



UNIVERSITEIT VAN PRETORIA
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YUNIBESITHI YA PRETORIA

Can Islamic Banking work in South Africa?

GIBS MBA 2005/6

**Research Project
November 2006**

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A research report submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfillment of the requirements for the degree of Master of Business Administration

November 2006

ABSTRACT

In little more than a decade, Islamic banking has grown into a \$300 billion a year industry worldwide and is now finding its way to South Africa hence providing a wealth of opportunities to new and existing players in the South African banking industry. One of the key factors differentiating Islamic financial institutions is the need to demonstrate compliance with Shariah in all their activities. There is a lack of consensus in the industry as to whether certain transactions or activities are compliant, which can cause confusion among practitioners and customers as well as restricting the concept of Islamic finance from wider acceptance and recognition.

Therefore, the purpose of this study is to test whether Islamic Banking can work in the South African market. Qualitative research was conducted to determine the South African banking environment, customer sceptism, controversies and challenges faced with regard to this growing industry.

Content analysis of 16 depth interviews with banking representatives, South African Reserve Bank representative, Islamic scholars and Muslim customers revealed interesting insights that guided the research to possible outcomes. Together with presenting a model that Islamic banking can use, a number of strategic implications and limitations are discussed, and directions for future research are also addressed.



DECLARATION

I declare that this research project is my own, unaided work. It is submitted in partial fulfillment of the requirements of the degree of Master of Business Administration for the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination in any other university.

.....

Date:

Zahied Buksh

ACKNOWLEDGEMENTS

My sincere thanks and appreciation to:

- Almighty Allah for guiding me in the completion of this report.
- My beloved wife Ruwaida for her unwavering support during these two years of our life. Without your support this would not have been possible.
- My children Aaliyah, Yusuf and Yahya, the best kids a dad can ask for.
- My supervisor, Terence Taylor for his guidance and resourcefulness.
- Margie Sutherland & Neale Penman for instilling the discipline required to properly explore the research topic.
- Margie Sutherland for always keeping a look out for me on new books and articles relating to Islamic Banking.
- My previous boss, Julian Kearney for nominating and encouraging me to do the MBA.
- All the respondents, you definitely provided invaluable insights for my analysis.



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ABBREVIATIONS

AAOIFI	:	Accounting & Auditing Organisation for Islamic Financial Institutions
ATM	:	Automatic Teller Machines
CA	:	Chartered Accountant
CEO	:	Chief Executive Officer
CRM	:	Customer Relationship Management
FNB	:	First National Bank
FSB	:	Financial Services Board
GCC	:	Gulf Cooperation Council
IDB	:	Islamic Development Bank
MBA	:	Master of Business Administration
OIC	:	Organisation of Islamic Conference
POS	:	Point of Sale
PWC	:	Price Waterhouse Coopers
SARB	:	South African Reserve Bank
UUCSA	:	United Ulama Council of South Africa

CHAPTER 1 - INTRODUCTION

1.1. BACKGROUND

This paper focuses on whether Islamic banking can be done in South Africa. It is estimated that there are approximately 1.2 million Muslims in South Africa, and according to statistics derived by First National Bank (FNB), about 250,000 to 300,000 are economically active, many of these are sole traders and business people.

Albaraka Bank, part of the Saudi Arabian-based Dallah Al Baraka Group, and the Islamic Bank were the first Islamic banks to be granted a banking license by the South African Reserve Bank (SARB) in 1989, in response to the need for a system of banking in line with Islamic economic principles.

In 1998, the Islamic Bank was liquidated amid allegations of reckless trading which left many Muslim customers disillusioned about the prospects of Islamic banking in South Africa. The SARB associated the liquidation to the lack of effective corporate governance and this led to changes made to the Banks Act to ensure that proper corporate governance was established within the banking industry.

Years later, in May 2004, FNB launched Shariah-compliant banking. According to Ebi Patel, chief executive officer (CEO) of the bank's Islamic Finance division, Islamic banking has proved to be a lucrative niche thus far. The Shariah-compliant banking

initiative followed the introduction of Wesbank Islamic Finance, which has made it possible for Muslims to buy assets like cars with the help of a major bank, without contravening religious principles. An Islamic division within a conventional bank is known as an Islamic Window.

Absa in November 2005 also recognised the unique requirements of the Muslim community and have created Absa Islamic Banking as an alternate financial system to conventional banking.

With controversies surrounding the growing trend of Islamic banking worldwide, the researcher finds it interesting to explore this concept in the South African market. However before this is fully explored, an understanding of the development of the modern banking system is necessary.

The modern banking system in nearly all countries of the world is mainly evolved from and modeled on the practices in Europe, especially that in the United Kingdom. The roots of this system revolve around the basic principles of capital certainty for depositors and certainty as to the rate of return on deposits. In order to enforce these principles for the sake of the depositors and to ensure the smooth functioning of the banking system, Central banks have been vested with powers of supervision and control.

The desire of Muslims to seek the equivalent of modern capitalism goes back to Egypt in the early 1960s. The Islamic Development Bank (IDB) was established in 1975 by

the Organisation of Islamic Conference (OIC), but it was primarily an intergovernmental bank aimed at providing funds for development projects in member countries. In the mid seventies, Islamic banks came into existence in Saudi Arabia and the United Arab Emirates. Since then, Islamic financial institutions have emerged in a large number of Muslim countries, taking the form of commercial banks, investment banks, investment and finance companies and insurance companies. During the 1990s Islamic financial institutions have become increasingly more innovative, developing more complex instruments and structures to meet the demands of modern day business.

More than two thirds of Islamic finance business is currently originated in the Middle East. The Gulf Cooperation Council (GCC) countries, with the exception of Oman, are all major markets for Islamic finance. Bahrain is regarded as the hub for Islamic finance. Other major non-GCC markets for Islamic finance include Egypt, Malaysia, Turkey, Indonesia and Pakistan.

In little more than a decade, Islamic banking has grown into a \$300 billion a year industry, with 200 Islamic banks and financial institutions operating in 27 Muslim and 16 non-Muslim countries (Dudley 2001). These Islamic banks have been growing at a rate of around 10% over the last decade (Iqbal 2000). Though the largest demand for Islamic finance comes from the Arab world; only 20% of the population presently uses this type of banking. Already the world's leading traditional western banks, including Citibank, HSBC, and BNP Paribas have launched Islamic windows. In South Africa

two of the leading conventional banks, FNB and Wesbank have launched Islamic windows.

Clientele are not confined to Muslim countries but are spread over Europe, United States of America, the Far East and now also South Africa. At a recent conference on Islamic Banking (2005), sponsored by the Arab Bankers Association of America, Paul Homsy, a legal expert, cited new surveys showing that 30% of the 7 million American Muslims want to adhere to strict Islamic principles when dealing with their finances. In the United Kingdom, experts say the Muslim population of 2 million includes over 160,000 high net worth potential banking and financial services clients.

In the face of globalisation, consolidation and fierce competition, many Islamic banks now rank among the top three in their markets. The development of new products has enabled Islamic banks to offer competitive returns. Two decades ago those using Islamic banks just wanted somewhere to place their money and showed little concern about how much it earned. Today the younger generation of sophisticated investors wants to see a better rate of return while keeping close to their Islamic principles. The target market for Islamic banks is middle-class investors and high-net worth investors.

De Lorenzo (1997) states that Muslims engaged in financial intermediation are thus required to meet the demands for innovating financing from their clientele. This has led to a requirement for translating established Islamic norms for financial intermediation

(e.g. Murabaha, Mudarabah and Musharakah) into operational instruments within the legal framework of contemporary banking.

For ensuring that any new formulations and modalities are within the ambit of established Islamic norms, all Islamic banks have a Shariah Supervisory Board. These Boards have devised new modes of financing to replace interest-based transactions. The management of an Islamic banking institution brings its day to day problems before its Board which, after examining the relevant details, will decide whether or not the proposed transactions are in line with Shariah principles. Such decisions by the Board are called fatwa's.

As Justice Muhammad Taqi Usmani says in the Introduction to the Compendium, "The function of a Shariah Supervisory Board is of a very delicate nature. On the one hand, they are meant to abide strictly by Islamic principles, and on the other they have to fulfill the requirements of constantly emerging needs of the contemporary marketplace. The task entrusted to the Shariah boards is indeed a difficult one; because when we claim that Islam provides solutions to the problems of every time and place, we do not mean that Islam has given a specific rule for each and every minute detail of every transaction."

1.2. THE RESEARCH PROBLEM

There is a limited system of Islamic banking in South Africa currently. The aim is to explore if the Islamic banking system can work in South Africa and to really

understand this better we need to understand the definition of Interest in an Islamic context. The definition of Al-Riba (interest) as it is used in the Arabic language means to excess or increase. In the Islamic terminology interest means effortless profit or that profit which comes free from compensation or that extra earning obtained that is free of exchange. Al-Riba has been described as a loan with the condition that the borrower will return to the lender more than and better than the quantity borrowed. As Muslims, their main concern when it came to financial transactions was to avoid Riba in any of its forms, despite the fact that the basic foundation of the world economics and finance today is that of interest.

In the Noble Quraan (Al- Baqarah, 275-281), Allah (God) says “O you who believe be afraid of Allah and give up what remains (due to you) from riba (from now onward), if you are a believer”.

The verse of Surah Al-i-Imran says “O ye who believe! Devour not usury, doubled and multiplied; but fear Allah; that ye may (really) prosper.” (Al-i-Imran 3:130)

In the Bible (Old Testament), God also talks about the prohibition of interest. “Thou shalt not lend upon usury to thy brother, usury of money, usury of victuals, usury of anything that is lent upon usury” (Deuteronomy 23:19)

“He that by usury and unjust gain increase his substance, he shall gather it for him that will pity the poor” (Proverbs 28:8)

There are deep divisions between scholars and regulators as to what exactly is acceptable for a banking system, particularly on the fundamental question of whether interest can be levied and paid. There are some jurisdictions, such as Pakistan and

Iran that are exclusively Islamic whereas Eqypt, Kuwait, Malaysia and Indonesia have established “mixed” systems which combine aspects of Western and Islamic banking practices. Saudi Arabia remains hesitant because recognition of the concept might imply acknowledgement that the rest of the banking system is non-Islamic.

1.3. RESEARCH AIM

- Make the hidden obvious i.e. Many Muslims enter interest related financial transactions, completely aware that interest is totally prohibited. Create awareness that there is an approved alternative.
- Understand if Islamic banking can work in South Africa
- Get a better understanding of how these products work according to Islamic economics and principles.

CHAPTER 2 - THEORY & LITERATURE REVIEW

2.1. INTRODUCTION

The theory and literature review begins by discussing the South African banking industry. The researcher seeks to provide an understanding of the banking industry and the major players in the South African banking environment. This sets the framework of the discussion.

Islamic banking is a concept that distances itself from interest and therefore the researcher tries to illustrate this with theory and literature about the consequences of interest.

The researcher then discusses the Islamic banking system to ensure that there is an understanding of the system through the relevant theory and literature.

With Islamic banking becoming a fast growing industry, the researcher also feels that it's important to present literature on the current state of Islamic banking.

Finally the researcher presents literature surrounding the challenges faced by Islamic banks. All these concepts should help the researcher determine whether Islamic Banking can work in South Africa.

2.2. THE BANKING INDUSTRY IN SOUTH AFRICA

To understand if Islamic banking can work in South Africa, the researcher needs to explore and understand the banking environment in South Africa.

According to Mboweni (2004), over the past decade, South Africa has established a well-developed banking system which compares favourably with those in many developed countries and which sets South Africa apart from many other emerging market countries. South Africa has a mature banking sector, with a moderate level of private-sector indebtedness and a respectable and first-rate regulatory and legal framework. South Africa's banks are regulated in accordance with the principles set by the Basel Committee on Banking Supervision. Consequently, the banks comply with international sound practice and offer a sophisticated banking system to the public.

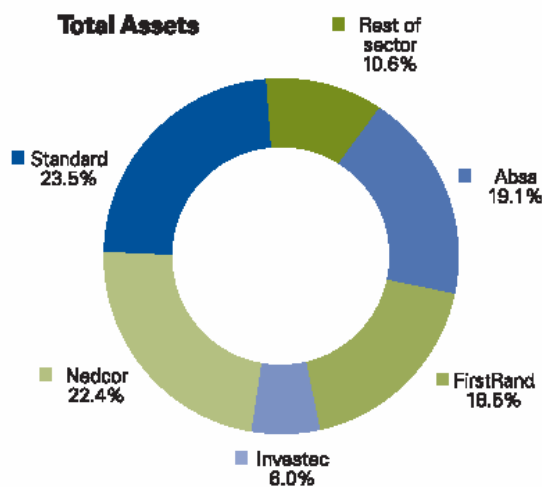
Mboweni (2004) further adds that customers have online, real-time, nationwide access to bank accounts twenty four hours a day, everyday of the year. South Africa's political transformation, together with the relaxation of exchange controls and the liberalisation of African economies, has resulted in South Africa becoming an increasingly important financial centre. South Africa is now also well positioned to provide global services through the international offices of our banks and the presence of international banks in South Africa.

Currently, there are 38 registered banks in South Africa. This number consists of 15 South African controlled banks, 6 non-resident controlled banks (subsidiaries), 15 local branches of international banks, and two mutual banks. In addition, 44 international

banks have authorised representative offices in South Africa. Representative offices, however, may not take deposits.

Five major groups continue to dominate the South African banking sector. These groups are the Absa group, the Standard Bank group, the FirstRand Bank group, Nedcor and Investec. They collectively control some 89.4 per cent of the total assets of the banking sector. The remaining 10.6 per cent of assets in the banking sector are currently held by the other 31 banks, excluding the two mutual banks.

FIGURE 1: Total Assets held by Banks of South Africa (KPMG Banking Survey 2004)



The four pillar policy relates to having a minimum number of substantial banks (so called “pillars”) on which the domestic banking industry relies and discourages the merger between any of those four banks. The primary reasons for such a policy relate to the maintenance of minimum levels of competition, in the interests of prudential and

systemic stability, in order to avoid the spread of risk and to promote reliance on a broader platform of institutions.

According to the South African Minister of Finance, who has responsibility for national financial policy, South Africa also follows a “four-pillar” policy. Recently, the Minister stated that South Africa maintains a “four-pillar” policy of having four big, locally owned banks regulated by the Office for Banks.

TABLE 1: Market Share of South African Banks (KPMG Banking Survey 2004)

Market Share: Overdrafts & Loans						
Bank	Installment Finance	Mortgages	Credit Cards	Corporate Overdrafts	Individual Overdrafts	Other
Absa	24.0%	30.7%	25.0%	17.5%	29.2%	8.9%
FirstRand	30.4%	15.6%	23.3%	19.6%	22.0%	10.8%
Investec	1.4%	3.7%	3.3%	10.6%	1.3%	8.7%
Nedcor	18.9%	26.3%	18.9%	26.0%	12.8%	17.2%
Standard	22.3%	23.0%	28.8%	16.2%	14.8%	23.9%
Rest of Sector	3.0%	0.7%	0.7%	10.1%	19.8%	30.4%
	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

The market share of South African banks, by overdrafts and loans, is reflected in the table 1 above. It is evident from the above table which banks control the banking sector in South Africa.

