relations. Research findings indicate that although CRM implementation is heavily stressed in IFIs, the required strategic results are not achieved. This qualitative study conducts its research through a questionnaire and short surveys that were distributed out to both employees and customers. About 40 candidates volunteered in the questionnaire, which was formulated using the CRM Value chain model and the author's own proposed framework. The success stories of some of the IFIs have also been studied to propose solutions and recommendations which would assist fellow IFIs in implementing CRM strategies that are more goal congruent with the organization's strategic goals.*

**KEYWORDS:** Customer Relationship Management (CRM), Islamic Financial Institutions (IFIs).

### ACKNOWLEDGEMENT

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## **1. INTRODUCTION**

In these times of globalization, IFIs have found themselves amidst unforgiving competition, increasing customer demands, and the need to keep up with new emerging technologies. The addition of the internet has proved to be yet another challenge towards the smooth running of local IFIs. Pakistan is a developing country and in this internet age, when customers have access to a variety of products and services worldwide, it is becoming increasingly difficult for local IFIs to respond to the needs of customers (Malik & Wood-Harper, 2009). Islamic banks and especially Takaful companies, instead of acquiring new customers, are struggling to retain the old ones (Malik & Wood-Harper, 2009).

Today, IFIs in Pakistan have realized this issue and are actively considering integrating Customer Relationship Management (CRM) solutions in their businesses. CRM builds business management models centered on a 360 degrees approach to the customers (Rodrigues, 2012). CRM has the potential to bring in new customers and retain the existing ones. It assists in cutting costs because customer retention is less costly and demands less resources. The whole objective of CRM is to help IFIs understand the current customer needs, get an idea about their behavior through past interactions, and what they plan to do in the future to meet their own goals (Anderson & Kerr, 2002).

CRM in Pakistan is extremely misunderstood as data collection and expensive complicated software, when the bigger picture consists of not just algorithms and charts. “It is a simple philosophy that places the customer at the heart of a business organization’s processes, activities, and culture to improve his/her satisfaction of service and, in turn, maximize the profits for the organization” (Malik & Wood-Harper, 2009). Currently, in the Islamic financial sector of Pakistan, CRM tends to merely be an I.T. system that only records customer details (necessary or unnecessary), without producing the required results. It bypasses the entire aim of CRM implementation to be goal congruent with the organization’s mission statement (Malik & Wood-Harper, 2009).

This research paper will delve deeper and highlight to what extent CRM is being incorporated in the organization structure of IFIs in Pakistan, specifically Islamic banks, and Takaful companies. It will identify what steps are being taken to overcome challenges in implementing CRM. At the same time, it will also investigate CRM strategies, applied by these IFIs, that have provided with most positive results. Alongside, it will also investigate challenges faced by IFIs in the current crisis of COVID-19.

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CRM is like a ‘make or break’ tool that, if implemented and understood in the right manner, can give an IFI the kick start it needs to become profitable over a much shorter time period, otherwise it can further degrade business growth. IFIs must focus on CRM which encourages to work smart and see immediate results. It is important to “Make the right offer at the right time to the right customer” (Malik & Wood-Harper, 2009).

A powerful and efficient CRM in IFIs will encourage the customers to choose and make transactions via IFIs, instead of choosing conventional institutes as conventional institutes have highly effective and fascinating CRM techniques which causes an average person to get attracted towards them. This simple tool leads to customer retention, required for IFIs in the long run (Malik & Wood-Harper, 2009).

Functional and customized CRM techniques will play a gigantic and vital role towards the awareness of Islamic Banking system and Takaful companies. It is a cardinal source of strength for Islamic Financial Institutes across the globe (Malik & Wood-Harper, 2009).

Trustworthy reporting is another crucial point for increasing the firm’s good reputation and revenues. Authentic reporting will open the weakness of the institute and CRM facilitates this factor. IFI can pinpoint the weakness and work on to them to turn those weaknesses into strengths which lead to more productivity (Greenberg, 2010).

Looking at the latest and current situations of IFIs in Pakistan<sup>4</sup> is the main criteria of this research. The objectives of this study are to conduct an in-depth survey analysis, which presents the steps each of the IFIs are taking to acquire and retain profitable customer relations.

Other objectives of the study include pinpointing the challenges IFIs in Pakistan are facing in implementing CRM and highlight the new challenges IFIs are facing due to changes brought by the novel coronavirus of 2019 in maintaining connection with customers.

Finally, working out the best possible solutions for the above stated problems and challenges through an investigative research of success stories e.g., Meezan Bank’s increasing popularity.

The study deals with various problem areas that need improvements and greater focus. Problem statements include the failure to customize products and services according to changing customer needs. Today’s customers are more aware and educated, they expect a greater degree of variability in terms of products and services. As times are moving to favor more online facilities and lifestyle, it is becoming a need for IFIs to enhance their product and service portfolio which favor advancement.

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<sup>4</sup> Refer to appendix section that contains pie charts indicating current market share status of Islamic bank and Takaful industry.

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Other problem statements include the inability to keep up with technology, paucity of customer-centric culture in the organization, ‘Overload of outdated data with no means of processing it into clear and concise information’, misunderstanding CRM as merely sophisticated use of software and technology while failing to understand the main purpose of CRM and, inability to adopt and apply innovative ways of CRM quickly, when faced with unpredictable situations and crisis.

The subsequent sections are organized as follows: section two represents the literature review. The third section represents the research methodology and the conceptual framework that was used. The fourth section extensively analyzes the research findings and uses graphic representations. The fifth section provides with recommendations and solutions for Islamic banks and Takaful companies in problem areas that were highlighted through survey analysis. It also summarizes the key points that need to be focused and advice for future research along with the limitations of this paper.

## **2. REVIEW OF LITERATURE**

### **2.1 CRM origins and evolution**

According to (Rodrigues, 2012) origins of the concepts of CRM date back to the late 90’s of the last century and although it might not seem too long ago in comparison with other well-established concepts in business literature, much work has been done and value has been associated with CRM. It is difficult to trace back and authenticate who was the first theorist to define CRM, but several sources mention Lehtinen together with his colleagues to be the first ones to define and thoroughly research CRM (Lehtinen, 2007, pp. 18-19). According to Lehtinen, the concept of “CRM came into being together with development of marketing which gradually became more personal until it transformed into direct customer marketing, also known as one-to-one marketing (Lehtinen, 2007).”

Over time this concept of marketing has steadily been transformed from ‘*Transactional to Relational*’ (Dohnal, 2002). Classical/transactional marketing is now being categorized as a historic marketing tool, and new relational marketing trends are being established and favored by industry leaders. According to Dohnal et al., “Relational marketing is a process of identifying, establishing, maintaining, improving, and if necessary timely termination of economic relations with customers and other concerned subjects for the mutual benefit of all involved parties, which is achieved by mutual fulfilling of obligations and values” (Dohnal, 2002, p. 32). Kotler et al. also extensively emphasizes, that relational marketing is a key area that marketing professionals need understanding of, the author goes on to say: the seller, who knows how to build a strong relationship with customers will achieve many successful businesses in the future. (Keller, Kotler, Brady, Hansen, & Goodman, 1992, p. 731)

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## **2.2 CRM definition**

CRM definitions are diverse, and each author brings in a new dimension, yet all affirm concepts of customer relationships, customer management, marketing strategy, customer retention and personalization (Zineldin, 2005). As one of the simplest definitions says, the CRM concept helps the company in anticipating customer needs and wants, resulting in building strong customer relationships (Schermerhorn, 2008). Whereas a little more detailed definition mentions, CRM is a process of understanding customers and working toward satisfying and exceeding customer expectation through the provision of customer needs and desires (Nickels & McHugh, 2008). Nickels et al. not only mention satisfying customer needs, but going above and beyond, to exceed customer expectations. This suggests that in constantly changing market situations, merely responding to customer needs is not enough. Instead of this reactive CRM approach, companies need to take a more *'proactive approach'* towards CRM, where they anticipate and respond to future customer needs. According to Adam et al., CRM is an enterprise approach that comprehends and affects customer behavior by using effective communications to improve customer acquisition, client retention, customer commitment, and customer profitability (Lo, Lee, & Stalcup, 2010)

Perhaps a more suitable definition in the context of this specific research is defined by Ling et al. and Joseph et al., both stress on the aims of retaining customers and making long term profitability decisions:

*"CRM comprises of a set of processes, which enables systems supporting a business strategy to build long term, profitable relationships with specific customers. The key objective of CRM is to enhance customer value through a better understanding of individual needs and preference"* (Ling & Yen, 2001).

And:

*"Management of customer relationships based on the integration of customer information throughout the business enterprise in order to achieve maximum customer satisfaction and retention."* (Joseph F. Hair, Bush, & Ortinau, 2003).

## **2.3 Modern CRM concepts**

Modern concepts of CRM are derived from the theories of total quality management (TQM) and more technologically advanced archetype (Zineldin, 2005). This is because the current marketing environment is becoming highly saturated and unforgivingly competitive (Chou, Lin, Xu, & Yen, 2002), along with continuous variation in customer preferences and purchasing habits. It comes as no surprise that constant changes in customer buying decisions are heavily influenced by the

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internet which has made the world a global village and enriched us all by providing constant updates related to new trends and preferences. As a result, companies have been forced to tailor their offerings, understand customer drivers and customer profitability to maximize their overall customer portfolio (Chen & Popovich, 2003).