According to the PWC Banking survey (2005), the big four banks (excluding Investec) have 19.8 million retail customers. The projected number for 2008 is 22.8 million

customers. The number of retail accounts held by them is estimated to be 31.2 million in 2005, rising to 35.4 million in 2008. They have also emphasised the importance of physical locations in their future strategies. They anticipate that the number of branches will increase from approximately 2,500 in 2005 to 2,700 in 2008. Similarly the number of ATMs will increase from 12,488 to 14,428 by 2008. The Banking Association has revealed that 90% of Mzansi accounts are new bank customers, 56% are female, and 27% are aged between 16 and 24 and 62.5% aged between 25 and 54. 26% are in Gauteng and 22.5% in KwaZulu Natal. The big four banks employ 116,118 people at present and expect numbers to remain flat over the next three years. The projected total for 2008 is 115,723.

Mboweni (2004) further states that following South Africa's re-entry into international financial markets in 1994; locally registered banks have increasingly been expanding their operations into other countries. At the same time, international banks have been expanding their operations into South Africa. Besides adding further depth and sophistication to the South African market, these foreign banks began to tap into the South African labour market. Consequently, the arrival of these predominantly resourceful and experienced banks posed formidable challenges to local banks. In a quest to survive and excel, South African banks had to devise means to adapt to the new terrain. As a result of the increased competition, lending margins have been placed under greater pressure, and several banks have had to expand their businesses and

enter markets with slightly higher credit-risk profiles. Currently, the major banks offer a wide range of services to both individual and corporate customers. One-stop relationship banking, with an emphasis on universal banking, instead of isolated services, has gained in importance during the past few years. Nevertheless, several banks, especially small local and foreign banks continue to service niche markets, where they hold some form of competitive advantage.

2.3. THE CONSEQUENCES OF INTEREST

The western world has a long history of sentiment against charging interest.

Aristotle (1943) singles out usury for particularly harsh treatment. “There are two sorts of wealth getting, one is a part of household management, and the other is retail trade. The most hated sort, and with greatest reason, is usury, which makes a gain out of money itself and not from the natural object of it. For money was intended to be used in exchange, but not to increase at interest.” This argument set the tone for many centuries to come.

All theories of interest are based on the presumption that money is treated as a commodity. It is therefore argued that just as a merchant can sell his commodity for a higher price than his cost, he can also sell his money for a higher price than its face value, or just as he can lease his property and can charge a rent against it, he can also lend his money and can claim interest thereon. Islamic principles do not prescribe

to this presumption as money has no intrinsic utility. Money and commodity have different characteristics and therefore they are treated differently (Usmani, 1991).

Robertson (1998) observes that today's money and finance system is unfair, ecologically destructive and economically inefficient. The money-must-grow imperative drives production (and thus consumption) to higher than necessary levels. It skews economic effort towards money and against providing real goods and services.

Interest based loans have a persistent tendency in favour of the rich and against the interests of the common people. Usmani (1991) further adds that interest-based loans have a persistent tendency in favor of the rich and against the interests of the common people. It carries adverse effects on production and allocation of resources as well as on distribution of wealth.

Some of these effects according to Usmani (1991) are the following:

a) Limiting Effects on Allocation of Resources

Loans in the present banking system are advanced mainly to those who, on the strength of their wealth, can offer satisfactory collateral. While deposits come from a broader cross-section of the population, their benefit goes mainly to the rich.

The banking system thus tends to reinforce the unequal distribution of capital.

b) Limiting Effects on Production

Since funds in an interest-based system are provided on the basis of strong collateral and the end-use of the funds does not constitute the main criterion for financing, it

encourages people to live beyond their means. The rich people do not borrow for productive projects only, but also for conspicuous consumption. Similarly, governments borrow money not only for genuine development programs, but also for their lavish expenditure and for projects motivated by their political ambitions rather than being based on sound economic assessment. Non-project-related borrowings, which were possible only in an interest-based system, have contributed to the increase of ballooning debt.

c) Limiting Effects on Distribution

When business is financed on the basis of interest, it may bring disadvantages either to the borrower if he suffers a loss or to the financier if the debtor earns huge profits. Although both situations are equally possible in an interest-based system, and there are many examples where the payment of interest has brought total ruin to the small traders, yet in the present banking system, the disadvantage brought to the financier is more pronounced and much more disturbing to the equitable distribution of wealth.

In the context of the modern capitalist system, it is the banks which advance depositors' money to the industrialists and traders. Almost all the giant business ventures are mostly financed by the banks and financial institutions. In numerous cases the funds deployed by the big entrepreneurs from their own pocket are much less than the funds borrowed by them from the common people through banks and financial institutions. If the entrepreneurs having only ten million of their own acquire 90 million from the banks and embark on a huge profitable enterprise, it means that 90% of the projects are created by the money of the depositors while only 10% was

generated by their own capital. If these huge projects bring enormous profits, only a small proportion (of interest which normally ranges between 2% to 10% in different countries) will go to the depositors whose input in the projects was 90% while all the rest will be secured by the big entrepreneurs whose real contribution to the projects was not more than 10%. Even this small proportion given to the depositors is taken back by these big entrepreneurs, because all the interest paid by them is included in the cost of their production and comes back to them through the increased prices.

The net result in this case is that all the profits of the big enterprises is earned by the persons whose own financial input does not exceed 10% of the total investment, while the people whose financial contribution was as high as 90% get nothing in real terms because the amount of interest given to depositors is often repaid by the depositors through the increased prices of the products and therefore in a number of cases the return received by depositors becomes negative in real terms.

Robertson (1998) further explains “The pervasive role of interest in the economic system results in the systematic transfer of money from those who have less to those who have more. Again this transfer of resources from poor to rich has been made shockingly clear by the Third World debt crisis. It is partly because those who have more money to lend get more in interest than those who have less; it is partly because those who have less often have to borrow more. When we look at the money system this way, the argument for an interest free inflation- free money for the twenty first century seems to be very strong”.

2.4. THE ISLAMIC BANKING SYSTEM

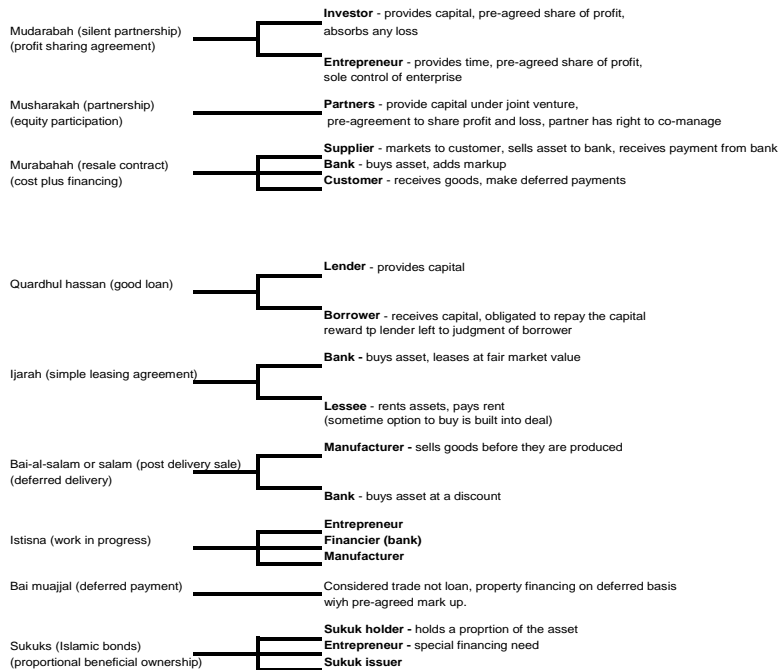
An Islamic banking system is a system that is based on the principles of Shariah (Islamic law) and guided by Islamic economics. The Islamic economic system prescribes certain norms of social and economic behaviour pertaining to issues such as property rights, resource allocation and types of economic freedom.

Khan and Mirakhor (1986) state the primary objective of this system is social justice and specific patterns of income and wealth distribution.

Khan and Mirakhor (1990) further state that the principal restriction under which the Islamic financial system must work is the injunction against interest. It is important to note that what is forbidden by Islamic law is the fixed or predetermined return on financial transactions and not an uncertain rate of return represented by profits.

For this reason the modern concept of Islamic banking has developed on the basis of risk-sharing, owning and handling of physical goods, involvement in the process of trading, leasing and construction contracts using various Islamic modes of finance. The different financing modes that can be employed are represented in Figure 2 below.

FIGURE 2: The Topology of Islamic Banking (Adapted from Bahrain Monetary Agency and Tiemsani and Matthews)



On the economic front, a number of Islamic countries have recently adopted practical steps towards “Islamizing” their banking system. Khan (1986) has recently demonstrated that an interest – free banking system is quite consistent with a Keynesian or classical economic theorizing. Kahn’s main purpose was to test empirically the hypothesis that the financial (banking) system becomes more stable without interest-bearing assets (Islamic system) than if these assets were to exist (western system).

Kuran (1986) suggests that the economic system envisaged by Islamic economists is one in which individuals are guided by a set of norms which may be classified as production and consumption norms. Production norms allow individuals the freedom to

produce and trade for profit but in exercising this freedom, they must refrain both from causing harm to others and from earning more than normal profits. Consumption norms give individuals freedom in how they spend their incomes as long as they refrain from illegitimate activities (e.g. adultery, alcohol), show moderation in consumption and make contributions to the less fortunate members of society.

According to Kuran (1986) the principal ingredient to these norms is altruism, i.e. the idea that individuals should place the welfare of society above their own person interests.

Khan (1986) and Darrat (1988) contend that the Islamic banking system is superior to the traditional banking system because it results in a more stable financial sector. This stability arises from the elimination of speculation on financial instruments (e.g. bonds) which bear a fixed nominal rate of return. Additionally, the western practice of paying depositors a fixed rate of return prevents banks from instantaneously adjusting to potential asset shocks, which in turn can lead to bank failures. Under an Islamic system, the value of the bank's liabilities will fluctuate with the value of its assets.

Table 2 compares the Islamic financial instruments and practices with those of conventional banking.

TABLE 2: Comparison of Islamic & Conventional Banking Practices (Enrico & Farahbaksh 1998)

Characteristics	Islamic Banking	Conventional Banking
Nominal value guarantee of: Demand deposits Investment deposits	Yes No	Yes Yes
Equity-based system where capital is at risk	Yes	Yes
Rate of return on deposits	Uncertain, not guaranteed	Certain and guaranteed
Mechanism to regulate final returns on deposits	Depending on banks performance/profits from investment.	Irrespective of banks performance /profits from investment.
Profit & Loss Sharing principle is applied	Yes	No
Use of Islamic modes of Financing PLS and non-PLS modes	Yes	N/A
Use of discretion by banks with regard to collateral	Possible for reading moral hazard in PLS modes. Yes in non-PLS modes	Yes always
Banks 'pooling of depositors' funds to provide depositors with professional investment management	Yes	No

2.5. THE CURRENT STATE OF ISLAMIC BANKING

At present about 45 countries, encompassing most of the Muslim worlds have some type of Islamic banking or financial institution. According to Khan and Mirakhor (1986), this development, which has gained momentum since the second half of the 1970s, has taken two forms.

The first has been an attempt to establish Islamic financial institutions side by side with traditional banking. In such attempts, two types of institutions have evolved.

- Islamic banks that have been established mainly in Muslim countries
- Islamic investment and holding companies that operates in some Muslim but mostly non-Muslim countries.

The second form has involved an attempt to restructure the whole financial system of the economy in accord with Islamic concepts. This has taken two directions, one in which the entire economy and its institutions are transformed into an Islamic one, as in the case of the Islamic Republic of Iran and the other where Islamisation of the economy is undertaken through a gradual process beginning with the banking sector as in Pakistan.

The current state of Islamic banking is surrounded by many controversies today. There is an ongoing dispute among scholars about whether the Quraan advocates a total ban on interest.

Khan (1986); mentions that the dispute arises from a lack of consensus about the exact meaning of “riba”, an Arabic word for the predetermined return on the use of money.

Kuran (1986) concurs with this view by suggesting that it is not clear that the Quraan’s ban on the institution of interest is applicable as it prevails today. He argues that the Quraan bans riba, an ancient Arabic practice of “doubling and redoubling of debt when the borrower failed to make restitution on time.” Viewed in this context, the Quranic ban must have been concerned with this potent source of inequality and the communal friction that riba would engender.

Conventional bankers argue that the entire concept is flawed and that behind it interest in effect exists. They point out that the management costs charged as an alternative to interest charges tend to rise and fall in line with what is happening in these markets.

Mashkoo (1993) suggests that the new Islamic banking system is not much different from the previous Western-style system. He argues that the new system retains many of the features of the old system, but the changes in terminology have given the illusion of a new system. For example, banks levy a “commission” or “service charge” instead of interest on loans to borrowers

Usmani (1991) said that “Islamic banks are using the instrument of Murabaha within the framework of the conventional benchmarks like Libor, where the net result does not differ from interest-based transactions. When the common people realize that the

net result in the transaction of the Islamic banks is the same as was in the transactions of conventional banks, they become sceptical towards the function of Islamic banks. It therefore, becomes very difficult to argue for the case of Islamic banking before the common people, especially before the non-Muslims who feel that it is nothing but a matter of twisting documents only. If the present state of affairs is allowed to continue, many Muslims may develop doubts about the feasibility, practicability and usefulness of the 'Islamic system of banking' notwithstanding that the fault lies with them and not with the system".

2.6. CHALLENGES FACING ISLAMIC BANKING

Islamic banks have struggled for a quarter of a century, gaining some success yet facing some challenges.

2.6.1. SUPERVISION OF ISLAMIC BANKS

Al-Anjari (2002) states that to protect the interests of the public and the economy from financial panics, most governments have created elaborate regulatory bodies. In most countries Islamic banks are put under the supervision of the central bank of the country. Most of Islamic banks in the contemporary world operate in a mixed environment in which interest based banks function side by side with the Islamic banks. The central banks subject the Islamic banks to the same controls, conditions and regulations that they apply to the interest based banks.

Al-Anjari (2002) highlights the following factors that require Islamic banks be treated on a different footing:

a. Islamic banks, like all other commercial banks are required to keep some of their deposits with central banks. Central banks usually pay interest on those deposits which Islamic banks cannot accept. An alternative is needed to ensure that Islamic banks get a fair return on their deposits with the central banks.

b. Central banks function as lenders of last resort to commercial banks providing loans at times of liquidity crunch. Although most of Islamic banks function under the supervision of central bank, they cannot always benefit from such a facility because, funds are usually provided on the basis of interest.

c. Legal reserves imposed on deposits with conventional banks. Their rates vary between demand, saving and time deposits. These requirements may apply to the same extent only in case of Islamic banks' demand deposits. The Mudarabah deposits of Islamic banks are similar to banks' equity. Therefore, they should be exempted from legal reserve requirements.

d. In countries where the central bank conducts open market operations, Islamic banks are not able to participate in these operations because of interest-based nature of the securities bought and sold. Thus, Islamic banks are constrained by the fact that financial assets that could be liquidated quickly are not available to them. This introduces some rigidity in the asset structure of Islamic banks.

e. Lack of understanding the correct nature of Islamic financing techniques may also be partially responsible for rather inappropriate policies of the central banks towards

Islamic banks. This is particularly true of Musharakah and Mudarabah. In debt financing, granting of a loan by a bank is a one-time activity, no matter what the size of the loan is. But Musharakah and Mudarabah are ongoing activities and participation of an Islamic bank in these activities continues as long as the project financed is in operation. This may have important implications for reporting as well as control and regulation of Islamic banks by the central banks.