Consequently, emphasis on these key areas has led to heavy concentration of marketing attention on improving long-term customer profitability and letting go of the traditional ways i.e., product-centric marketing (Chen & Popovich, 2003). This also means that CRM is no longer a one way channel, in the fast-moving modern times it is crucial to understand the main purpose of CRM which is to take input from customers and give output back to them, essentially it is a two-way communication (Payne & Frow, 2004). Two-way communication is also one of the solutions for ever-changing customer preferences due to unimaginable pace of advancement in technology and the internet.

Simply put, in modern times, firms cannot compete favorably with minor advantages and ploys which can be easily replicated by competitors (Bose, 2002). To hit real long-term milestones, CRM implementation is critical. It will enable firms to rise above minor advantages and integrate real attention towards customer relationships across all areas of business. Firms that are most successful at delivering what customers want are more likely to be future leaders of the industry.

#### **2.4 Objective and benefits of CRM in the Islamic financial sector**

Islamic banks and Takaful companies of the current time are moving towards a revolutionary phase in their industry lifecycle in that they have started laying stress more than ever on building lasting relations with their customers. In his book Foss explains the objectives such financial institutions would be trying to achieve by incorporating CRM in their business, which include:

- Creating consumer-centric culture and organization.
- Procuring customer relationships.
- Expanding customer contributions.
- Aligning efforts and resources behind the most valuable customer groups' (Foss & Stone, 2002).

On the other hand, Dyché (2002) briefly presents an approach that might enable banks to achieve such objectives. He mentions the idea of collecting customer data even before implementing any CRM strategies: "The bank would need a complete view of its customers across the various systems that contain their data. If the bank could track customer behaviors, executives can have a better understanding in predicting future behavior, and customer preferences. In this way, the data and the applications will help the bank to manage its customer relationships and continue to grow

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and evolve” (Dyché, 2002). Then and only then, can we make use of the CRM system and move towards gaining insight into the behavior of customers and focus on the value of those customers (Onut, Erdem, & Hosver, 2008). The “CRM system or software comes with its own privileges and benefits such as:

- Provide better customer service.
- Make call centers more efficient.
- Cross sell products more effectively.
- Help sales staff close deals faster.
- Simplify marketing and sales processes.
- Discover new customers.
- Increase customer revenues” (Malik & Wood-Harper, 2009).

There is quite a few CRM software developed to date; some of the most widespread ones are undoubtedly SAP, Siebel, Sales force, Amdocs etc, although in the Islamic banking sector SAP and Siebel Systems are very popular (Malik & Wood-Harper, 2009).

## **2.5 CRM components**

Different authors have presented with different CRM dimensions e.g., Dyché’s approach on CRM solution/ways, categorizes it as Operational CRM and Analytical CRM (Dyché, 2002). Others have used Proactive and Reactive CRM measures to classify the former. Two main CRM elements are extensively used in many organizations including in the Islamic financial institutions are organizational and technological factors (Rafiki, 2019). Both go hand in hand, firms need to realize that simply investing in high-tech computers and up to date CRM software will not be enough, organizational factors must support and play an equal role. Some companies adopt CRM systems merely because it is the most advanced technology and they believe they should have it since their competitors have it as well (Chou, Lin, Xu, & Yen, 2002). Such actions will hinder firms from gaining real benefits of value creation from CRM.

For the purpose of this research, we will be focusing on organizational and technological approach towards CRM. Factors that contribute towards effective CRM implementation are:

### **2.5.1 Organizational factors**

Organizational factors refer to the factors that relate directly or indirectly to the structural, operational, and managerial sides of the business (Becker, Greve, & Albers, 2009). Payne and Frow, (2004) goes on to say, major organizational factors associated with CRM success consist of the company’s structure and its operational business practices. Buttle (2001) argues that companies are being sold front-office and back-office solutions, but are missing out on the fundamental,



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strategic benefits that CRM can provide. This further signifies the importance of organizational factors, which can be further divided into: top management support, customer orientation and training orientation.

#### *2.5.1.1 Top Management role*

In any type of organizational culture, top management has the most influence over its employees and business practices. Therefore, it becomes extremely critical for senior executives and officers to be involved in building up a customer-centric culture. In cultures that evolve around directive, transformational or authoritative leadership styles (Fagaly, 2018), it will be a key factor for top management to adopt high value for CRM as subordinates will follow and learn from the seniors. This will affect not only within the firm but will be reflected outside the firm, when customers feel leaders of the firm are committed towards customer value creation, long-term relations with customers will be cultivated based on trust.

This will establish a necessary level of commitment from staff, with relevant expertise to support the needs of CRM (Lo, Lee, & Stalcup, 2010). Support from top management will set stages in CRM initiatives for leadership, strategic direction, and alignment of vision and business goals (Mendoza, Marius, Pérez, & C.Grimán, 2007). And finally, it will help CRM deployments and implementation initiatives (Kale, 2004).

#### *2.5.1.2 Customer Orientation*

Customer orientation is defined as: “The set of activities, behaviors, and beliefs that place high priority on customers’ interests and continuously create superior customer value” (Cai, 2009). “Customer orientation is an imperative element for CRM achievement, and it is related to marketing and information technology, which encourages to create customer loyalty and other positive impacts to organizational performance” (McNally, 2007). Customer orientation is facilitated by the presence of social media. Companies that aim to get perfect market information can also hire special customer-oriented companies that hold data which helps in building sustainable customer relations. If the information is perfect, it can guarantee improved CRM performance and better decision-making.

#### *2.5.1.3 Training Orientation*

Creating a positive first impression is necessary in any business interaction. Therefore, employees working directly with customers need to have appropriate training and advanced problem-solving skills to serve customers in the best possible manner. Investment in training is a long-term benefit, and it helps in overall quality creation by customizing each customer experience. It brings in tangible and non-tangible advantages. “Employee training is a key factor in the implementation



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process incorporating customer service, improving efficiencies, and nurturing consumer confidence, eventually leading to repeat purchases” (Reichheld, Schefter, & Rigby, 2002). The author also brings in the element of motivating staff; training helps in creating motivated staff. A demotivated employee would risk and might even deteriorate potential customer experience.

#### *2.5.2 Technological factors*

While organizational factors discussed the implementation of CRM strategy, technological factors will discuss how to formulate this strategy in the first place by gathering data and processing that data using IT software and more. Technological factors will enable data collection and processing information to create a more personal interaction with the customer (Kotler, 2002). In the context of CRM, information technology is an enterprise-focused endeavor encompassing all departments, resulting in various technologies working together such as data warehouse, websites, and intranet/extranet, phone support system, accounting, marketing, and production. According to Goldenberg, IT is not just an application but if implemented properly, it enables firms to have cross-functional, customer-driven, technology-integrated business process management strategy that maximizes customer relationships (Goldenberg, 2000). Factors that attribute directly to the technological aspect of CRM includes customer data, customer information processing, and IT system compatibility with changing times.

##### *2.5.2.1 Customer data*

The essence of CRM lies in getting the complete view of the customer. This is essentially building a customer portfolio using customer data mining retrieved from all the touch points to uncover and determine the right type of customers (Chen & Popovich, 2003). A strong customer profile will assist in making predictions of future customer purchases, eventually bringing in revenue at a higher rate than in the past.

Alternatively, IFIs can hire specialized customer data collecting companies, although this may prove to be more costly than its potential benefits. For this reason, companies are shifting to a more recent collection method known as *big data*. “Big Data is large volumes of data, extracted from a variety of sources and in various formats processed by highly sophisticated software e.g., web logs/ cookies, customer social media, customer bank transactions, government documents on customers, customer GPS tracking etc.” All this data in turn helps in predicting customer behavior and future purchases.



Figure 1: Sources of big data from Kaplan (2019).

Although big data can provide primary sources of information, it is accompanied by various challenges. It can be overwhelming for IFIs to process and store such a vast amount of data. It is definitely a costly method of data collection and so users have to specifically determine what data is needed by the firm, to make sure not just anything is being stored, resulting in a drastic increase in information storage costs. At the same time, it becomes critical to equip the IT department with more advanced data processing systems that will direct to making the most suitable decisions. Many researchers agree that poor-quality customer data and information will result in poor data analysis followed by poor decisions made (Kirkby & Nelson, 2001; Ryals & Payne, 2010).

#### *2.5.2.2 Customer Information Processing, CIP*

Professor Tom Davenport of Boston University explains, “Technology has evolved to the point where it is possible to put customer information from all over the enterprise into a single system. Until recently, we didn’t have the ability to manage the complex information about customers, because information was stored in 20 different systems” (Berry, 2003).

This advancement and innovation in technology coupled with the internet are the main drivers of present and potential customer profitability which makes it possible to appropriately apportion and allocate the firm’s resources to all departments that affect customer relationship (Chou, Lin, Xu, & Yen, 2002).

CRM systems together with Executive Information Systems (EIS), Decision Support Systems (DSS), Management Information Systems (MIS), and Transaction Processing Systems (TPS), can help not only transform customer data into business knowledge, but also integrate the CRM strategy into information system packages at every management level. This will enable the implementation of CRM strategies from a strategic level of business, all the way down to the operational level.

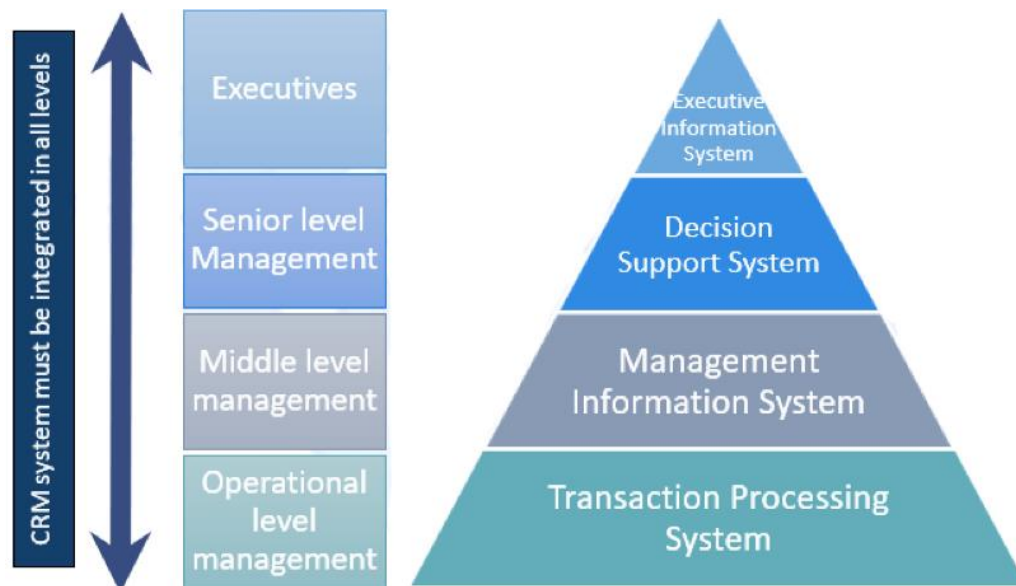


Figure 2: CRM system working hand in hand with other information systems.

Source: Anthony's hierarchical framework.

IFIs deal with constantly changing product offerings as well as increasingly knowledgeable customers, therefore, it is crucial for them to make use of these information systems (Rafiki, 2019).

#### 2.5.2.3 IT system compatibility with changing times

Even though the pace of advancement and innovation in technology is growing exponentially, the uncertainty factor still cannot be excluded from the equation. In fact, with new emerging technology the risk and uncertainty factor also keep adding up. Volume, variety, velocity, and veracity of data is another challenge in making the future less unpredictable (Kaplan, 2019). Therefore, it becomes impossible to be prepared enough for unpredictable events. To deal with such events and scenarios, IFIs need to have flexibility in the IT system and practices. If the unpredictable cannot be avoided beforehand, it can certainly be dealt with as it occurs. IT staff need to have the necessary skills to make decisions swiftly in such critical situations to avoid losing business and customer trust. Building customer trust and loyalty is crucial as it would come

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to aid of business in such unpredictable times. They need to be trained in a tough environment through sensitivity analysis and simulations that to try to replicate various scenarios to some degree. Firms' ability to be compatible with changing times is a key factor especially in these periods<sup>5</sup>, as we go further into the future.

## **2.6 CRM Integration**

CRM integration was vaguely touched upon earlier but now we will see how CRM integration across all departments helps in achieving CRM goals. "CRM needs a supportive culture, it's unlikely to yield dividends in companies which only pay lip service to customer focus" (Buttle, 2001). What the author meant by supportive culture, is that all departments must work collaboratively in a way that supports goal congruency. Goal congruence requires all department managers to focus on objectives that benefit the entire company. If the company aims on achieving strong customer relations, then all departments need to focus on practices that enable it. CRM is unlikely to flourish "if IT, human resources, and procurement processes are not aligned with the CRM agenda" (Buttle, 2001, p. 4). This also means that performance measurement of department managers must be based on indicators that are more aligned with customer satisfaction, quality, percentage of complaints received, or number of new customers acquired. In other words, performance measures need to be more non-financial than financial to promote goal congruent decisions by managers.

To identify what departments need to work together and be aligned with CRM agenda, we first need to identify areas of the business that contribute to the value creation process through the *value chain model*. 'The CRM value chain is a proven model which businesses can follow when developing and implementing their CRM strategies. The basic purpose of the CRM value chain process is to ensure that the company builds long-term mutually beneficial relationships with its strategically significant customers' (Buttle, 2001, p. 2). Strategically significant customers can be defined using the pareto principle or the 20/80 rule, which states that those 20% of a company's customers who generate 80% of total profits need to be focused on more.

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<sup>5</sup> This is referring to the pandemic of 2019, which hit the business industry with a blast, resulting in requiring major changes in how businesses run. (More discussed later)

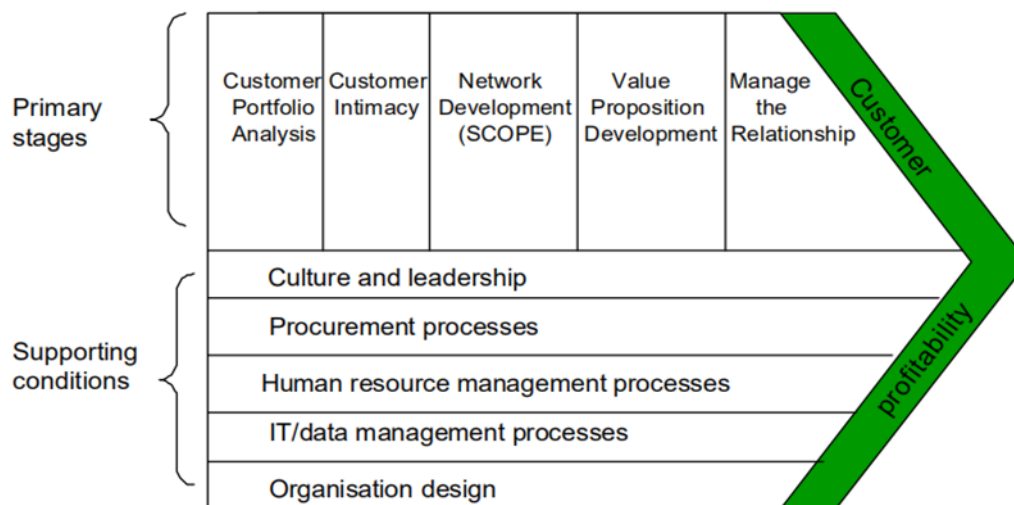


Figure 3: CRM Value Chain.

Source: Adopted from Buttle (2001).

### 3. RESEARCH METHODOLOGY

This section of the paper presents with how the research work has been approached. Since the nature of the paper relates to social science phenomena, it is qualitative, more specifically case study research. Qualitative data sources used online interviews and questionnaires, documents and texts, and the researcher's impressions and reactions. Furthermore, with regards to content analysis: archival records and participant-observation were also the basis for the findings.

Descriptive analysis is conducted by distributing questionnaires to support the arguments and amplification on the CRM practices in Islamic Banks and Takaful companies. The questionnaire was a combination of closed-ended and open-ended questions and was designed to have broad sections which exactly portrayed the framework used for this research. It was distributed out among employees of the research sample companies (participants of research). Employees were chosen from the departments that directly add value to the customer interaction, in this manner the value chain model of CRM has been incorporated in this research.

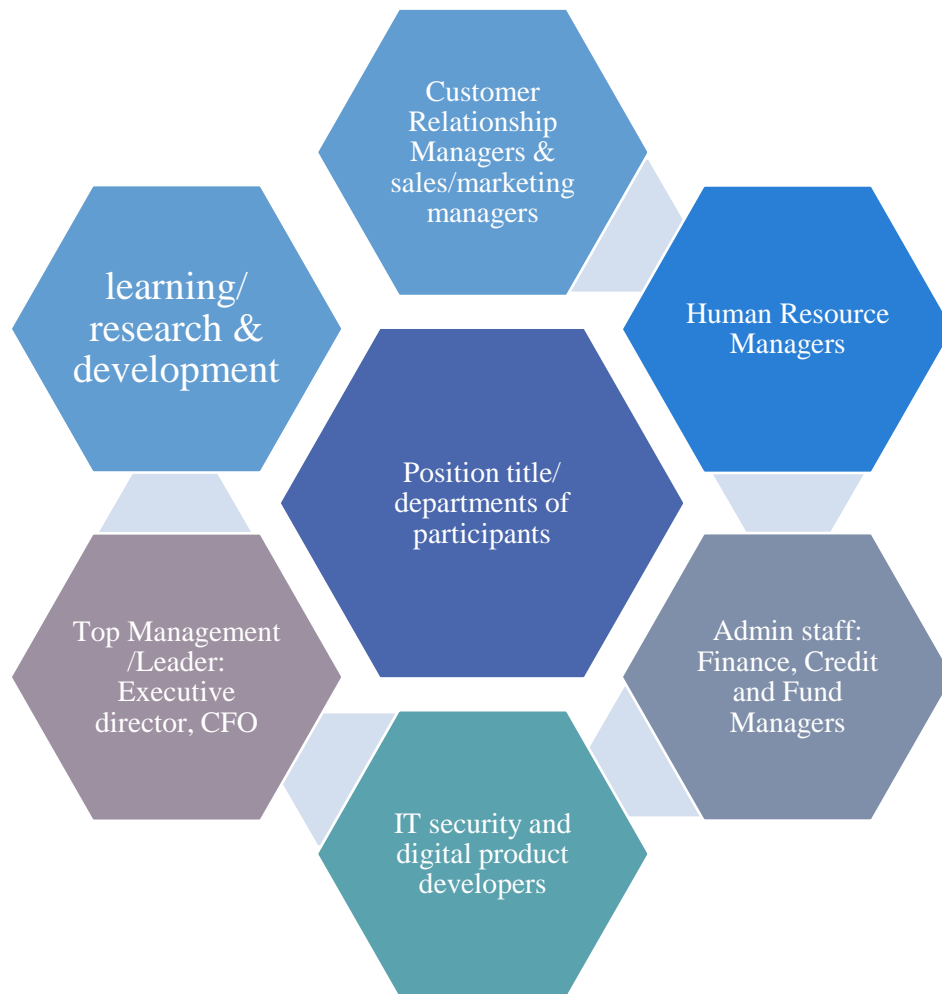


Figure 4: Participants/employees volunteered are in charge and associated with.