2.6.2. SHARIAH SUPERVISORY BOARDS

Iqbal, Ahmad and Khan (1998) state that banking supervision is needed in case of Islamic banks as much as in case of conventional banks. However, because of the special nature of operations of Islamic banks, it has different control and supervisory requirements. There is also an additional dimension of supervision in case of Islamic banks. This relates to shariah supervision of their activities. At present, most Islamic banks have their own shariah Boards. Questions have been raised about the autonomy and powers of these Boards. Shariah Boards of different banks could issue different rulings on similar practices which may raise doubts in the minds of clients.

Minimum

shariah standards for each type of contract issued by an autonomous body will go a long way to assure customers of the “shariah compatibility” of those contracts as well as actual operations. This need becomes more important in the wake of the entry of several Western banks in Islamic banking.

It must be mentioned here that since Islamic banks do not fall under the jurisdiction of a single Government, such a Board can be constituted only if the Islamic banks agree to abide by a common discipline. They must realise that doing so will be in their own long run interest. If Islamic banking is not perceived to be “Islamic”, it will not be long when the existing Islamic banks will lose much of their market.

2.6.3. PRODUCT INNOVATION

Ulph (2002) mentions that according to Ismail Dadabhoy, Executive Director of Islamic Finance, UBS Warburg, London, apart from Malaysia, most of the Islamic market is limited to two main products, murabaha (cost-plus financing) and equities. This means you have either the very short end or the long end; there is nothing in between. He laments that to date “the banks and investors have contented themselves with moderately satisfactory returns from the equity market and from short term murabaha investments”.

Iqbal, Ahmad and Khan (1998) define “financial engineering”, as the art of designing financial products to meet the needs and tastes of the users with regard to risk, maturity and yield. Financial markets are becoming more and more sophisticated, and competitive. In order to exploit the fast changing market environment and face increasing competition, financial engineering and innovation is imperative. Until now, the Islamic financial tools have essentially been limited to classical modes developed centuries ago. They were developed to meet the needs of those societies. While they may serve as useful guidelines for contemporary Islamic contracts, there is no reason to be restricted only to those.

Ulph (2002) states that according to Rodney Wilson, a Professor of Economics at Durham University, Islamic banks usually enjoy greater freedom of manoeuvre than their conventional counterparts, as their niche market is less crowded, and competitive pressure less. There is generally greater client loyalty too, and a lower turnover of deposits. Given the stable deposit base, Islamic banks could afford to be more venturesome in their financing activities.

Ulph (2002) further highlights that without a significant capital market to operate in; Islamic finance will only be on the surface without deep roots and without much needed liquidity and transparency to foster a secondary market. You need to facilitate exit as well as entry, and for that you must free up liquidity. As it is, with the lack of an Islamic capital market, and the absence of any benchmarks forged for future issues, the development of a credit market, Islamic bonds and the expansion of takaful insurance (or the development of capital management services will remain a pipedream.

2.6.4. TEACHING, TRAINING RESEARCH & DEVELOPMENT

According to Iqbal, Ahmad and Khan (1998), there is a serious shortage of scholars who possess even a working knowledge of both Islamic fiqh and modern economics and finance. Similarly, many managers of Islamic banks are not very well trained in the use of Islamic modes of finance. Unfortunately, very little effort has been made to meet these requirements.

In the area of teaching, some universities in some Muslim countries particularly, Egypt, Saudi Arabia, Pakistan and Malaysia have initiated some teaching programs to produce graduates with the dual specialisation. However, a close examination of their curricula would reveal that they are not well designed to achieve this objective. This may also be confirmed by the fact that the Islamic banks have not been able to find a reasonable number of suitable managers from the graduates of those universities nor could anyone of them find a place in the shariah board of any Islamic bank.

The managers of Islamic banks may have been attending some short-term courses either on the job or elsewhere but there is not many formal training programs meant to prepare the employees of the Islamic banks for the needs of the system. Most of the employees of the Islamic banks, including the managers and financial experts come from traditional sources lacking necessary expertise in Islamic banking. An institution is what its employees make it. Therefore, it is extremely important to have the people with the right kind of skills and commitment.

Iqbal, Ahmad and Khan (1998), add that the future of Islamic banking and finance crucially depends on teaching, training and research in the desired specialisation. There is also a need to arrange short courses for shariah scholars in economics and finance and similar courses for economists in shariah. The efforts in this area need to be enhanced to several times of current levels.



2.7. LITERATURE CONCLUSION

The purpose of the literature was to build a foundation on Islamic banking and the conventional banking environment in South Africa. Although the literature is not that current, it does provide the base for further research in this field and as there is a growing trend in Islamic banking worldwide and more recently in South Africa, literature will undoubtedly be forthcoming.

CHAPTER 3 - RESEARCH PROPOSITIONS

3.1 INTRODUCTION

The proposed research seeks to identify whether Islamic banking can be done in South Africa. The review of the literature (as documented in Chapter 2) has shown that research was done some ten years ago on this topic when Islamic banking began as a theological dream. Today Islamic banking has become a practical reality across the Middle East and is starting to spread to the West and mostly recently has started to develop in South Africa.

Welman & Kruger (2001) recommend that after the research areas have been identified they should be delineated to identify one or more research propositions.

With this in mind, the researcher set out to generate propositions in order to:

- Provide the study with direction
- Assist in selecting the relevant research design
- Derive a framework within which results could be presented

The following propositions were identified as being relevant to the research problem

1. Islamic Banking will work in South Africa
2. There should be no controversies affecting a viable Islamic institution
3. Muslim customer sceptism can be overcome
4. The challenges facing Islamic banking in South Africa can be overcome

3.2 FORMULATING THE RESEARCH QUESTIONS

The aim of the study was to gather as much qualitative information about the topic to form a non biased conclusion. The researcher devised questionnaire's that set out the measurement questions, the results of which provide the data against which best practice criteria could be compared. Structured face to face interviews using a compiled interview guide (Appendix 1 to 4) was put forward to the different groupings and the latter's responses was recorded. Due to some interviewees not been in Johannesburg, some interviews had to be conducted telephonically and recorded.

Henning (2004, p3) states that qualitative research is designed to understand, and also explain in argument, by using evidence from the data and from the literature, what the phenomenon or phenomena that we are studying are about.

CHAPTER 4 - RESEARCH METHODOLOGY

4.1 RESEARCH DESIGN

According to Penman (2006) “research design is a plan for selecting the sources and types of information used to answer research questions”, the results of which provide a framework for assessing results and presenting relationships between the variables being considered.

A literature review was done to ensure the clear formulation of the research questions as advised by Welman & Kruger (2001).

The review of the literature (as documented in Chapter 2) demonstrated that the majority of research done in this field was not that current. Thus there was no specific preceding research which could either be confirmed or dispelled by any quantitative means.

4.2 POPULATION, SAMPLING AND UNIT ANALYSIS

The population of relevance consisted of the following groupings:

- All Representatives of South African Islamic banks and Islamic windows of conventional banks.
- All South African Islamic Scholars that have been exposed to the field of Islamic economics
- All Representatives of the South African Reserve Bank

- All South African Customers of Islamic products and services

Welman and Kruger (2001) state that researchers rely on their experience, ingenuity and or previous research findings to deliberately obtain units of analysis in such a manner that the sample they obtain may be regarded as being representative of the relevant population. To ensure this degree of representation, the sample was selected from four different categories of groupings as mentioned in the population of relevance.

Non-probability sampling in the form of purposive sampling (Welman and Kruger, 2001) was used in this study as the researcher had decided to interview a specific sample of decision makers. This kind of sampling was used specifically for the decision makers of Islamic banks and Islamic windows of conventional banks, the South African Reserve Bank and consumers of Islamic products.

According to Welman and Kruger (2001) “in the first phase of snowball sampling a few individuals are approached from the relevant population. These individuals then act as informants and identify other members from the same population for inclusion in the sample. The latter may in turn identify a further set of relevant individuals so that the sample, like a rolling snowball, grows in size”.

Snowball sampling (Welman and Kruger, 2001) was used for the Islamic scholars. The advantage of this was that an Islamic scholar identified a further set of relevant Islamic scholars so that the sample grew in size which was useful as current data shows that

even the Islamic scholars had differed in opinion. Seeing that Islamic scholars operated in close circles, this provided a good basis for the correct referrals which saved time and ensured that relevant data was collected.

The researcher interviewed sixteen individuals from the population as listed in the table below.

TABLE 3: Respondent groupings and Sampling Method

Population	Sampling Method	Sample Size
Bank Representatives	Purposive sampling	3
Islamic Scholars	Snowball sampling	4
SARB Representative	Purposive sampling	1
Muslim Customers	Purposive sampling	8
	TOTAL	16

4.3 DATA COLLECTION

The proposed research made use of four structured interview schedules (Appendix 1 to 4); each one specifically designed for the different population groupings.

In using structured questionnaires Welman & Kruger (2001) mention that the interviewer is limited to the questions and how they are asked as well as the order in which they appear on the schedule. There is little freedom to deviate from the schedule.

Data was collected through a series of questions that was posed to the population groupings. The interview schedules consisted of questions that flowed in a justified sequence, covering the attractiveness of Islamic banking, issues with interest, challenges facing Islamic banking, regulatory requirements, product availability and affordability, religious requirements, customer interest and matters of interpretation.

According to Welman and Kruger (2001), the questions should begin with a few easy and non-threatening items that are clearly related to the stated purpose. Later on, more in-depth questions may follow.

Welman & Kruger (2001) highlight the advantages and disadvantages of using the face-to-face interview method to collect data:

The advantages are:

- The interviewer is in control of the interview process, so any misunderstandings or vague responses can be cleared up. Consequently the responses obtained are of a high quality.
- The response rate is very good, often better than telephonic interviews and postal surveys.

The disadvantages are:

- High preparation, traveling and interview costs because of the time this takes.

- Interviewees may give responses that they think the interviewer wants to hear.

4.4 INTERVIEW PROCESS

The researcher sat with each respondent and explained the purpose of the research and provided an outline of what data would be required. The discussions were initially conducted at a broad level and slowly narrowed down to the stated purpose.

Respondents across all four categories were primed by being asked to describe their understanding or lack of understanding of Islamic banking according to Shariah principles. All respondents were then asked to comment on the collapse of the Islamic bank and the effects it has had on the credibility of Islamic banking in South Africa. The researcher also tested whether there was independence between the bank's board and the shariah board. The researcher tested respondents expectations of Islamic banks in comparison to accustomed offerings by conventional banks and what can be done to remove customer sceptism in the market. To conclude, respondents were asked what they saw as challenges facing Islamic banking in South Africa.

Each depth interview lasted on average 30–60 minutes, and was digitally recorded and transcribed. Interviews were conducted at representative's work offices, homes, and telephonically in some cases due to the fact that the respondent resided in another province, namely KwaZulu Natal and Port Elizabeth. The researcher recorded the respondent's name, email address and telephone number for research verification

purposes (Appendix 5). A total of 16 interviews were conducted over the course of one month.

4.5 DATA ANALYSIS

Once the required data had been collected and transcribed (in respect of the interview schedules), detailed content analysis took place.

According to Welman & Kruger (2001), this involves the contents of these sources being examined systematically to record the relative incidence (frequencies) of themes and of the ways in which these themes are portrayed.

The analysis of the data was guided by the need to answer the research questions.

Two sections of data were analysed. These were:

- Analysis of demographics
- Analysis of research propositions

The analysis of the findings is discussed in Chapter six.

4.5 RESEARCH LIMITATIONS

- The researcher focused mainly in Johannesburg and did some interviews telephonically with representatives based in KwaZulu Natal and Port Elizabeth. Respondents are not reflective of the entire Muslim population in South Africa.

- Snowball sampling may result in the research results being homogenous in nature and therefore conclusions drawn from the data may not accurately represent the population.
- Welman & Kruger (2001) recommended that the interviewer be properly trained and should be consistent in the formulation of questions. Although it was a simple questionnaire, the researcher was not officially trained to conduct face to face interviews.
- The interviews were conducted mainly in the respondent's offices and with a few interruptions in the form of telephones and knocks at the door; the respondent's concentration at times could have been interrupted.

CHAPTER 5 - RESULTS

5.1 INTRODUCTION

This chapter sets out to consolidate all findings with regard to the questions asked and answered by the respondents. Overall responses were extremely good and provided sufficient data to interpret the results. The research data for 16 respondents were categorised into two categories

- Respondents profile
- Research questions

5.2 EXPLANATION OF THE CALCULATIONS

The raw data obtained in the interviews was analysed further to get to the tables and figures represented in this chapter. The frequencies obtained from adding up the raw data were then used to calculate the percentages as seen in the tables.

Also per the content analysis process described in Chapter 4, the raw data from the depth interviews was analysed for word and phrase frequencies.

5.3 RESPONDENT PROFILE

5.3.1 RESPONDENTS AGE

The age intervals of the respondents are represented in Figure 3 while the age group count and respective percentages are depicted in Table 4 below.