To cancel out effects of biased responses from the employees, a short survey was also prepared and distributed out to the customers. Hence, both sides of the picture are considered, and any effect of predilection, prejudice, and prepossession has been minimized. Therefore, two questionnaires were designed. In total 40 respondents participated in both the questionnaire and short survey combined. 21 of them were employees and another 19 were customers. Non-probability sampling was used; specifically, purposive sampling method, as qualitative research relies on subjective judgment.

### 3.1 Sample Participants

Following are the participants under this investigation:

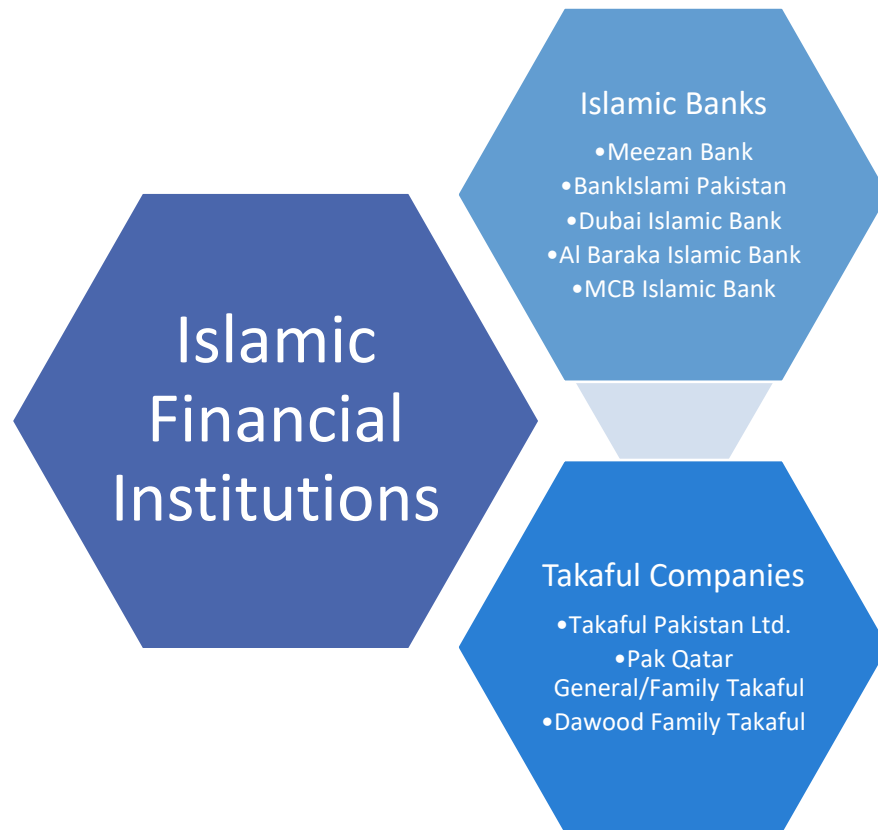


Figure 5: Study Sample

### 3.2 Conceptual Framework

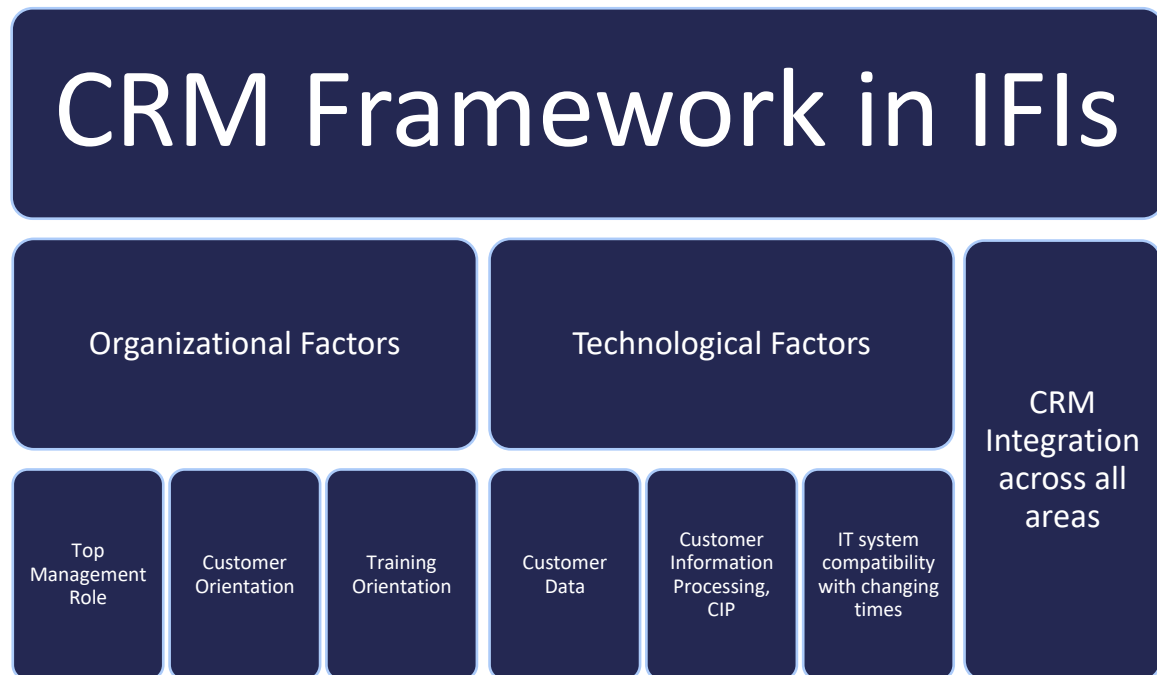


Figure 6: Proposed conceptual framework of the study.

This study uses the proposed framework in preparing the questionnaire. All findings are based around it. The framework is a modification of how CRM is traditionally applied in IFIs of Pakistan. These modifications have become necessary considering how current crisis due to COVID-19 have impacted various businesses, including IFIs. Along with this framework, CRM value chain model has also been used to target business areas and departments that play key roles in adding to customer profitability. Henceforth, participants of the questionnaire were all selected from such value adding areas/departments.

## 4. ANALYSIS AND FINDINGS

### 4.1 Questionnaire analysis from employees

#### 4.1.1 Analysis of organizational factors

##### 4.1.1.1 Top management role

The outline of questions in this part of the questionnaire related to how involvement of the top management introduced CRM in strategic activities of business. The top management has a key role in incorporating CRM values in the company's mission statement.

As shown by the results, most employees agreed that the top management was actively involved in incorporating concepts of CRM in the organization's statement. The breakdown of results showed



that 65% of IFI employees strongly agreed with it. Even though the top management incorporated CRM in the organization's vision, it was seen that only 55% of the employees agreed with the fact that the latter played a role in encouraging and discussing CRM objectives with middle level management. Trends also highlighted that a mere 40% strongly agreed that the top management stimulated interest in the subject matter.

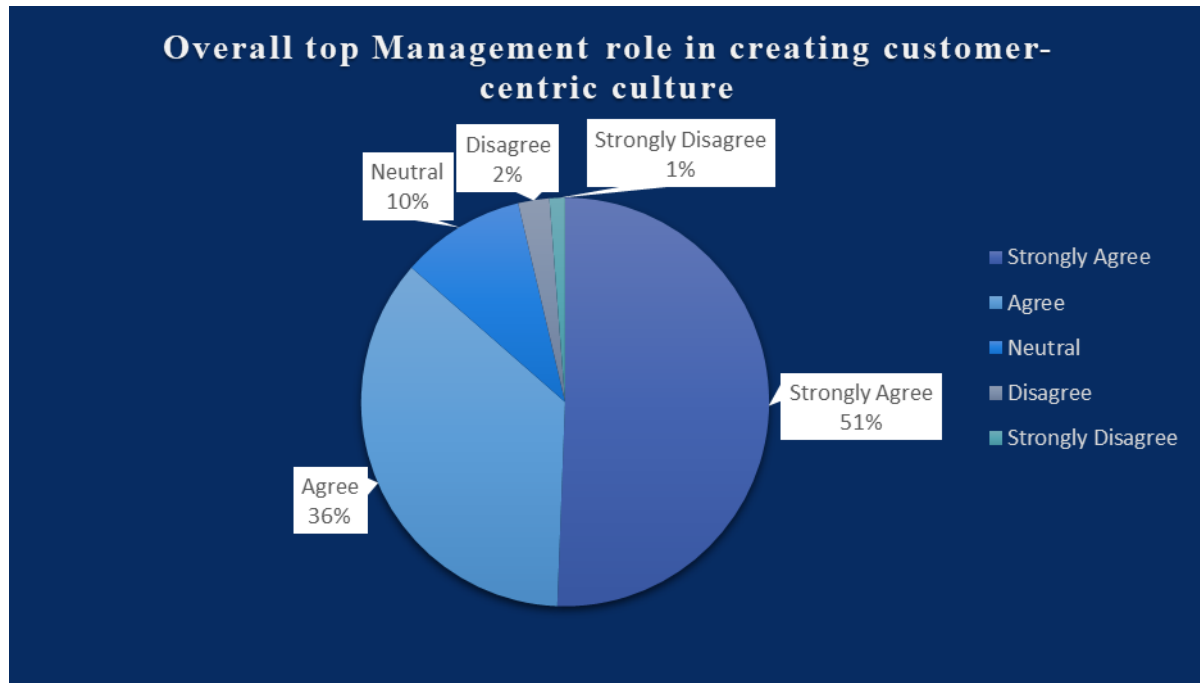


Figure 7: Overall findings in the top management section.

As seen, a majority strongly agrees that top management plays its role towards creating a customer-centric culture in the organization.

#### 4.1.1.2 Customer orientation

A considerable majority indicated that they value customer loyalty and satisfaction but the perspective that seems to be given little consideration was being able to listen to customer feedback and promptly act on it to make changes. Through rigorous observation it was felt that employees were reluctant to express their opinions regarding this concern, therefore, it has been suggested to ask the same point but with customers that were facing issues. Later we will discuss what customers have to say on this.

Quite a few of the respondents remained neutral towards areas such as finding innovative and more interactive ways to connect with their customers. While a further breakdown also showed that 30% remained unsure whether customers were placed at the heart of the business or not. This could indicate that senior management might have failed in delivering their CRM objectives to all

middle managers or it could also indicate that improvements are needed to create a more customer-centric culture.

An absolute 100% agreed that customers were kept updated through emails, but a majority did not ponder if email was the right way to contact customers for all sorts of solicited and unsolicited updates. Employees were unsure if emails were kept customized to requirements of customers.

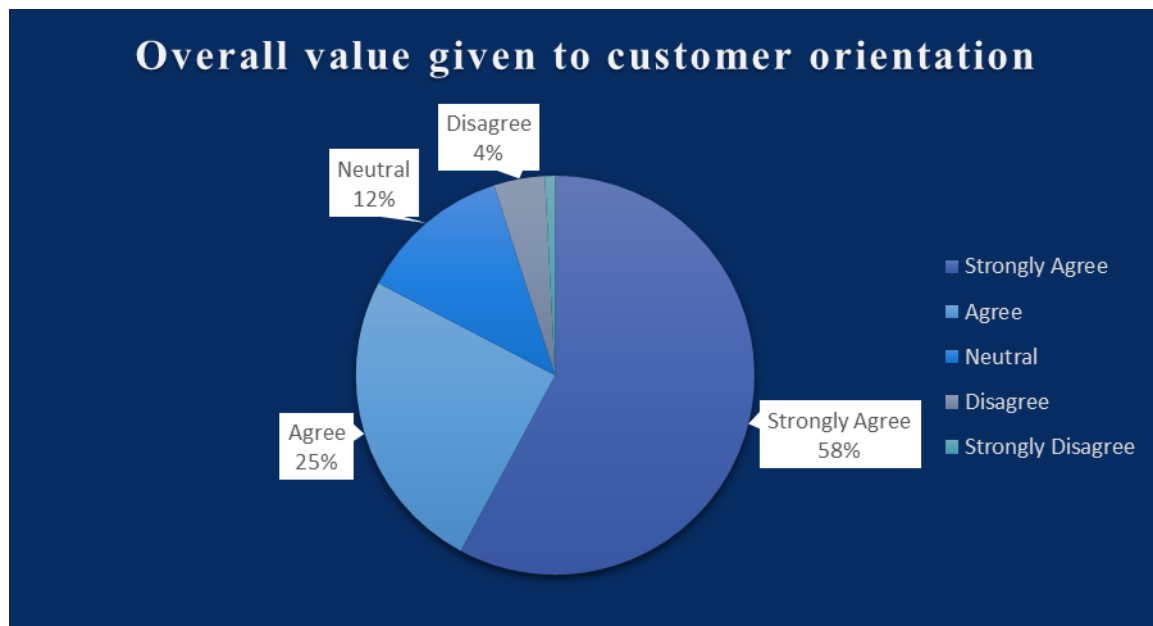


Figure 8: Overall findings in the customer orientation section.

Even though results pointed out quite a few areas that need to be delved into deeper, overall, the results showed a majority of 58% strongly agreed that customers were given top priority and all efforts were made to ensure their loyalty and satisfaction.

#### *4.1.1.3 Training orientation*

About 75% of employees agreed that their company arranges training programs periodically that helps in CRM directly or indirectly. For the rest 25% IFIs that do not conduct training programs following questions were not applied to them. Questions in this section of the questionnaire were related to the effectiveness of training programs in terms of enabling employees to address customer complaints innovatively and providing customer relation employees with a skill set to customize their responses and solutions which best serve customer interest. Questions also touched on whether these training programs equip employees with strong interpersonal skills. It also inquired if training programs directly have had a positive impact on customer satisfaction level.

Breakdown of overall results from this section pinpoint that only 21% strongly agree with training programs enabling them to deal with customer complaints effectively. Consequently, only 36% strongly agreed that training programs have positively impacted customer satisfaction. It can be

evaluated that the two are directly co-related, if employees are unable to address customer complaints more innovatively and effectively then eventually customer satisfaction will suffer.

The section also addressed if training programs educate I.T. personnel in handling CRM information packages, to which only 36.8% agreed. This is another area that IFIs seem to be struggling in. Upon observing the number of respondents, it was observed that even if companies are arranging such training programs to encourage CRM practices, effectiveness of the latter needs more focus as a majority of responses under this section were 'not sure' and resided with staying neutral to most of the statements. Again, customer evaluation has been carried out regarding this perspective to cancel out biased results.

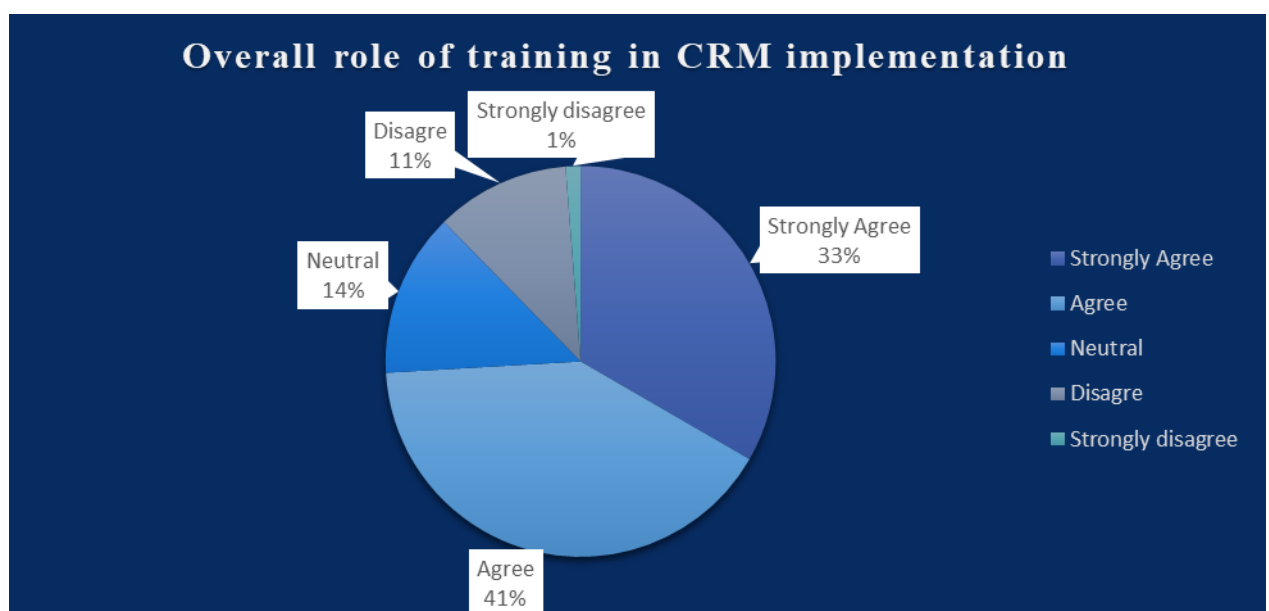


Figure 9: Overall findings in the training orientation section.