FIGURE 3: Respondents by Age Group

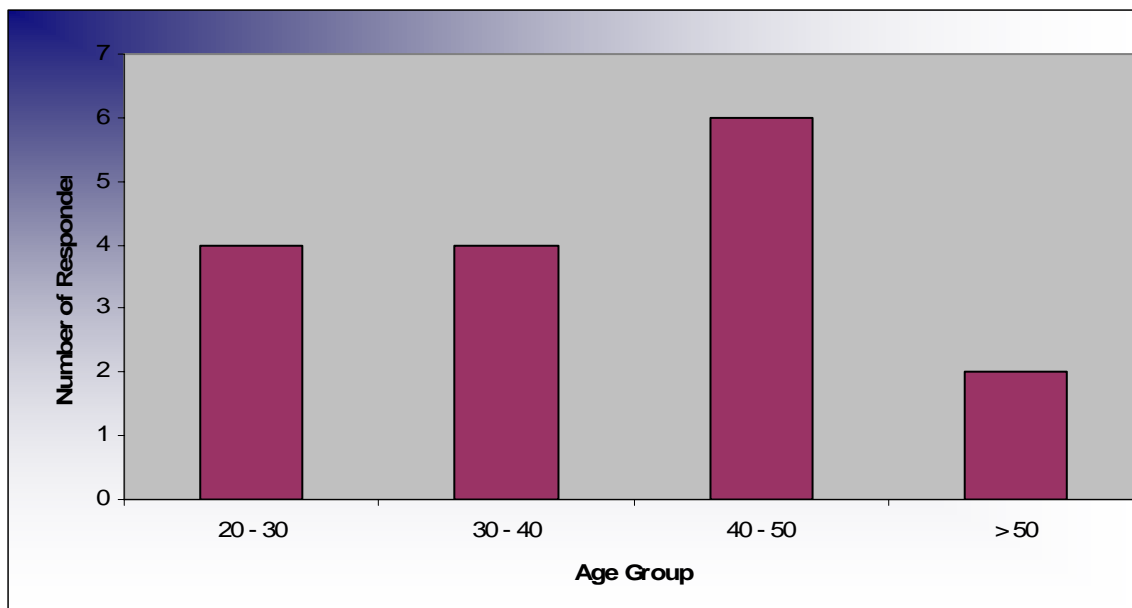
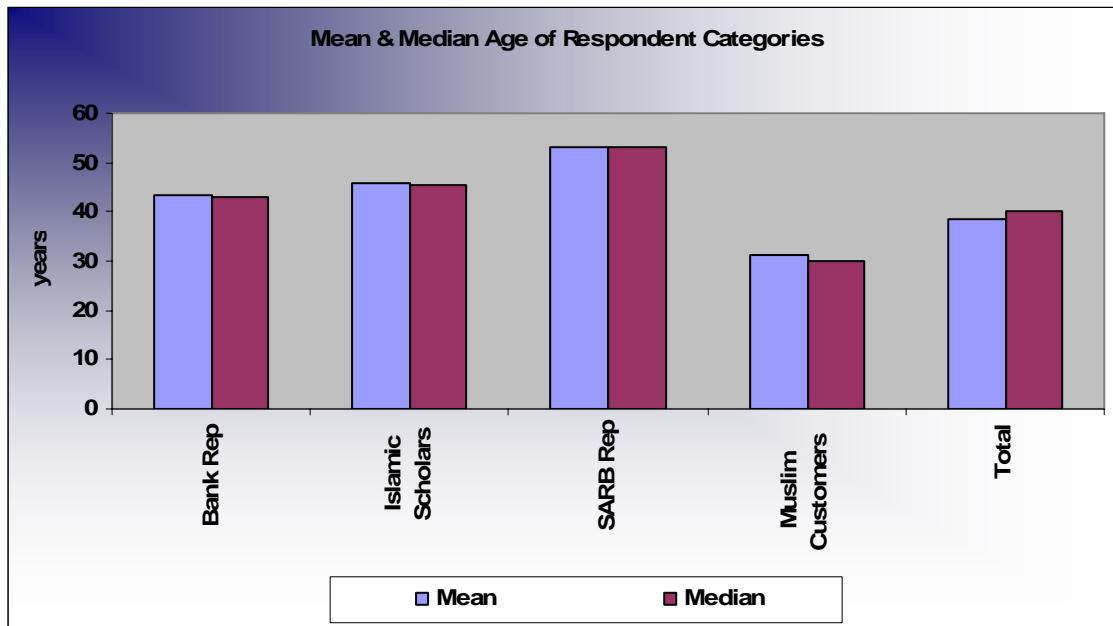


TABLE 4: Respondent Age group frequency and percentage

Age Group	Frequency	%
20 - 30	4	25%
30 - 40	4	25%
40 - 50	6	38%
> 50	2	13%
TOTAL	16	100%

FIGURE 4: Mean & Median Age of Respondent Categories



The mean age of the total respondents was 38.6 years and the median age was 40 years. The majority of respondents were between the ages of 40 to 50.

5.3.2 RESPONDENTS GENDER

The gender profile of the respondents is presented in Figure 5 below

FIGURE 5: Respondents by Gender

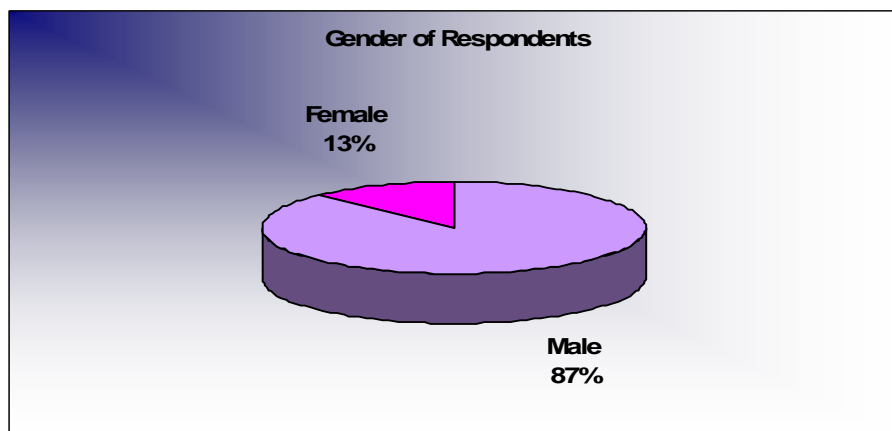


TABLE 5: Respondent Gender frequency and percentage

Gender	Frequency	Percentage
Male	14	87%
Female	2	13%

Table 5 illustrates that a significant majority of the respondents (87%) were male.

5.3.3 RESPONDENTS BY CATEGORY

The category of respondents is presented in Figure 5 below.

FIGURE 6: Respondents by Category

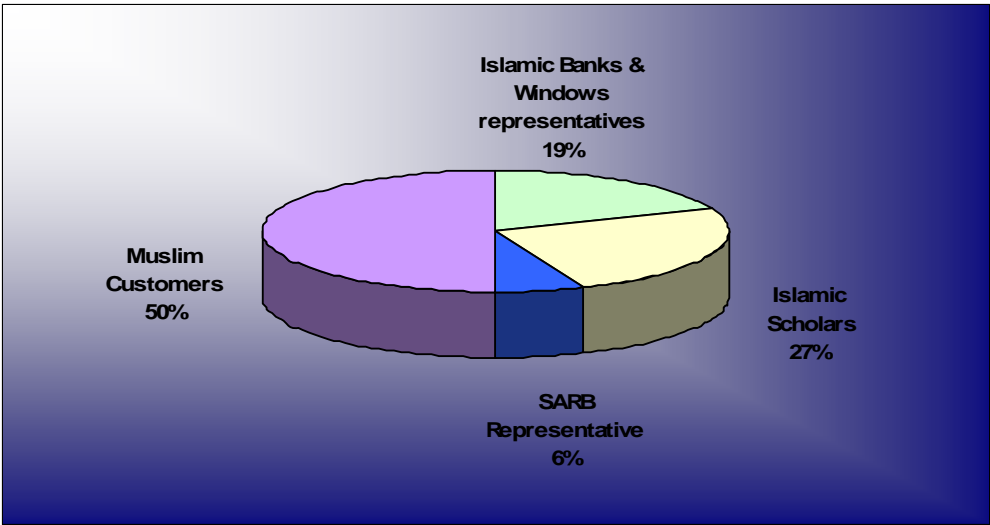


TABLE 6: Respondent Category frequency and percentage

Respondent Categories	Frequency	%
Islamic Banks & Window reps	3	19%
SARB Representatives	1	6%
Islamic Scholars	4	25%
Muslim Customers	8	50%
TOTAL	16	100%

Table 6 illustrates the mix of the respondent categories. The majority of respondents by category were Muslim customers (50%).

5.3.3 RESPONDENTS BY LOCATION

FIGURE 7: Respondents by Location

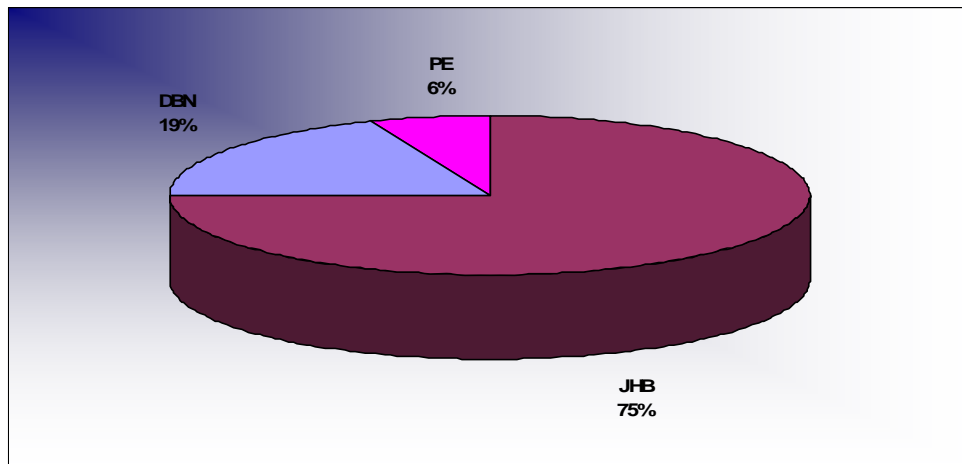


Figure 7 illustrates that the majority of the respondents (75%) were interviewed in Johannesburg.

5.4 RESEARCH PROPOSITIONS

The following section provides data that assisted in confirming the research propositions.

Proposition 1 - Islamic Banking will work in South Africa

Figure 8 below shows the current Islamic banks in the South African market. Albaraka bank has been in South Africa for 17 years. Within this period South African Muslims have also witnessed the liquidation of the Islamic Bank as well in 1997. In South Africa the global trend of Islamic windows that is a business unit operating on Shariah principles within a conventional bank has started. The two conventional banks to launch this product offering are The First Rand Group and Absa Group.

FIGURE 8: Islamic Banks in existence in South Africa

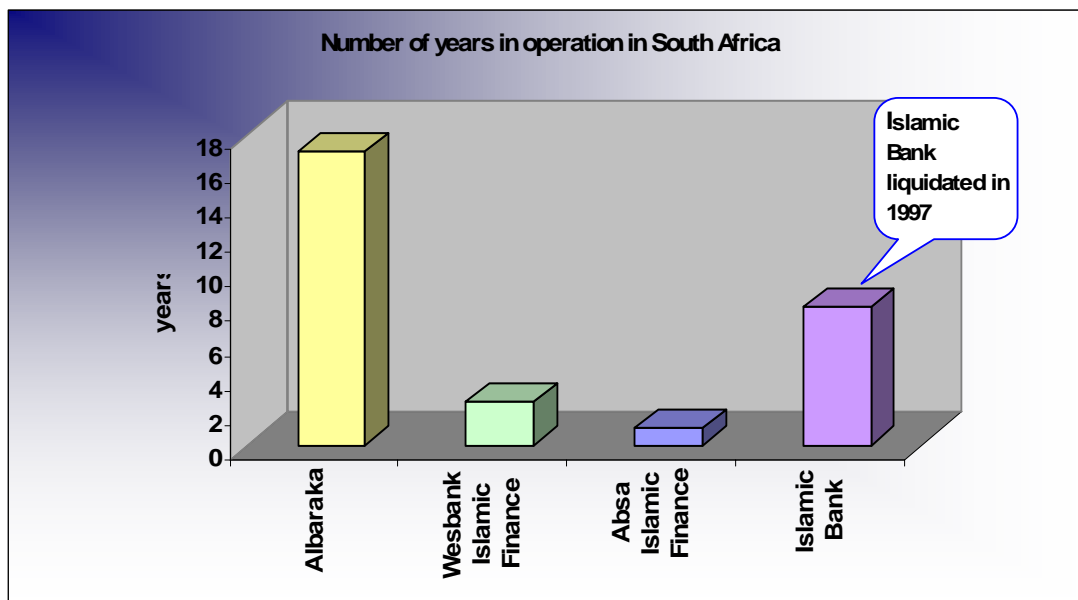


TABLE 7: Regulatory Framework in South Africa (KPMG Banking Survey 2004)

<i>Tier</i>	<i>Shareholder based/Company based/Profit motive based</i>	<i>Member based/Common bond based/Not profit motive based</i>
Tier 1	Banks registered in terms of the Banks Act Minimum capital: R250m	Mutual banks
Tier 2	Core banks/Savings and Loans Minimum capital: R50m Secured loans Minimum, say, 30 percent unsecured loans Payment system services	Co-operative banks Minimum capital: in the form of membership subscriptions Secured loans Place excess funds with a linked bank
Tier 3	Narrow banks/Savings Banks Minimum capital: R10m Invest in investments with the lowest credit risk, e.g. treasury bills, gilts, etc. Limited payment system services	Financial co-operatives (FSCs) Place funds with a linked bank

The regulatory framework has three main elements:

- regulatory objectives, i.e. why we regulate and what we hope to achieve through regulation;
- regulatory structure, i.e. the structure of agencies that carry the delegated regulatory responsibilities of the community; and
- regulatory effectiveness, which can be broken into two subcomponents:
 - regulatory backing, which includes the political, legal and financial backing
 - available to regulators to enable them to carry out their duties effectively; and
 - regulatory implementation, i.e. the instruments, tools and techniques used by regulatory agencies to implement regulatory oversight.

TABLE 8: Quarterly DI900 analyses of individual banks (SARB – August 2006)

Bank - Rm	Capital & Reserves	Deposits	Other Liabilities	Total Assets
Standard Bank	34,102,065	372,407,555	89,007,069	495,516,689
Absa Bank	35,791,383	359,057,103	34,428,155	429,276,641
FirstRand Bank	28,726,430	289,709,876	39,601,463	358,037,769
Nedbank	30,409,401	292,155,586	24,920,298	347,485,285
Investec	11,855,545	88,962,804	12,254,667	113,073,016
Citibank N.A.	1,686,770	38,738,335	9,661,939	50,087,044
JP Morgan Chase Bank	310,596	18,985,347	9,596,312	28,892,255
Imperial Bank	2,736,564	24,265,065	400,736	27,402,365
Calyon Merchant Bank	491,208	18,076,042	6,600,162	25,167,412
Deutsche Bank	304,014	19,803,084	1,302,127	21,409,225
ABN Amro Bank	508,945	13,466,744	1,248,263	15,223,952
African Bank	2,464,922	5,931,700	661,641	9,058,263
HSBC Bank	544,177	7,401,804	999,755	8,945,738
Commerzbank	509,295	6,420,971	883,598	7,813,864
Societe Generale	197,602	5,461,945	149,392	5,808,939
Standard Chartered	383,133	3,875,793	137,214	4,396,140
Mercantile Lisbon Bank	644,875	3,340,026	212,580	4,197,481
Teba Bank	484,422	1,802,064	80,668	2,367,154
Capitec Bank	705,421	794,735	197,178	1,697,334
Regal Treasury Private Bank	420,383	1,095,649	5,781	1,521,813
China Construction Bank	157,182	1,293,835	17,071	1,468,088
Albaraka Bank	93,149	1,150,956	70,699	1,314,804
Sasfin Bank	340,527	806,334	85,787	1,232,648
HBZ Bank	93,379	1,046,062	32,150	1,171,591
Meeg Bank	83,267	788,887	27,316	899,470
Marriott Merchant Bank	121,125	673,975	30,033	825,133
SA Bank of Athens	87,112	691,655	29,069	807,836
State Bank of India	92,512	484,630	125,235	702,377
GBS Mutual Bank	68,411	477,486	16,101	561,998
Bank of Taiwan	115,512	430,803	6,637	552,952
Rennies Bank	337,488	131,540	50,969	519,997
Habib Overseas Bank	27,861	428,111	12,474	468,446
Bank of China	71,161	204,192	7,968	283,321
VBS Mutual Bank	20,100	215,370	-	235,470
Bank of Baroda	89,287	98,261	501	188,049
TOTAL	155,075,224	1,580,674,325	232,861,008	1,968,610,559

Table 8 above represents the banking sector in South Africa, showing capital, reserves, deposits, other liabilities and total assets of the individual banks. The DI900 is a statutory return submitted monthly to the South African Reserve Bank by each registered bank. According to the SARB, Albaraka Bank (highlighted in orange) is the only registered Islamic bank in South Africa. Wesbank Islamic finance and Absa

Islamic finance are considered Islamic windows. Interesting to note that HBZ Bank and Habib Bank, because of their Muslim names are often confused by respondents as Islamic banks. These banks do offer clients deposits at no interest rates, however they also operate on conventional banking practices.

Islamic financial institutions offer a range of products and services that should meet the tests of Shariah. Table 9 below provides an overview of the products and services and the underlying Shariah contracts. These contracts are discussed with the respective Shariah boards and the finer details of these contracts can be examined at the institution's offices. These contracts are divided into four categories, namely:

- Exchange based contracts, such as murabaha, bai-bithaman-agil, ijara, salam, istisna, istijrar.
- Participatory contracts, such as mudaraba and musharaka that underlie equity-based financing contracts and securities
- Contracts that underlie deposit products, such as wadiah and amana.
- Contracts that underlie fee based products, such as Wakalah and ujr

TABLE 9: Full range of Islamic Products & Services (Rating of Islamic Financial Institutions, 2005)

Products/Services	Underlying Shariah Contract(s)
- Deposit Services	
Current Deposit	Wadiah Wad Dhamana / Qard Hasan
Savings Deposit	Wadiah Wad Dhamana / Mudaraba
General Investment deposit	Mudaraba
Special Investment deposit	Mudaraba
- Retail / Consumer Banking	
Housing & Property Finance	BBA / Ijara wa Iktina / Diminishing Musharaka
Hire Purchase	Ijara Thumma Al-Bai
Share Financing	BBA / Mudaraba / Musharaka
Working Capital Financing	Murabahah/ Bai Al-Einah/ Tawarruq
Credit Card	Bai Al-Einah/ Tawarruq
Charge Card	Qard Hasan
- Corporate Banking / Trade Finance	
Project Financing	Mudaraba / Musharaka / BBA / Istisna / Ijara
Letter of Credit	Musharaka/ Wakala/ Murabaha
Venture Capital	Diminishing Mudaraba/ Musharaka
Financing Syndication	Musharaka + Murabaha/ Istisna / Ijara
Revolving Financing	Bai Al-Einah
Short-term Cash Advance	Bai Al-Einah/ Tawarruq
Working Capital Finance	Murabaha/ Salam/ Istijrar
Letter of Guarantee	Kafala + Ujr
Leasing	Ijara
Export/ Import Finance	Musharaka/ Salam/ Murabaha
Work-in-Progress, Construction Finance	Istisna
Bill Discounting	Bai al-Dayn
Underwriting, Advisory Services	Ujr
- Treasury / Money Market Investment Products	
Sell & buy-back agreements	Bai al-Einah
Islamic Bonds	Mudaraba / Mushraka + BBA / Istisna / Ijara
Government Investment Issues	Qard Hasan/ Salam/ Mudaraba
- Other Products & Services	
Stock-Broking Services	Murabaha/ Wakala/ Joala
Funds Transfer (Domestic & Foreign)	Wakala/ Joala
Safe-Keeping & Collection (Negotiable Instruments)	Wakala/ Joala
Factoring	Wakala/ Joala/ Bai al-Dayn
Administration of Property, Estates and Wills	Wakala
Hiring of Strong Boxes	Amana/ Wakala
Demand Draft, Traveller's Cheques	Ujr/ Joala
ATM Service, Standing Instruction, Telebanking	Ujr

Table 10 below, illustrates all the product offerings currently available by the Islamic banks and Islamic windows in South Africa. The comparison to Table 9 illustrates the gap with regard to product development. The researcher was unable to successfully set up an interview with Absa Islamic banking. The product types available by the institution were taken from the Absa website.

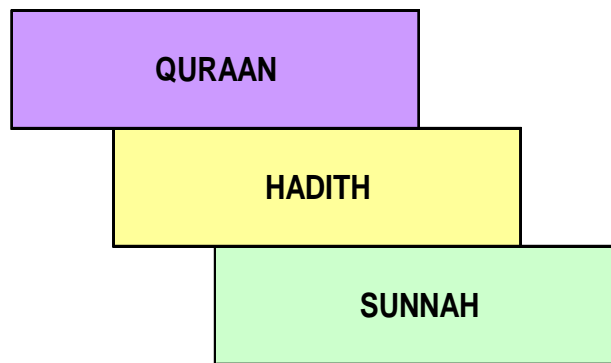
TABLE 10: Range of Islamic Products & Services offered by SA banks & Islamic windows

Albaraka Bank	Wesbank Islamic Finance	Absa Islamic Finance
- Deposit Services		
Participation Account Regular Income Provider Junior Jump Account Monthly Investment Plan Haj Investment Scheme Savings Investment Account	Business cheque accounts Personal cheque accounts Youth savings account Adult savings account	Islamic cheque account Islamic savings Islamic target save
- Retail / Consumer Banking		
Vehicle and asset finance Residential property finance Commercial property finance	Vehicle and asset finance Residential property finance Commercial property finance Debit cards Petrol cards	Vehicle and asset finance
- Corporate Banking / Trade Finance		
Trade Finance	None	None
- Treasury / Money Market Investment Products		
None	None	None
- Other Products & Services		
Futuregrowth Albaraka Equity Fund Stainless Steel tank containers Estate planning & administration of estates Takaful (insurance) Foreign exchange services	RMB Islamic Equity Fund	

Proposition 2 - There should be no controversies affecting a viable Islamic institution

The Islamic scholar respondents refer to three sources of Islamic teachings when doing traditional research to ensure that Islamic principles are adhered to and that no controversies surround their findings. These three sources, illustrated in Figure 9 below, should be used together and not in isolation.

FIGURE 9: Islamic Research Dependence



These sources have been defined as follows:

Quraan - The Glorious Quraan is the holy book of Islam. It is the literal word of God and the culmination of God's revelation to mankind, revealed to the Prophet Muhammad (peace be upon him) over a period of 23 years by the Angel Jibreel (Gabriel).

Hadith - A saying or tradition of the Prophet Muhammad (peace be upon him).

Sunnah - A word spoken, or an act done, or a confirmation given by the Holy Prophet Muhammad (peace be upon him).

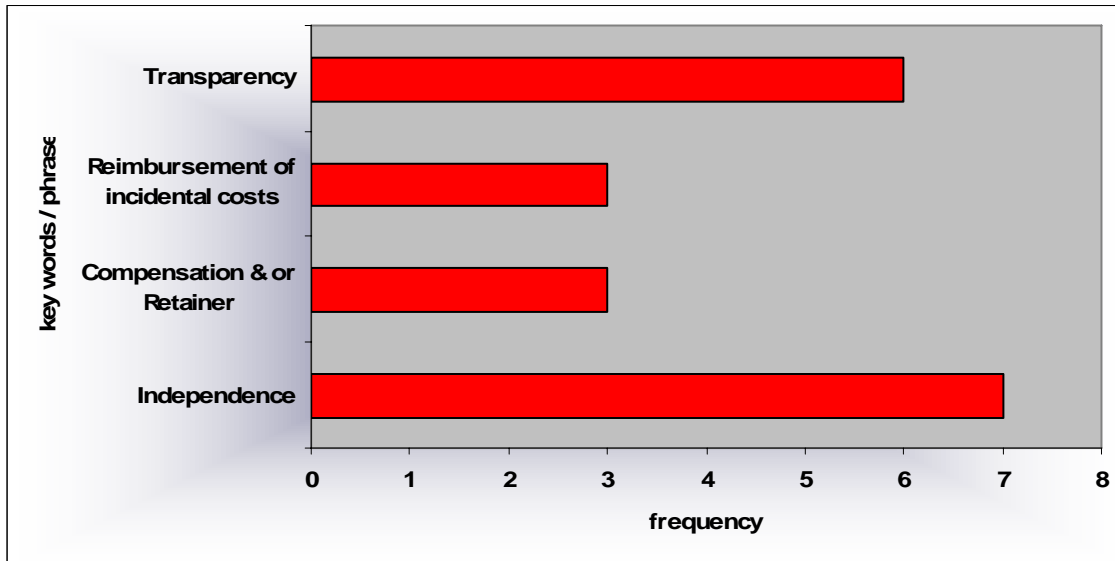
The majority of respondents hoped that the pillars of integrity, independence, transparency, competence and shariah are clearly identified and defined within Islamic

institutions. These elements should be the backbone on which Islamic institutions operate and this is in line with Islamic principles and teachings. This is where Shariah boards have a major role to play.

According to the Accounting & Auditing Organisation for Islamic Financial Institutions (AAOIFI), the powers of the Shariah Boards include, among others, the following:

- Achieving harmonisation and convergence in the concepts and application among the Shariah supervisory boards of Islamic financial institutions to avoid contradiction or inconsistency between the fatwa's and applications by these institutions, thereby providing a pro-active role for the Shariah supervisory boards of Islamic financial institutions.
- Helping in the development of Shariah approved instruments, thereby enabling Islamic financial institutions to cope with the developments taking place in instruments and formulas in fields of finance, investment and other banking services
- Examining any inquiries referred to the Shariah Board from Islamic financial institutions or from their Shariah supervisory boards, either to give the Shariah opinion in matters requiring collective reasoning, or to settle divergent points of view, or to act as an arbitrator.

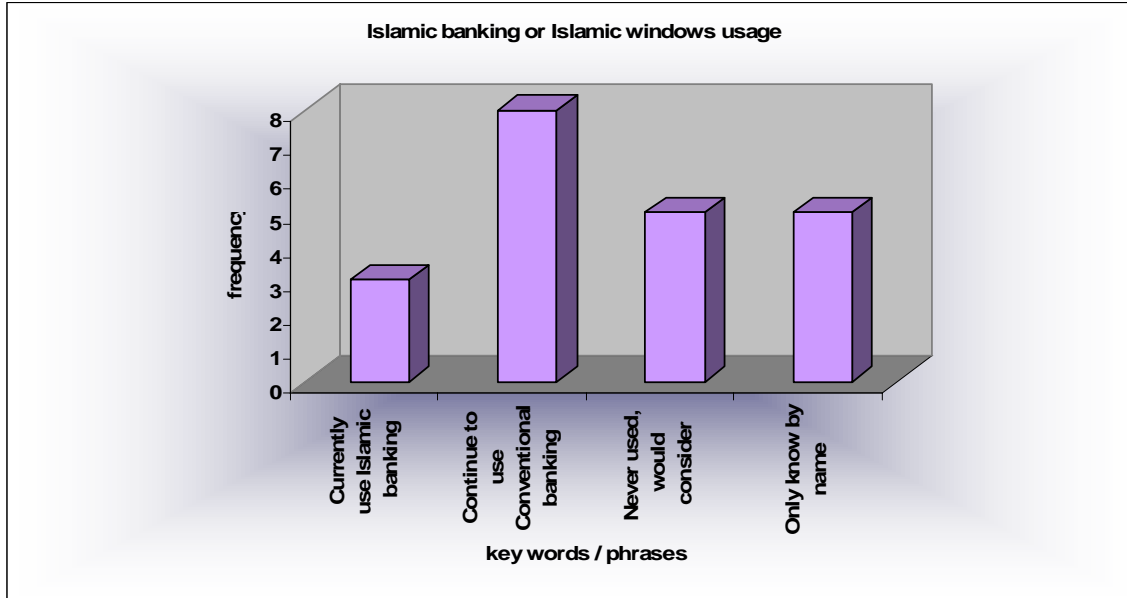
FIGURE 10: Islamic scholars and Independence – Keywords or phrases



Almost all respondents (frequency = 7), in the categories of bank representatives and Islamic scholars said that independence of Shariah boards and Islamic scholars were an important component to limit controversial issues. Seven instances were recorded whereby respondents said that the Shariah board should be independent from the day to day activities of the commercial side of the business. 50% Of Islamic scholars felt that they should be compensated for their services whiles 50% of them felt that money and Islamic scholars don't mix.

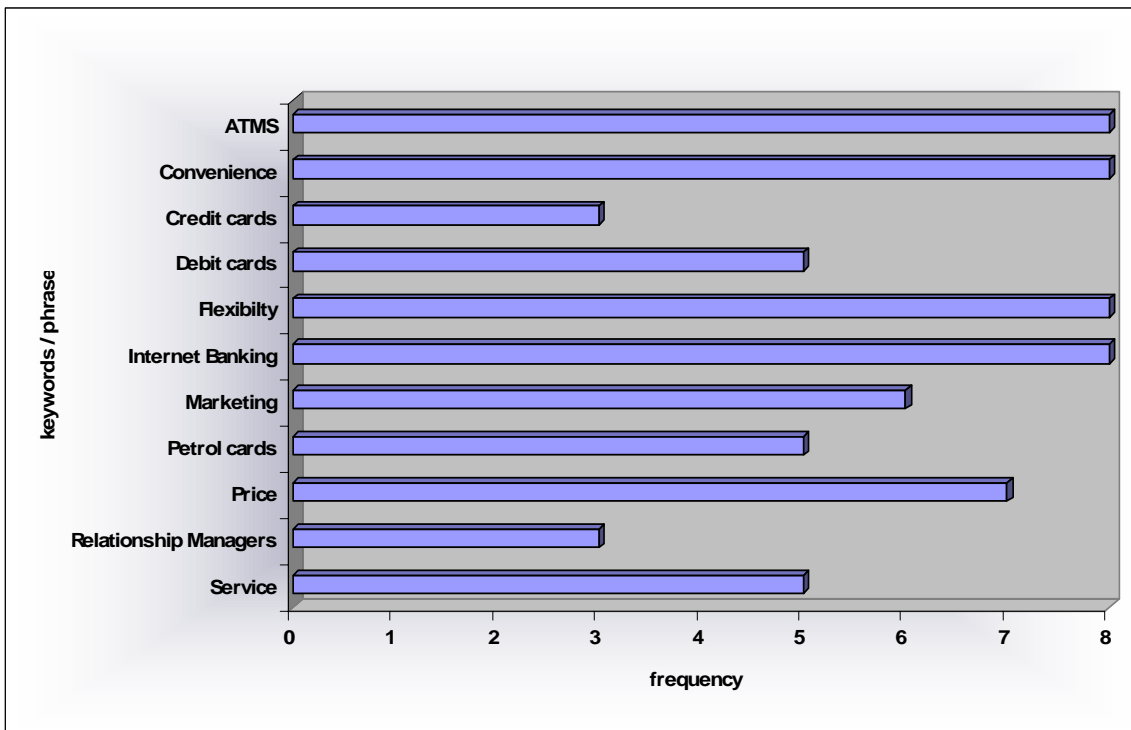
Proposition 3 - Muslim customer sceptism can be overcome

FIGURE 11: Relationship between respondents & Islamic banks – Keywords or phrases



When queried about banking with Islamic banks or Islamic windows, the majority of respondents (frequency = 6), never used Islamic banks or windows, while every respondent (frequency = 8) still continues to use conventional banking offerings. However these respondents did point out that if Islamic banking established themselves with the correct product and service requirements (listed in Figure 12), they would definitely consider banking with the Islamic institutions. Other respondents (frequency = 5) only knew the Islamic banks or Islamic windows by name, they never knew what products or services were offered. Only three respondents currently use Islamic banks or windows. The main reason for this is that the respondents are not fully convinced with the product and service offerings of Islamic banks.