#### 4.1.2 Analysis of technological factors

##### 4.1.2.1 Customer data measures

Questions included in this section were about whether a reasonable investment was made in collection and storage of customer related data. If quality data required by staff in direct contact of customers e.g., call center operators had access to customer history and relevant data when responding to their queries, and if all data was updated regularly.

A big part of this section inquired about the familiarity of IFIs with the buzzword 'Big Data' and if it were utilized to extract useful information that could benefit in serving the customer well. Although 12 out of 21 respondents indicated that their organization does realize the importance of data, only 7 of them strongly agreed that "Big Data" was used in their organization to reveal trends

and patterns in the market and predict customer behavior. Further breakdown reveals that exactly 7 more respondents were unsure and indicated that their organization was not that involved in big data collection while the remaining disagreed with both familiarity with big data and its application. Big data is a new way of working out consumer behavior and it requires skilled analysts to use vast amounts of data to produce beneficial data. It can be deduced that currently more skilled data analysts are required who can make use of big data in IFIs of Pakistan.

Overall trends of responses for all above questions can be summarized as follows.

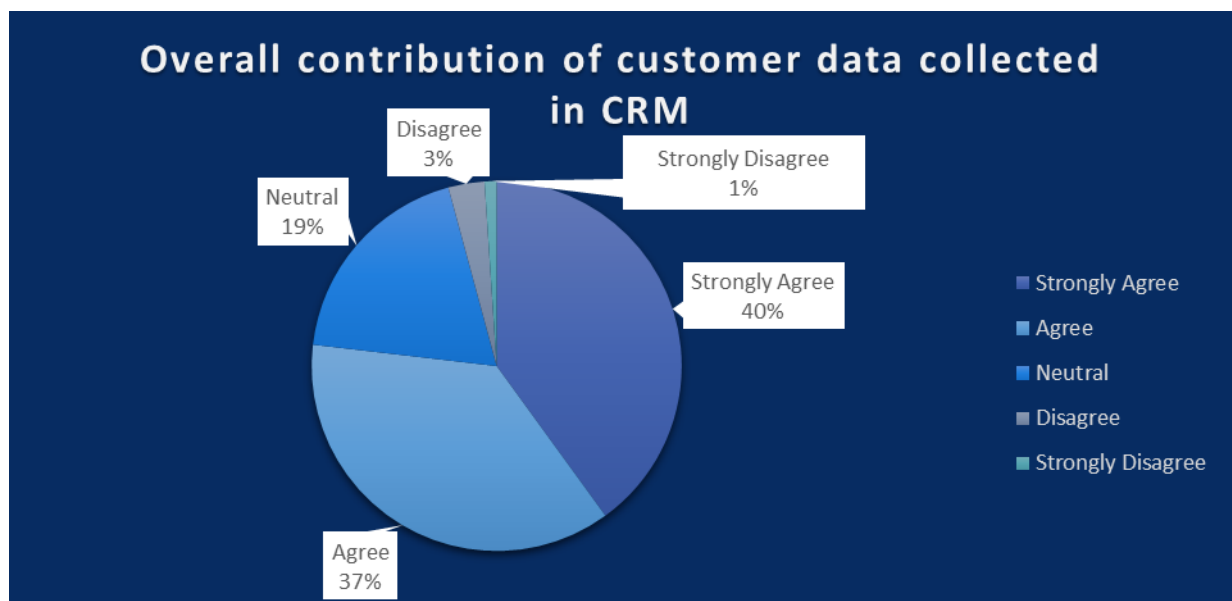


Figure 10: Overall findings in the customer data measures section.

#### 4.1.2.2 Customer information processing (CIP)

This area of the questionnaire seems to be more challenging for some respondents than others. The questions inquired about,

- Degree of investment made in purchase and installation of CRM software.
- Whether computer-based CRM systems were used.
- If data collected was processed into clear and concise information.
- If that information was used towards product development and providing customer demanded services.
- How was this software used for customer retention?

Starting with one of the first statements, nearly 25% of the respondents stated that they were not using computer-based CRM systems at all. These were mostly respondents from the Takaful industry. From the 75% remaining, it was seen that half of them agreed that they have made

reasonable investment in CRM software. Even though half of 75% that had computer-based CRM software agreed, only 30% of them confirmed that they make use of the software to produce clear and concise information. This gives rise to another question, why are the rest of IFIs, that do have CRM software, not using it to produce useful CRM information? Are they only collecting all customer data for no apparent reason? This is the major highlight of the section and certainly needs to be looked at in more detail. These results also portray lack of knowledge about CRM packages and need to process information.

The 30% that did confirm usage of CRM software also mentioned various software IFIs are using currently for CRM. They included Siebel and IBM's CRM software, while most IFIs were using in-house CRM software. It was also observed that some respondents confused CRM software with other risk management related software, this further shows that there is little knowledge to differentiate processes that are related to CRM and other routine business managing processes.

All these statements lead to the most important question: whether CRM information was being used in product development. If IFIs are struggling with processing information and producing it, it would be even more difficult to develop products in-line with customer demand. Therefore, answering this question was challenging for the participants.

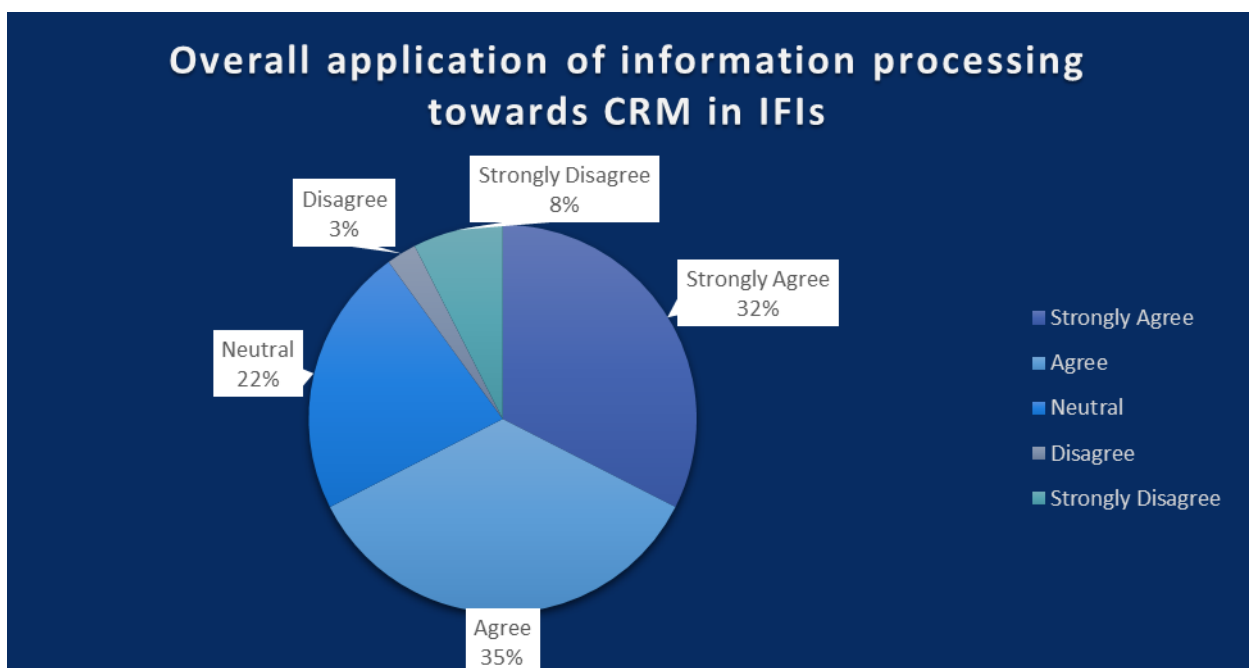


Figure 11: Overall findings in the customer information processing section.

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#### *4.1.2.3 IT system compatibility during COVID-19*

This section was specifically designed to study the impact of unforeseeable conditions i.e., the emergence of a pandemic upon maintaining close customer relations. The intention behind it was to assess how compatible IT systems of IFIs are in continuing to stay in contact with customers under COVID-19.

Questions in this section included:

- How quickly were IFIs able to come up with solutions in continuing business operations because of strong back-end support from the IT department?
- Is increased online presence a sustainable change and will it continue to be part of a digitalization process (post the pandemic)?
- Have they maintained a strong connection with their customers during COVID-19, through more updated channels e.g., social media?

From the breakdown of overall results, trends show that Takaful companies were still finding it difficult to remain in close connection with their customers via social media. One of the Takaful company's Executive directors does mention that they plan to use such channels soon. Due to limited IT resources, it is found that the Takaful sector has been a little behind in continuing to remain in close contact of customers. On the other hand, Islamic banks have adjusted rather well to changes in business operations. Their support from IT has led them to be aware with regards to their customers and continue serving them.

The highlight of the section was rather odd, when asked about the sustainability of the digitalization process post COVID-19, 35% of the sample population strongly disagreed compared to only 15% who strongly agreed, and a considerable number was unsure of the future changes. It is difficult to explain why most IFIs feel that merely through a questionnaire, hence, an in-depth interview needs to be carried out regarding this matter.