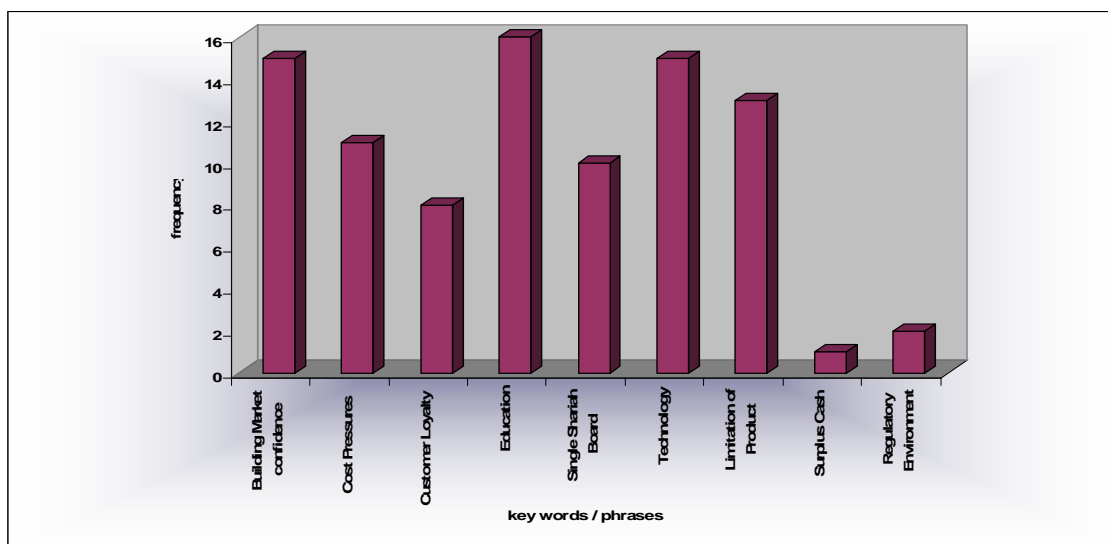
FIGURE 12: Product & Service requirements of Customers – Keywords or phrases



When queried about the specific product and service-related factors that should be in place before migrating from conventional banking to Islamic banks or windows, most respondents (frequency = 8), mentioned access to ATMs, internet banking, flexibility of products and convenience as a main requirement. The majority of Muslim customers are accustomed to the way and workings of conventional banks and making that transition would not be based purely on religious requirements but rather Islamic banking also having the above products and services in place as illustrated in Figure 12 above.

Proposition 4 - The challenges facing Islamic banking in South Africa can be overcome

FIGURE 13: Challenges facing Islamic banks or windows in South Africa – Keywords or phrases



When asked to mention the challenges facing Islamic banking in South Africa, the most common response (frequency = 16) was that both the customer and Islamic scholars need to bridge the education gap. There is definitely a lack of understanding on both sides. This was followed by responses relating to market confidence and technology. The collapse of the Islamic bank has definitely impacted on respondent's confidence levels. The lack of technology is another challenge that was raised by respondents as been too basic, as it does not fulfill their banking requirements. Also mentioned frequently (13 to 2 times) were challenges relating to product limitation, cost pressures, single shariah boards, customer loyalty, regulatory requirements and surplus cash.

CHAPTER 6 - DISCUSSION OF RESULTS

6.1 INTRODUCTION

Once the results had been consolidated and documented in chapter 5, the researcher set about analysing and interpreting them with the intent to relate the findings back to the literature, where applicable and make recommendations.

6.2 RESPONDENTS

The demographic data findings are as follows:

TABLE 11: Demographic data findings

Respondents	%	Comments
Age groups 40 - 50 years	38%	The respondents have many years of experience in their respective fields and provided valuable insight with regard to the findings.
Male	87%	Gender did not influence the data in anyway.
Muslim customer segment	50%	Provided good insight as to what customers are looking for in terms of product and service offerings.
Respondent Profile	70%	Reside in Johannesburg

In conclusion, the data could be accurate if one takes into account the homogenous nature of the sample, however it would not be accurate to say that these results accurately represent the population.

6.3 FINDINGS ON THE RESEARCH PROPOSITIONS

Four research propositions were proposed by the researcher. The purpose of this section was to establish whether this research project had successfully answered the research propositions and whether it supported and challenged the information in the literature review. Each proposition is discussed in more detail in this section.

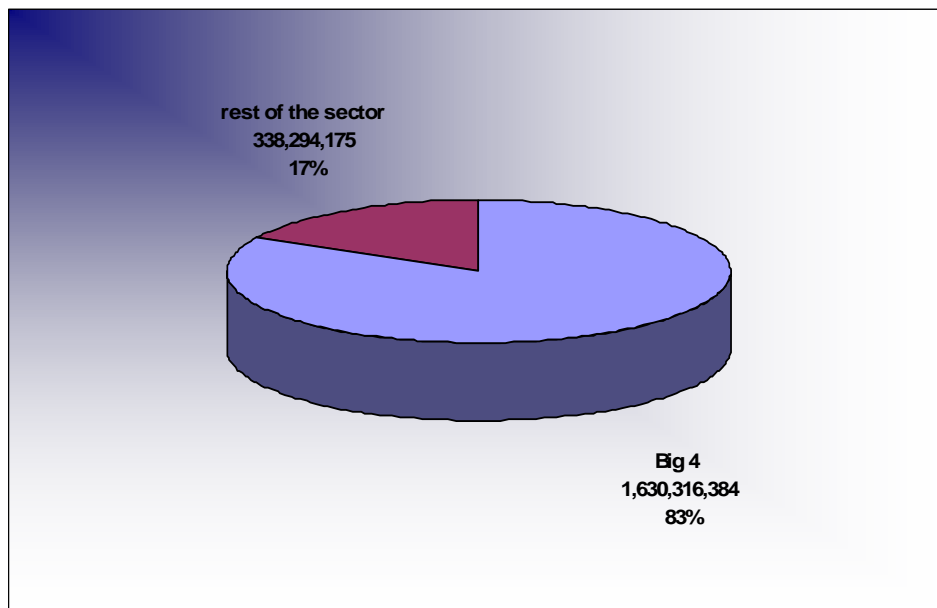
Proposition 1 - Islamic Banking will work in South Africa

South Africa chose a market-based model for its economy, which implies that market participants make their own choices with regards to markets, activities, products and services, based on considerations of risk and return.

According to Usmani (1991), interest based loans have a persistent tendency in favour of the rich and against the interest of the common people and this statement concurs well with the South African banking sector, to date, as it has focused on the formal sector of the economy, consequently neglecting the needs of the emerging component of the market. Apart from taking into account factors such as the geographic and demographic distribution of the population, income, wealth, under-banked and un-banked, and the level of the incidence of under-banking and non-banking of people, the South African banking system remains stable, and in general, banks are sound and continue to benefit from South Africa's economic health. The banks are well capitalised, and the average risk-weighted capital-adequacy ratio for the banking system as a whole was 13.3 per cent (SARB - December 2005).

The data from the research supports Mboweni's (2004) comments regarding the stability of the South African banking industry. Growth in the total balance sheet remained strong throughout 2006. By the end of August 2006, the total assets of banks comprising money, loans and advances, investment and trading position and non-financial assets had increased to a level of R1 968,6 billion (Table 8, chapter 5). The four largest banks (one of which is now internationally owned) represent 83 percent of the total banking sector as illustrated in figure 14 below.

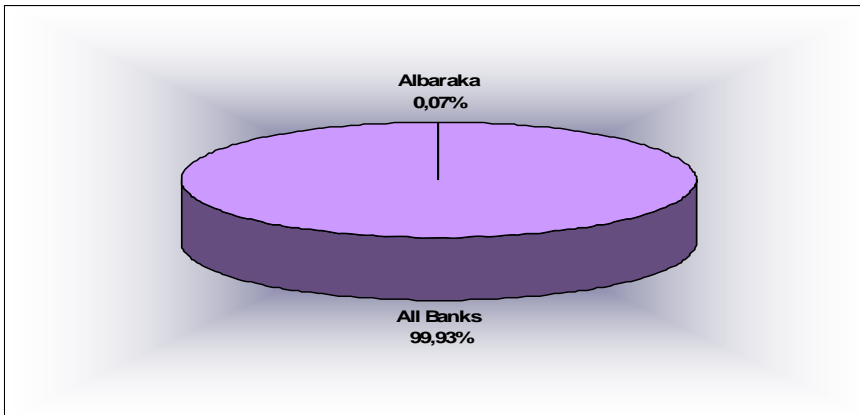
FIGURE 14: Representation of Total Assets of SA banking sector (DI900 SARB Aug 2006)



According to the SARB, Albaraka bank is the only registered stand alone Islamic bank in South Africa. In DI 900 reports their assets are reported separately, while the Islamic windows which form part of the respective conventional banks are reported

within The First Rand group and Absa group respectively. Islamic banking especially in terms of assets is a small representation in the bigger banking sector of South Africa (Figure 15 below).

FIGURE 15: % share of Albaraka Assets compared to the Rest of the Sector (DI900 SARB Aug 2006)



The South African banking industry has fairly high barriers to entry, as new market entrants need R250m as a capital requirement; hence Islamic windows have been established within conventional banks. These business units are linked to a stable business, reputable brand and don't need a banking license. They have access to established technology, systems and operations.

FIGURE 16: Standalone Islamic banks vs Islamic windows



According to Ebi Patel; CEO of Wesbank Islamic finance, “Being part of a larger conventional bank has its positives and negatives. The positives definitely outweigh the negatives”.

There seems to be mixed feelings and doubt within the Muslim community about Islamic windows being part of conventional banks as these are Non Islamic institutions. Islamic scholars have given this the green light by ensuring that any product or service offered by the Islamic window must be approved through the Shariah board. South African Muslims spend far too much time being judgmental rather than seeing the bigger picture; however we are of the opinion that it is much easier judging and passing opinions for the majority of these individuals.

According to Islamic scholar Emraan Vawda, “when you buy a packet of biscuits from Pick ‘n Pay, the biscuits are considered halaal for consumption as there is nothing within

the ingredients that makes it haraam (prohibited), yet we don't consider the fact that Pick n' Pay is not an Islamic supermarket. There is no difference between the transaction from Pick n' Pay and the transaction from an Islamic Window".

According to Usmani (1991), if the present state of affairs continue, many Muslims may develop doubts about the feasibility, practicability and usefulness of the Islamic system of banking, notwithstanding that the fault lies with them and not the system. This statement definitely supports the data we found amongst the Muslim respondents, which is highlighted in the above comments.

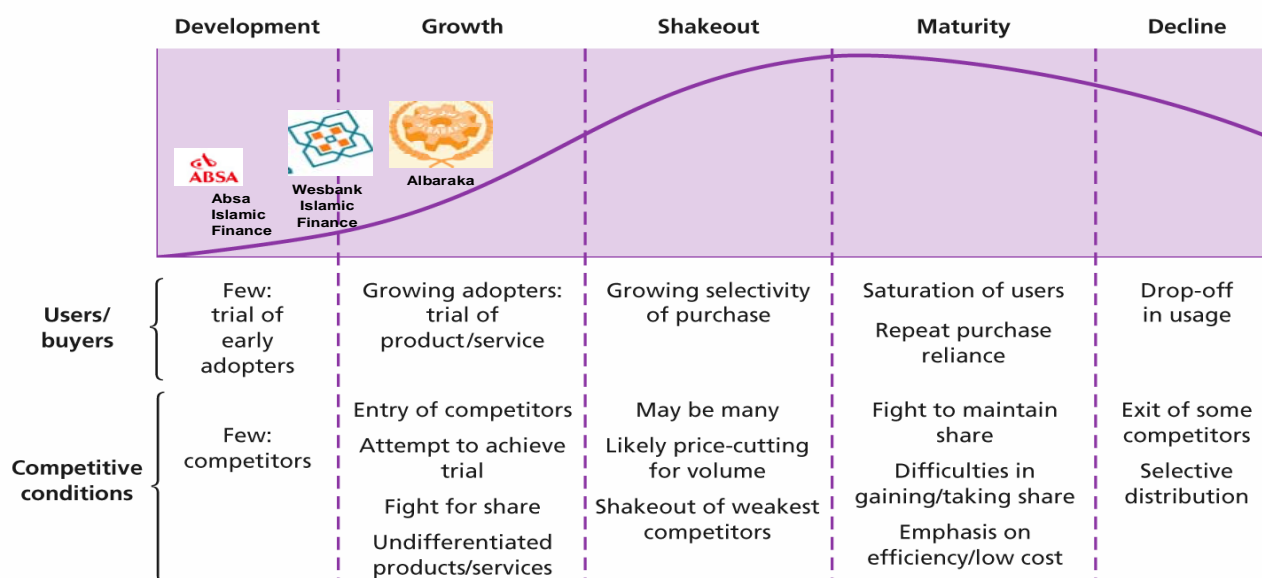
It's time the Muslim communities in South Africa change their mindset and stop looking for faults, accept and support these initiatives as the Islamic banks and windows are trying with the help of Islamic scholars to provide an alternative.

According to Khan and Mirakhor (1986) Islamic banking has basically taken two forms, the first is establishing Islamic institutions side by side with traditional banking and the second form is to restructure the whole financial system. In South Africa, Islamic banks and windows have adopted the first form and established "mixed" systems which combine aspects of Western and Islamic banking practices.

Islamic banking in South Africa is a niche operation catering mainly for the Muslim community. In some cases respondents strongly felt that certain of the institutions only cater for certain parts of the community. Some views were that Islamic banking was just for the rich. These findings in South Africa are in contradiction as Usmani (1991),

states that this is the approach of conventional banks, as they only benefit the rich. This should not be the case for an Islamic bank as the principles of Islamic banking is profit and loss sharing as well as social upliftment and this principle according to Khan and Mirakhor (1986), the primary objective of an Islamic system is social justice and specific patterns of income and wealth.

FIGURE 17: Product Life Cycle of Islamic banks in South Africa (Doyle 1976)



The product life cycle model is a good model to show where Islamic banking is in its cycle within the South African banking environment. The fact that Albaraka has been in operation for 17 years (Figure 8, chapter 5), operating with limited product offerings (Table 10, chapter 5) and branch networks, it is evident that Islamic banking can work

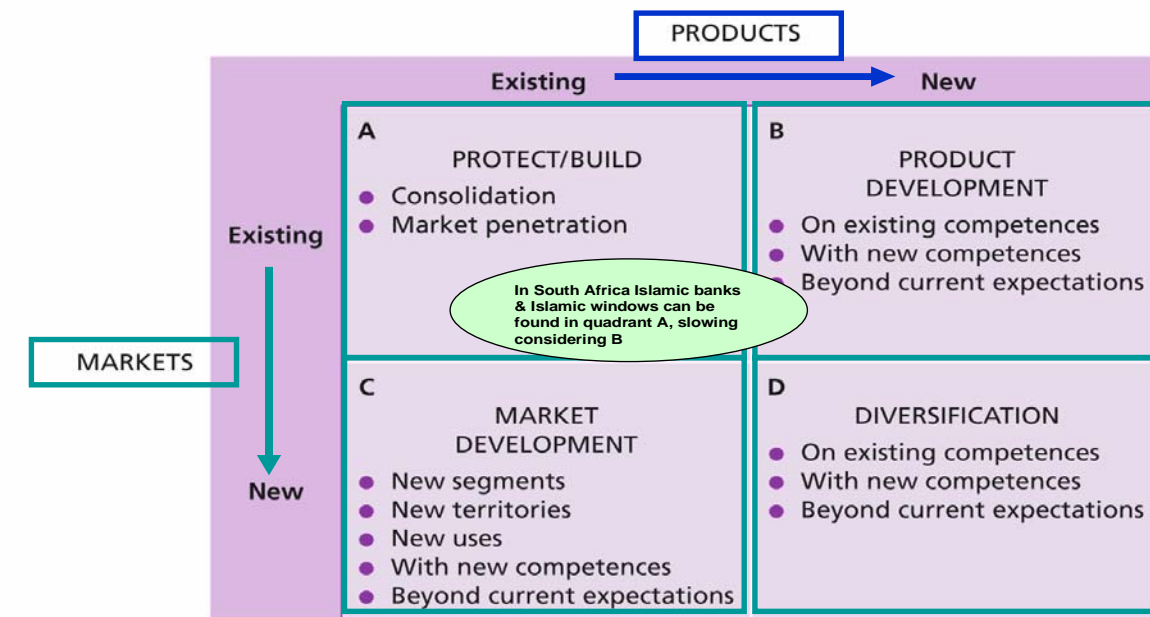
in South Africa, however it is still in a growth phase as illustrated in Figure 17 above. Albaraka's growth has been stifled mainly due to access to additional capital. During the last two years new entrants have entered the market and daily other competitors are researching this offering. Both these new entrants are still early adopters and while there are only three choices in the market currently, gives them an opportunity to market their products and services and try to gain some market share. It is evident though from the customer requirements that Muslim customers that have become accustomed to conventional banks offerings, would not migrate merely just for basic products and services which are currently offered. As an Islamic bank you need to enter this market with a differentiated offering that would attract Muslim customers.

The liquidation of the Islamic Bank in 1997, left many Muslim customers angry as some of them lost their life savings. According to the Deputy Registrar of the SARB, Yvette Singh, "the collapse was solely due to the lack of corporate governance". In hindsight, it seems the collapse was a blessing in disguise as it has made the SARB make amendments to the Banks Act, especially in the area of corporate governance.

In the last few years bank liquidations have happened fairly frequently in South Africa, such as Saambou Bank Limited, BOE Bank Limited and Regal. The costs of banking failures accrue to all stakeholders in the failed banks and the outcome is a loss confidence in the banking system. When people start to believe that money is safer under their mattresses than in their bank, a breakdown of the payment system may

result. The problem may also become systemic, which can cripple the entire economy of a country.

FIGURE 18: Product Market Expansion Grid of Islamic Banks in South Africa (Ansoff 1957)



This product grid is a good model to highlight the current state of Islamic banking in South Africa in terms of market positioning and product. Islamic banks and windows in South Africa need to focus on its existing products within the existing markets, followed by the right product development (quadrant B of Figure 18). The current limited product and service offerings is essential and a step in the right direction but is not sufficient to attract Muslim customers away from conventional banks and give Islamic banks some competitive edge. Marketing Islamic banking as a religious

obligation is not enough as many of the customer respondents understand their religious obligation but want the convenience and flexibility that they currently experience, as access to ATMS and internet banking has nothing to do with an interest based transaction.

In conclusion Islamic banking in South Africa is still in its early stages and like everything new would be faced with challenges. The fact that Albaraka bank with their 17 year presence and limited product offering continue to operate is sufficient evidence that illustrates the viability of Islamic banking in South Africa Also the introduction of Islamic windows by conventional banks adds to the viability. If these institutions can focus on the respondent's views and requirements, Islamic banking can work in South Africa.

Proposition 2 - There should be no controversies affecting a viable Islamic institution

Controversies arise mainly due to a lack of an understanding of Islamic concepts and principles, allowing individuals to arrive at conclusions that don't align to the concepts and principles, which then cascades into controversial issues.

According to Khan (1986) and Kuran (1986), disputes arise from the lack of consensus about the exact meaning of riba and whether the Quraan advocates a total ban on interest. The data findings contradict these comments as per Figure 9, chapter 5, as the Islamic scholars are of the opinion that when data is collected, all three sources in the form of the Quraan, Hadith and Sunnah need to be considered. The interpretation of the Quraan only must not be considered in isolation. Superficial studies of the interpretation of the Quraan only will undoubtedly create controversies.

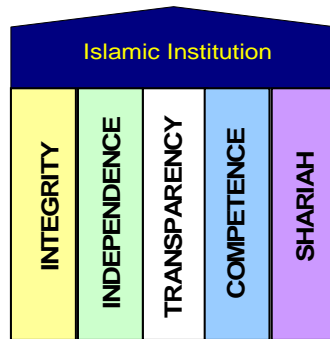
The majority of the respondents wanted to deal with an Islamic institution that had pillars (Figure 19 below) of integrity, independence, transparency, competence and shariah clearly entrenched in their institution, products and service offerings.

The pillars illustrated in figure 19 have been created by the researcher and based on the respondent's views.

These pillars are defined as follows:

- Integrity refers to wholeness, soundness, uprightness and honesty.
- Independence refers to not depending on something else for its validity and efficiency.
- Transparency refers to easily been seen through, easily understood, free from affection or disguise.
- Competence refers to technical, interpersonal knowledge and skills.
- Shariah refers to Islamic law, governing the life of Muslims, which is derived from the Quraan, Hadith and Sunnah.

FIGURE 19: Pillars Islamic Institutions should be built on



Each of these pillars has the ability to challenge any forthcoming controversies or statements against the Islamic institution. Just how Islam has five pillars that bring the

religion together, the data findings suggest that Islamic institutions should be based on the five pillars above.

Today websites play a crucial role in helping organisations display their offerings and information and this is one quick way to be transparent. Albaraka bank has come a long way in this respect while the two new Islamic window entrants have a limited web page (Appendix 6). Being part of conventional banks they should leverage this technology and create a webpage of substance. Many of the respondents want to see the following easily accessible, available and displayed on the internet sites of the institutions:

- Product & Service Offerings
- Profit Calculations
- Shariah Report
- Names of Islamic Scholars on shariah boards
- Financial statements of the institution
- List of charities non permissible funds are distributed to

We tried to do a parallel comparison between Islamic scholars and commercial professionals furthering their studies in respect to earning potential versus their independence. As a professional strives to obtain a degree, then an honours degree, a professional qualification (CA, advocate, judge, professor), followed by an MBA or doctorate, the thinking is that the more degrees and experiences one gets, the more

one expects to get paid more. The Islamic scholars were divided on this issue (Figure 10, chapter 5) as 50% felt that they should be paid for adding value and the other 50% felt that money can not remunerate the knowledge of an Islamic scholar as his study intentions were for the pleasure of his creator and guidance to the public. They did point out that any incidental costs in respect of attending shariah board meetings should be compensated. According to Islamic scholar Emraan Vawda, “Money and Islamic scholars don’t mix”.

With the current situation we has discovered that there are certain Islamic scholars offering their services to Islamic banks and windows at exorbitant rates and this type of behaviour would undoubtedly tarnish the principles of Islamic teachings and the industry. The Islamic institutions need to work together with the religious bodies in South Africa and put a stop to such behaviour at the outset and make it known to the public who these scholars are. We should never get to a situation where Islamic scholars are on the payroll of Islamic banks, as their independence would be impaired. There are also opinions that auditors are paid a salary for their independence and we should not differentiate between an auditor and an Islamic scholar.

We would like to draw the attention to the current Halaal food authorities' situation in South Africa with regard to the process to be followed to receive a certificate confirming that the food product is halaal. The main objective with certification revolves around money and this in itself manifests huge controversies amongst the Muslim community in South Africa and from an Islamic banking perspective I think CEOs of the Islamic banks and windows and the religious bodies should form a close relationship to ensure that the same situation does not happen in the banking industry as this would definitely be the demise of the Islamic banks and windows.

In conclusion, if Islamic banks and windows model their business models, public interactions and overall offerings on the five pillars described in Chapter 6, then they would definitely be in a position to mitigate any controversial issues around the institution and their product offerings. It must be borne in mind that ultimately the Islamic banks offering is based on a religious teaching

Proposition 3 - Muslim customer sceptism can be overcome

Usmani (1991) mentions that when the common people realise that the net result in the transaction of Islamic banks is the same as was in the transaction of conventional banks, they become sceptical towards the function of Islamic banks. South Africa Muslim customers definitely concurred with this statement but they do want flexibility and convenience from Islamic banks that they currently experience with their conventional banks. The majority of respondents still banked with conventional banks

in South Africa (Figure 11, Chapter 5); and from the data it is evident that customers are willing to try the Islamic banking offerings, but are cautious.

The customer segment was made up of students, professionals and business owners and this gave good insight to what the customer requirements are. Scepticism arose largely from the liquidation of the Islamic bank but many of the customers now understand the reasons behind the liquidation, however the majority of Muslim customers have become so accustomed to the conventional bank offerings that the challenge to migrate them is going to be extremely difficult. The limited product and service offerings currently offered by Islamic banks and windows do not appeal to them, as they feel that the main products are savings accounts without any transactional capabilities and asset based finance, which is a limited value proposition for the respondents.

Figure 12, chapter 5 highlights customer respondent's requirements in terms of product and service offerings and this data reflects why there scepticism remains alive within them as they are yet to see product and service offerings per Figure 12.

Technology plays a huge role in many of the product offerings by conventional banks. All the customer respondents had to have access to the internet and ATMs, as they considered these basic necessities. The majority of the respondents did not enjoy the experience of going into branches as they felt that too much of their time gets wasted in a branch.

The business owner respondents want to have a transactional cheque account whereby they can do their payments via the internet at their convenience within their work environment. The business owner respondents need speed points at point of sale and it is also a pre requisite that certain suppliers are paid electronically rather than by cheque. To have just a cheque account is not sufficient. Also some business owner respondents use cash in transit companies to transfer the cash deposits, this becomes an issue if they bank just with Albaraka, as Albaraka does not have such a facility with cash in transit institutions. Another businessman pointed out that his business is in Fourways and for him to drive to Albaraka's branch in Fordsburg to make cash deposits are just not practical and convenient.

Convenience, flexibility and price were another requirement that the majority of respondents wanted. This challenge does not only face Islamic banks in South Africa, as service across the entire banking industry is really appalling, hence the respondents are looking for this so badly that the data has reflected that this is really an important need.

Data from the professional customer segment shows that this segment due to their work pressures and demands, require relationship managers to attend to their banking needs. This segment is accustomed to private banks supplying them with relationship managers who take care of their needs from setting up debit orders, to delivering debit, credit and garage cards and sorting out all their vehicle and residential property

requirements via the telephone or personal visits, without this specific customer segment having to leave their offices.

We got the feeling that Islamic banks and windows are getting caught up in replicating each others products and trying to compete with each other for the Muslim customer. The data illustrates that their main focus should be to develop products that satisfy the customer requirements.

According to Mboweni (2004), the major banks offer a wide range of services to both individual and corporate customers. One-stop relationship banking, with an emphasis on universal banking, instead of isolated services, has gained in importance during the past few years and the data gathered supports this view point as customers in South Africa have been spoilt over the years with numerous product offerings from all the major banks. For example the average customer in his wallet has a product offering from each conventional bank, thereby highlighting the competitive nature of conventional banks looking to own wallet share.

According to the PWC survey (2005), they anticipate that the number of branches will increase from approximately 2,500 in 2005 to 2,700 in 2008; similarly the number of ATMs will increase from 12,488 to 14,428 by 2008. This data reflects where banking is going and Islamic banks and windows in South Africa need to start thinking about these concepts as well.

Another aspect that featured was that the respondents felt that Islamic banks and windows did not do enough with regard to Marketing. The business representatives felt that they advertised in community newspapers and community radio stations. Respondents felt that there is a need to start thinking about national newspapers and radio stations, which do bring a bigger cost factor with it, but this is the mediums that respondents use daily rather than occasionally looking at community mediums.

In conclusion, if the Islamic banks or windows listen to their customer needs, act upon these and make efforts to deliver such customised solutions, it will play a huge role in migrating the customer and then building customer loyalty. For the stand alone Islamic bank like Albaraka this would mean a huge investment in technology whereby the Islamic windows should leverage off their existing conventional technological capabilities and provide these solutions. If a competitive advantage is what is needed, this is where Islamic windows can make a huge impact immediately and then over time Muslim customer sceptism will be overcome.

Proposition 4 - The challenges facing Islamic banking in South Africa can be overcome

Islamic banking, like any other banking system, must be viewed as an evolving system. Shortcomings have arisen largely due to the fact that this industry is in its infancy.

Figure 13, chapter 5 illustrates the data that respondents felt were key challenges faced in the South African market.

All respondents undoubtedly felt that there is a lack of understanding amongst Islamic scholars and customer segments and this gap needs to be addressed fairly urgently.

The data findings are in accordance with the literature of Iqbal, Ahmad and Khan (1998) wherein they state that there is a serious shortage of Islamic scholars who possess even a working knowledge of both Islamic fiqh and modern economics and finance. Both sets of Islamic scholars need to bridge the gap as with Islamic banking on the scene, these scholars are now required to understand both sets of learning's.

According to Islamic scholar Emraan Vawda, the Islamic teaching centers are now making finance a part of the Islamic scholar's curriculum which is definitely a step in the right direction. The new generation of Islamic scholars that would graduate in the future would have a full understanding of both Islamic jurisprudence and economics.

Customers of Islamic banking products also need to be educated. For a product to be classified as been Shariah compliant, there are lots of technicalities used as part of the approval process. These technicalities are extremely complex and the common person should be educated about these as they would continue to think that Islamic banking is just a replica of conventional banks, when in fact when you talk to Islamic scholars they tend to highlight the differences with ease. Customer education is extremely important in the South African market especially as the Muslim customer is so sceptical and accustomed to conventional banking terminology and practices.

Usmani (1991) points out that it becomes very difficult to argue for the case of Islamic banking before the common people, especially before the non-Muslims who feel that it is nothing but a matter of twisting documents.

Iqbal, Ahmad and Khan (1998), add that the future of Islamic banking and finance crucially depends on teaching, training and research in the desired specialisation and this agrees to the data as all respondents agree that education is the backbone for the development of any discipline. In the area of research, the Islamic banks, neither individually nor as a group spend enough amount on research and development. It is extremely important to have the people with the right kind of skills and commitment. According to the data in figure 19, competence is one of the pillars Islamic institutions should be built on.

Once education levels are increased, this will definitely play a part in addressing the challenge of building market confidence. Many of the respondents felt that Islamic banks need to re-built market confidence. With Islamic windows, one positive is that they form part of conventional brands that the majority of Muslim customers recognise and feel secure with from a risk perspective. Building on this aspect can only make Muslim customers more comfortable. The stand alone Islamic bank, currently just Albaraka bank, would need to prove to the Muslim customer respondents that it is in a position to fulfill their requirements. Albaraka tends to keep a low profile, however their track record in South Africa, figure 8, chapter 5, should give respondents comfort with regard to their stability, which is starting to open up customer minds as figure 11,

chapter 5 illustrates that even though respondents have not used Islamic banks or windows in South Africa, they are willing to consider.

Today the majority of respondent's require products that are driven solely by technology. The conventional banks have spent millions of rands building infrastructure capabilities over the years to give the consumer access to convenient ways of banking. E-commerce channels like internet banking and mobile banking have given the banking industry a whole new dimension in facilitating the transfer of money today. As if these were not enough channels, banks are continuously looking for new channels and the latest piece of technology released by Nedbank (Fin week Nov 2006), is a mobile-based payment solution, called iMPi, which enables merchants to process credit card transactions without having to use a point of sale (POS) terminal.