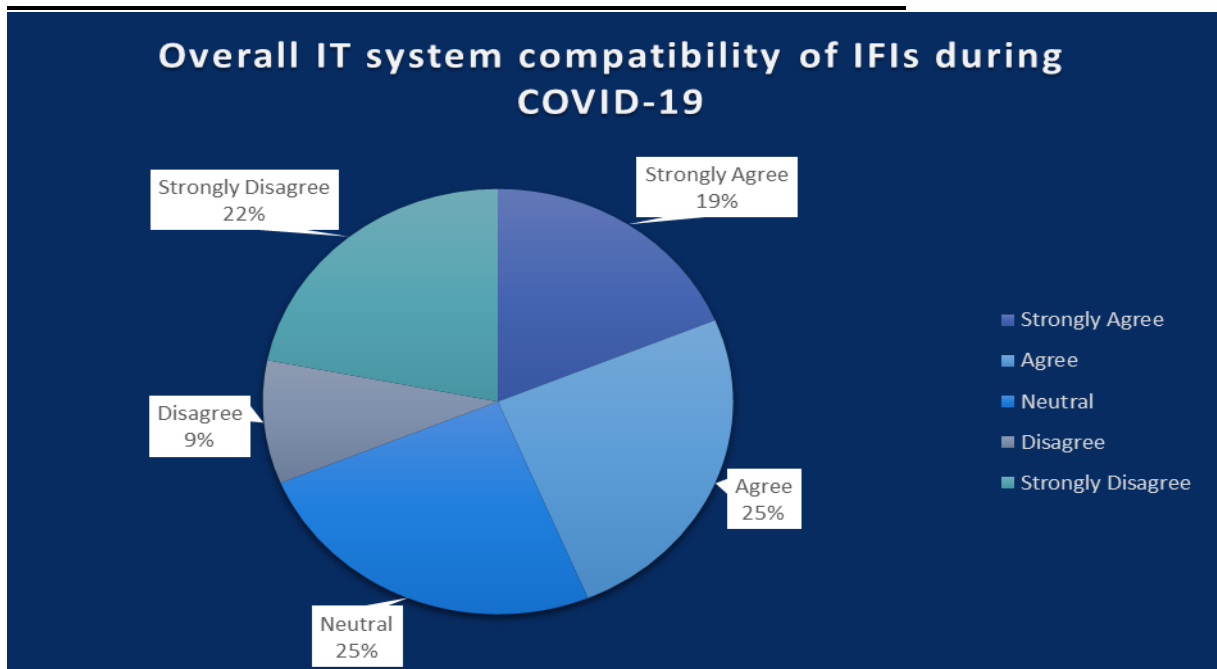


Figure 12: Overall findings in the IT system compatibility during COVID-19 section.

#### 4.1.3 Findings from CRM integration process in IFIs

Questions in this topic area related to how sales and marketing and I.T. department collaborate in making use of the CRM process and strategies to carry out their role in retaining and acquiring customers. Most of the IFIs agreed that CRM is indeed incorporated in various sectors of their business.

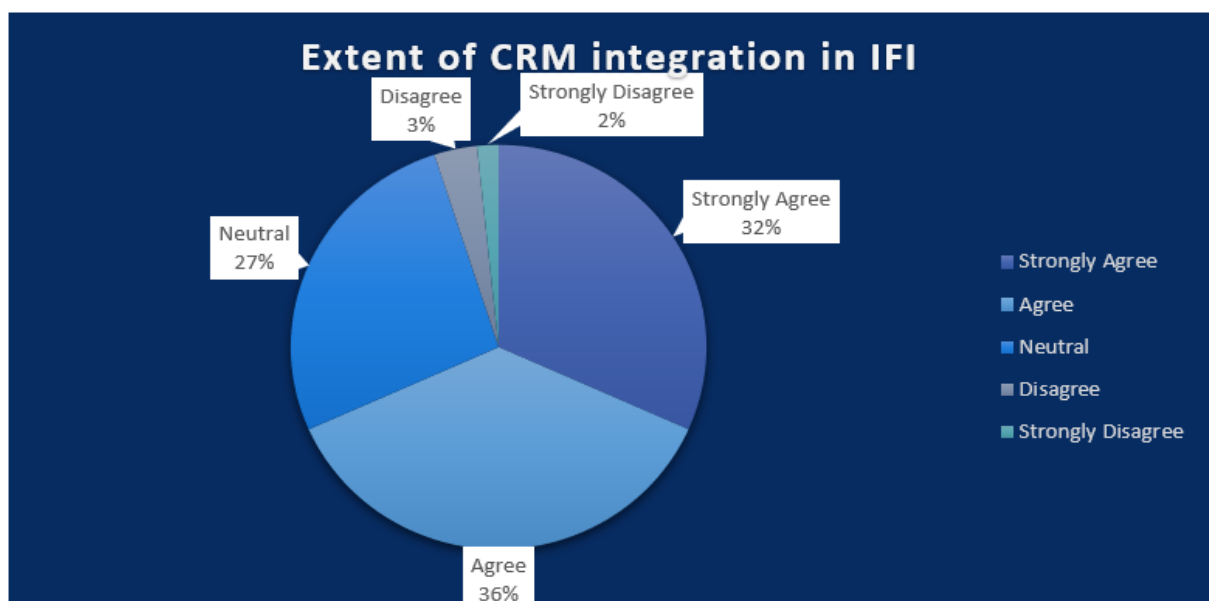


Figure 13: Overall findings in the CRM integration section.

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## **4.2 Survey results from customers**

Survey questions consisted of:

- How satisfied were they with the overall product range and service quality?
- What additional product or services that they desired were made available by their IFI?
- How convenient was it to get in touch about their problems and whether they felt their issues were resolved most of the times or not?

Overall, 62.5% of the sample population felt that there could be improvements made in the product range available of IFIs. These 62.5% also suggested additional product or services. Some of the suggestions included:

- Form filling and various administrative processes made available at home so that there is no need to go to the bank branch/Takaful company.
- Consumer product prices available on installments should be revised.
- *Al-Qard al-Hassan (interest free loan)* should be introduced especially to the employed sector.
- Upgrade of mobile banking with entry via biometric fingerprints.
- Introduce user-friendly and upgraded interface for customer mobile apps in both banking and Takaful services.
- A more accessible and quicker way to international transactions e.g., Transfer of funds needs to be introduced.
- Improved credit limit to make online purchases via Debit card.
- Time consumed for administrative processes in Islamic banks and Takaful branches be reduced.

On the other hand, 50% of IFI customers were satisfied with regards to ease of contact for problem solving matters. 30% however were not sure and remained neutral while the remaining 20% were unsatisfied. With regards to security, 75% of the customers felt financially secure in the hands of their IFI, and 25% felt improvements can certainly be made. In the discussion section of the paper, we will interpret these results and link customers and employee responses.

## **4.3 Success features of each IFI**

The questionnaire also asked about CRM features that are unique to each IFI and that has produced extremely positive results in the form of greater customer satisfaction and loyalty for them. Some of the respondent's responses are briefed in the table below:



#### Meezan Bank

- Free internet banking services
- To respond timely to customer queries, required information and need-based solutions
- Meezan has Zero tolerance policy with regards to ineffective management of customer relations.

#### Bank Islami

- In-house discussions ,idea generations , geographically required services are part of our CRM mechanism
- Handling customer complaints effectively.

#### Dubai Islamic Bank

- "Resolving customers' issue in minimum time." Majority of the customers lack patience and are unwilling to understand internal documentary work and processes. **The key is to listen to their problem and get it resolved by all means in least possible time without bothering them.**
- Frequent follow ups, Retention, Proper Handling of Client Queries and Complaints and Providing prompt Solutions, Provide Best Customer Service Environment, Reference Banking, Competitive Banking are our key points of success in Islamic Banking Industry.

#### Al Baraka Bank

- Outbound calls through phone banking to understand customer needs and satisfaction level

#### MCB Islamic Bank

- To be loyal with your internal (colleagues) as well as external (General Public) customers, always keep yourself in place of your customer and do accordingly.

#### Takaful Pakistan Ltd.

- Always stay customer centric, trying to become a leader rather than a follower. This is exactly what we are trying to achieve.

#### Pak-Qatar Takaful Ltd.

- Sometimes a simple call on customer's birthday or any random call in a quarter from sales personnel have much bigger impact then emails. This call should be a thankful call not product or sale call.
- Personally approaching the customers towards their queries/concerns subsequent to their initial approach to the servicing department. Ensuring over phone that their concern or issue has been addressed satisfactorily. Though the technological advancement has its own benefits, nothing can supersede the effects of a personal follow-up, portraying your true concern for your valuable customers, more importantly in the service sector.

#### Dawood Takaful Ltd.

- Customer Portfolio Management

## **5. CONCLUSION, RECOMMENDATION AND FUTURE RESEARCH**

Some of the tentative interpretations and deductions from the study findings, with solutions where possible, have been summarized in the following passages. Customer-centric culture is not fully achieved unlike what is assumed. The fact that a considerable number of employees were unsure if customers were kept at the heart of all processes further indicates that senior management of IFIs in Pakistan fall short in keeping their subordinates informed about the vision and objectives of the organization.

IFIs need to distinguish between solicited and unsolicited emails and need to customize information sent to customers. Whereas Takaful companies must divert attention on keeping their customers updated with latest developments and changes. Training programs must be provided by all IFIs especially by Takaful companies, and not just provided they need to be effectively delivered to equip staff with interpersonal skills to improve relations with customers and be able to customize support for each customer complaint or issue. Local IFIs need to understand that training is a long-term investment and should not avoid such opportunities for short-term benefit.

Rigorous training is necessary for I.T. staff, lack of experienced and skilled staff in advanced I.T. developments is apparent as most customer suggestions with regards to services were related to technology and how improvements are critical in times of COVID-19. Purposeful customer data needs to be collected to save storage costs of data and to make use of that data when the time comes. Skilled analysts and more innovative minds are needed in the Islamic financial industry, who can work with big data and use its findings to achieve a competitive edge in the entire financial industry of Pakistan.

It was disappointing when the results showed that even if the IFI had made an investment in CRM software little was done after that. Most IFIs were not even using these programs to process data they collected to produce clear and concise information which could be used to pinpoint their shortcomings and try to improve them. Trends also suggest that staff lack knowledge about CRM software and even confuse it with other management programs.

It comes as no surprise, that product development and services are not in-line with customer feedback. Even if IFIs collect customer feedback, it will be of no use to them if the data collected from customer feedback is not processed and directed to the research and development department or product development department, so that they listen to what the market needs and respond to them. CRM is all about listening to what customers need and if this is not understood it is natural that customer's satisfaction and trust would be lost, which is a long-term loss.

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IFIs in Pakistan must make sustainable changes in their digitalization process as opposed to what the findings indicate. Even though the Takaful industry in Pakistan is a rather new one, it is beneficial for them to focus more towards digitalization as this will speed up their progress. IFIs must train and be ready for challenging and unpredictable situations. They can do so by using simulations and challenging themselves, so when/if faced with adverse situations they are ready and equipped.

In this era of social customer ecosystem, IFIs in Pakistan can no longer just “Make & Sell”. Current standards of CRM applied in local IFIs need to improve. This paper is based around getting an overview of CRM strategies applied currently in IFIs of Pakistan and attempts to highlight areas that need improvement while at the same time, pinpoints success features of various IFIs. It builds up on background knowledge of CRM and uncovers some of the major problems and weaknesses through questionnaires and surveys distributed among both employees and customers. There is a definite scope of further research in this area, some of the targets for future work can include:

- To design and suggest an ideal CRM strategy which covers the vulnerabilities and conforms to the requirements of CRM in retaining and acquiring new customers towards Islamic financing options in Pakistan.
- To carry a comparative analysis with IFIs in more developed countries e.g., Malaysian and Bahraini IFIs, which are more advanced in terms of CRM implementation.

This research paper has its own limitations that include: evaluated results might be inconsistent with previous research as CRM can be studied through various CRM models and frameworks. Since non-probability sampling has been used the findings of this research are not indicative of the entire Islamic banking and Takaful industry population. Sample size can be increased, and more participants can be interviewed.

The time period for the research is insufficient for a far more critical and elaborate research using a much larger and diverse sample size and focus groups. Lack of previous case studies done on the chosen focus groups, especially Takaful companies in Pakistan. Hence, there is a vast and tremendous scope of critical research on this topic for researchers. Due to the prevailing pandemic, COVID-19, Islamic banks, and Takaful operations were limited and some firms were even temporarily closed, as ordered by the government. Therefore, limitation in ways data could be collected is unavoidable.

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## **APPENDIX**

### **I. Summarized Survey Questionnaire handed to employees**

This Questionnaire was distributed from May 2020 – June 2020

#### **Organizational Factors: Top Management**

1. Our top management considers Customer Relationship Management (CRM) to be part of the organization's vision.
2. Top management is effectively and heavily involved in CRM implementation.
3. Top management frequently discusses CRM with the middle management involved.
4. Top management stimulates employees' interest in achieving CRM objectives.

#### **Organizational Factors: Customer orientation**

5. We attempt to understand customer needs by relying upon close interactions with them, including listening to customer feedback.
6. Our core business values involve customer satisfaction.
7. Customer retention and customer loyalty are considered to be a top priority.
8. We consider our organization to have customer-centric culture.
9. Customer-centric culture enables us to promptly encourage our employees to focus on customer relationships.
10. We pay close attention to customer service and constantly work on introducing more interactive ways to connect with them.
11. We keep our customers updated by emailing important information and letters periodically or keeping our website up to date.

#### **Organizational Factors: Training orientation**

12. Our organization arranges periodic training programs and workshops that help in CRM (directly or indirectly).
13. Our training programs enable employee's to effectively and innovatively address customer complaints.
14. Our training helps employees understand how to tailor responses according to customer needs.



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15. Our training facilitates employees to develop interpersonal skills to build better customer relationships.

16. Our I.T personnel are trained to handle customer's information packages including CRM.

17. Training programs have shown improvement through increased customer satisfaction.

Technological factors: Customer data measures

18. The cost of data warehousing (acquiring and storage of data) within our company is reasonable.

19. Quality data is easily available when needed, e.g., call center operators have access to customer history and relevant data when responding to their queries.

20. Quality data is updated regularly and is available to employees, managers, and supervisors up to a great extent.

21. We are aware with the buzz word "Big Data" and its direct correlation with effective CRM. (Big Data: large volumes of data, extracted from variety of sources and in various formats processed by highly sophisticated software e.g., web logs/ cookies, customer's social media, customer's bank transactions, government documents on customer's, customer's GPS tracking etc. All of this data in turn helps in predicting customer behavior.)

22. "Big Data" is used in our organization to reveal trends and patterns in the market to predict customer behavior.

23. Customer data and feedback is the basis of developing new products and services.

Technological factors: Customer Information Processing and Availability

24. We have made a reasonable investment in purchase and installation of CRM software and packages.

25. What CRM software does your organization use? (optional)

26. We use computer-based CRM packages and systems to maintain and process customer database.

27. We not only gather customer-related data but process that data into clear and concise information.

28. We use information extracted from operational data and customer data to develop attractive offerings for our clients. e.g., internet services for transaction etc.



29. We greatly focus on customer retention strategies to offer e.g., loyalty programs to reward repeat customers.

Technological factors: Integration of CRM throughout organization.

30. Our sales force is equipped with adequate customer information.

31. Our marketing department is assisted in generating customized offers and responds promptly to changing market needs and scenarios.

32. We allow customer support personnel to access data on customer interactions with all functional areas.

#### Technological Factors: IT practices

33. We have maintained a strong connection with our customers during this COVID-19, through more updated channels e.g., social media (twitter etc.)

34. During this COVID-19 pandemic, we were able to respond quickly and come up with solutions in continuing our business operations because of strong back-end support from the I.T. department.

35. Increased online presence of our organization seems to be a sustainable change and it will continue to be part of a Digitalization process (post the pandemic).

36. Lastly, what CRM practice would you consider is unique to your organization and has produced extremely positive results in the form of greater customer satisfaction and loyalty?

## II. Market share of Islamic Banks and Takaful industry.

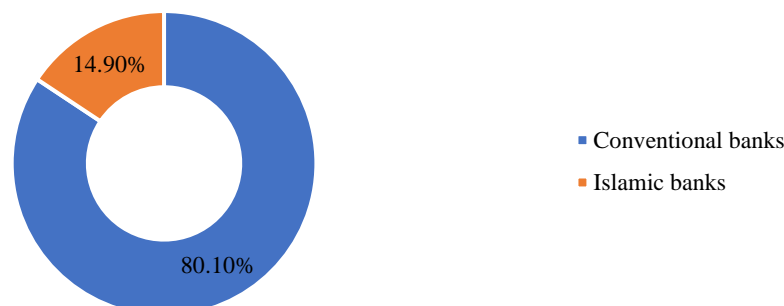


Figure 14: Market Share of Overall Banking Industry.

Source: The International News, 2020

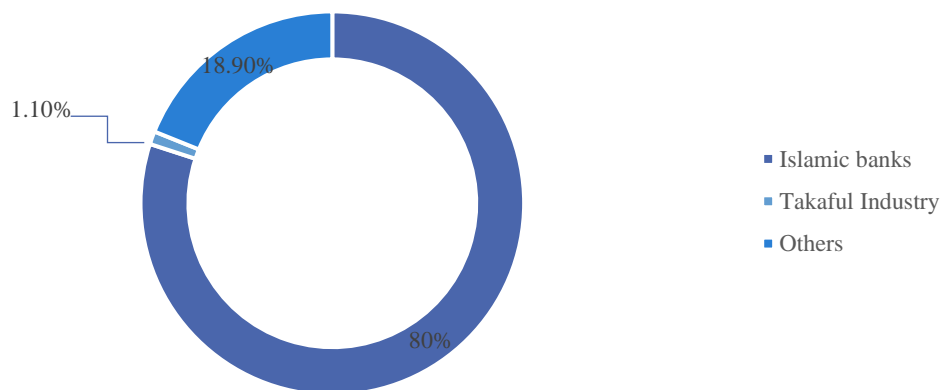


Figure 15: Market share of Islamic banks and Takaful companies in 2018.

Source: Islamic Banking Department, State Bank of Pakistan, Dec 2018.