Ulph (2002) states that according to Dadabhoj, Apart from Malaysia, most of the Islamic markets are limited to two products, murabaha and equities, which agrees to the data from respondents. Respondents felt that the Islamic banks and windows offer limited products, this is illustrated in table 10, chapter 5. The data reflects that the majority of these products across the Islamic banks and windows are the same in terms of functionality and offering. Apart from providing new innovative products, the thought of replicating current conventional banking products (i.e. the Internet, ATMs etc) seem to be a challenge as well. We assume that this could be a quick win for the Islamic banks especially in the case of Islamic windows. Instead of just offering the basic product offering of saving accounts, vehicle and residential finance, they should

leverage off their existing technology and come to market with the internet banking offering, a product in itself that would undoubtedly increase its customer base overnight.

Having a single shariah board for standardisation purposes is not only a challenge facing South African Islamic banks but rather a challenge facing Islamic banking worldwide. Only with standardisation, will institutions be able to produce Shariah-compliant reports that exercise credibility and influence and at the same time increase market confidence.

The majority of Islamic scholars in South Africa would cherish a single shariah board, but in reality this will never happen as the prospect of bringing together religious bodies, personal egos and agendas are extremely challenging. The Financial Services Board (FSB) that governs the financial services industry in South Africa should ensure that there are certain conditions that must be present for Islamic banks and windows to be affiliated to a single association or body; this would then ensure that quicker steps are taken to make this a workable reality.

According to Islamic scholar Siraj Desai, steps towards unification of shariah boards have been discussed on two occasions at the United Ulama Council of South Africa (UUCSA) and this is definitely a step in the right direction.

According to Ebi Patel; CEO of Wesbank Islamic finance, there is a need for an Association of Lenders to be formed by CEO's and representatives of Islamic banks and Islamic windows in South Africa.

According to Shabir Chohan; CEO of Albaraka bank, his institution is affiliated to the Accounting & Auditing Organization for Islamic Financial Institutions (AAOIFI), where leading Islamic scholars from the Middle East are represented and provide guidance for Islamic banks and institutions worldwide.

Each respondent had a view with regard to the single shariah board challenge and it's interesting to note that the common theme is to have a singular body which illustrates that ego and agendas aside this could be achieved.

In conclusion, for Islamic banks and windows to overcome these many challenges will definitely put these institutions under severe cost pressures. The banking industry requires existing and new entrants to have deep pockets as religious obligations is just one component to bank the Islamic way, as the respondents still want what they have been accustomed to, but through these institutions. Customer loyalty can only be built on giving the customer the right experience through the right choice of products and services.

6.4 MODEL OF THE FINDINGS

The key findings in this research were brought together and represented in a model as illustrated in Figure 20. The key areas of the model are:

- Product & Services

- Customers
- People
- Operations
- Marketing

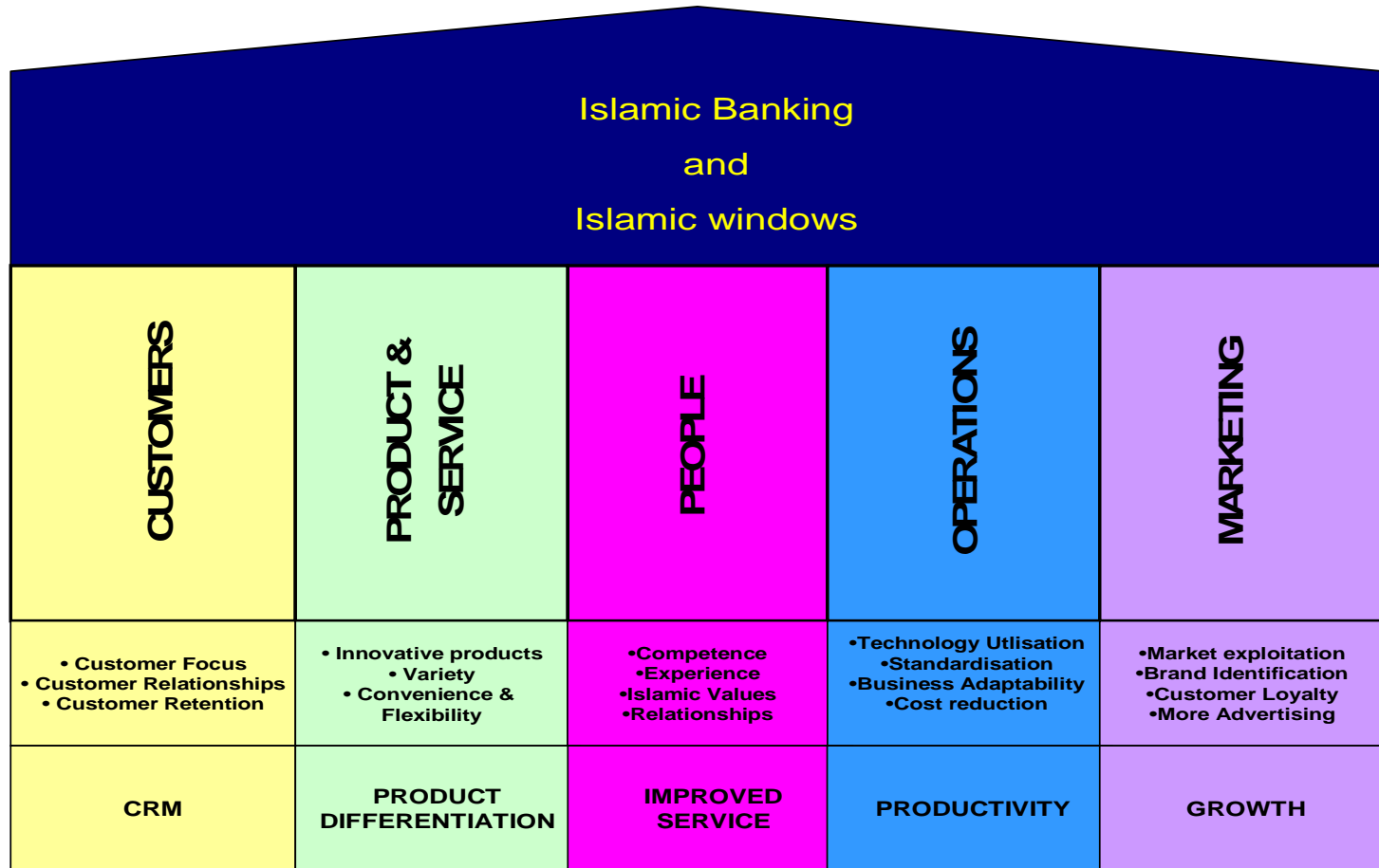
The purpose of the model was to consolidate the key findings, put them in context of the Islamic banking environment in South Africa and represent them graphically. All data gathered illustrates that Islamic banking in South Africa needs to reevaluate their value propositions in light of new entrants as competition will start to increase and provide the customer with a variety of choice. The organisations that can deliver the respondent's current requirements will undoubtedly gain immediate competitive advantage as customer respondents are willing to migrate but for the right offerings. We propose that in light of this, Islamic banks in South Africa measure their organisations against this proposed model and see where they need to make changes.

Islamic banking must center on the development of the bank's business model. Islamic banks in South Africa need to clearly define their value proposition by identifying their customer segments and the institutions ability to fulfill their customer segment requirements. The proposed Islamic banking business model consists of five competencies, namely customers, product and service, people, operations and marketing, each comprising different characteristics below them. By focusing on the customer the institution will be able to build customer relationships that will result in customer retention. To compete the institution needs to focus on its current limited

product and services. Customers require innovative products and want a variety as the customer has become accustomed to choice. Competent and experienced people would ensure improvement in service. Proper utilisation of technology adds value to the institutions productivity. Marketing will create brand awareness, market exploitation and bring about customer loyalty' adding to the growth of the institution.

Now is the time for Islamic banking to re-invent itself in South Africa as it still in the growth phase and has yet to enter the competitive phase, however quick reaction is needed as the conventional banks are starting to understand the lucrativeness of this niche.

FIGURE 20: Proposed Islamic Banking Business Model



CHAPTER 7 – CONCLUSION

7.1 CONCLUSION

The concepts of Islamic banking and finance in South Africa are still in their early stages of development and therefore, the Islamic banking system, like any other system, has to be seen as an evolving reality, that needs to be continuously tested and the concepts refined. The Islamic banking experience needs to be evaluated objectively and the challenges ought to be carefully identified and addressed. If this type of banking is seen in this light then the opportunity to grow and prosper will happen over time and it will be a success in South Africa.

The current institutions in South Africa need to re-group, re-think their value proposition and consolidate as new entrants are planning daily to enter this lucrative niche. The Muslim customer soon will have a variety of choice and productive offerings and not been able to cater for their requirements will accelerate your proposition to the decline phase of the product life cycle model. From the research it is evident that Muslim customers would rather choose a conventional bank with a brand name and stability, knowing that their risk is minimised. It is for this reason mainly that conventional banks have launched Islamic windows to ensure that the Muslim customer is retained within the banking group. Worldwide this occurrence of Islamic windows is proving to be

extremely successful and the major banks like Citigroup, HSBC, and Barclays etc. have all ventured into offering this product and service.

It was just a matter of time before the conventional banks in South Africa adopted this offering and currently with just two conventional banks in South Africa offering Islamic products, the potential of new conventional banking entrants is on the horizon, opening up this segment of the market to competition and choice in the future. This would be encouraging and good for Islam in South Africa as financial transactions play an important role in Islamic principles and economics. Standalone Islamic banks like Albaraka however need to re-evaluate their value proposition and create brand awareness quickly in the market if they want to continue to be part of this niche, as Muslim customers would soon be exposed to a variety of product choices by conventional banks in line with Islamic principles.

If Islamic banks and windows can leverage their value propositions by creating client awareness, offering innovative products through the efficient utilisation of technology, improved client service and focus which results in customer retention and growth, then the future for Islamic banking seems bright even with the challenges it faces. Muslims need to understand that an interest based economy will always be part of the global economy and that the alternative of Islamic banking in its current form with challenges is acceptable once approved by Shariah boards. If Muslim customers don't embrace this alternative then they would need to answer for their continued support of an interest based system as the excuse of an alternative system not existing, no longer applies, whether it is

in an Islamic or Non Islamic country that we live in. Islamic banking and windows are here to stay, so the focus should be on making it work in the context of Shariah principles and embracing and supporting the initiative, not looking at its faults and challenges.

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7.2 RECOMMENDATIONS

In South Africa the Islamic banks, windows and Islamic scholars should come together and create a united body for Islamic banking within the country. Each institution can continue with their separate shariah boards but allocate representatives to the united body. The objective of this body should be to protect the religion and the principles of Islamic economics. Such a body with the correct intentions can only be good for the industry and it would definitely promote the correct understanding.

Promote education in Islamic banking and finance in order to produce and disseminate authentic information on the technical and economic aspects of Islamic banking. Again the banks should come together and create a training institute in South Africa that would cater for students, banking staff, Islamic scholars and the like. This would definitely add to the development of the industry as education creates more awareness and acceptance. There could also be courses on product innovation as a research and training institute would afford the time to focus on these aspects as it is separated from the day to day business of the Islamic banks and windows. Each of the Islamic banks and windows as a joint

venture should set up such an institute, as the costs could be shared between them which make such an institute a cost effective reality.

Islamic banks and windows should not compete with each other as the Muslim customer is accustomed to choice and at the end of the day would make their own choice. Islam teaches you that your sustenance is determined by your creator and with this belief, Islamic banking leaders and Islamic scholars in South Africa should focus on their intentions and what they can do for the Muslim community in South Africa in ensuring that the products offered and principles that govern their business practices are all in accordance with Islamic teachings and principles, as the best of intentions only lead to a path of good and prosperity.

7.3 FUTURE RESEARCH

As Islamic banking and windows continues to develop in South Africa, additional research needs to be done to see whether it has grown from these early stages and highlight the stage it would be in at that point of the research, as there has been minimal research specifically for the South African environment up to now.

Islamic banking as alternative to the Mzansi account would be a good research topic as a principle of Islamic banking has to do with social upliftment and redistribution of wealth, especially with a huge impoverished society in South Africa.

Research with regard to expanding the Islamic banking offering alternative to Non Muslim customers as there has been a small interest shown currently by Non Muslims for this offering in South Africa. Look at what makes this offering attractive.

7.4 FINAL WORDS

The researcher undertook this research to gain a better understanding of Islamic banking and how it operates within the confines of Islamic principles and economics.

The findings suggest that it is a viable alternative however it faces many challenges not only in South Africa but worldwide; but at the same time it is an industry that is currently in a growth phase. The findings also illustrate that the Muslim customer is willing to embrace this alternative however the leaders providing this alternative must take into account the customer segment views as highlighted in the findings.

The researcher believes that the findings in this research project have assisted in answering the research problem.

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APPENDIX 1: INTERVIEW GUIDE FOR CEO'S

Questions
1. What is your business background?
2. When did the business start?
3. What was the strategic thinking behind your Islamic banking approach?
4. Today Islamic banking seems extremely attractive worldwide, what are your views on this?
5. Where do you get your funding from and is there any transfer pricing involved?
6. How do you compete with conventional banking products currently offered in the market?
7. Is there a lack of understanding by Muslim customers of the current Islamic banking offering?
8. Has Islamic banking in South Africa been effected by the collapse of the Islamic bank a few years ago?
9. Some researchers say that the profit is just another form of interest. Your views on this controversy?
10. What is the process followed in selecting and establishing the Shariah advisory board?
11. What decision making powers does the Shariah advisory board have?
12. What does the organization do with non permissible income?
13. Does your business get any support from the Central bank?
14. What is the process for the interest received on funds placed with the Central bank?
15. Being part of a bigger conventional bank, do you have autonomy to run your business?
16. What are your views about difference of opinion by Islamic scholars about Islamic banking? Is this good for the industry
17. What are your views on having two different banking systems in the same economy?
18. Can Islamic Banking work in South Africa?
19. What are the challenges facing Islamic banking in South Africa?

APPENDIX 2: INTERVIEW GUIDE FOR ISLAMIC SCHOLARS

Questions
1. Please give me your views and understanding around the concept of Islamic banking?
2. Is the distribution of interest to charities permissible?
3. What role does Islamic Scholars play in financial institutions?
4. Do banks support your role?
5. Has Islamic banking in South Africa been effected by the collapse of the Islamic bank a few years ago?
6. Why have some researchers written that there is controversy around the interpretation of the verses from the Holy Quraan around Riba (interest)?
7. Do you sit on any Shariah advisory boards in South African Islamic financial institutions?
8. What is the Shariah Board's role?
9. Do you feel that you have any decision making powers among the management team?
10. Should there not be one singular Shariah advisory board that caters for all Islamic banking institutions?
11. Can Islamic Banking work in South Africa?
12. What Islamic banks and some of the conventional banks are offering as Shariah based products, in your view is this in accordance with the principles of Islamic Banking?
13. Are Islamic windows permissible as people are of the opinion that these are divisions of conventional banks?
14. As Muslims are we interested in the source of funds
15. What are the challenges facing Islamic banking in South Africa?



APPENDIX 3: INTERVIEW GUIDE FOR SOUTH AFRICAN RESERVE BANK

Questions
1. What are your views on the growing trend in Islamic Banking?
2. Are banking licenses available for new banking entrants?
3. What are the requirements for a banking license?
4. Does the reserve requirements rule apply to Islamic Banks?
5. What caused the Islamic Bank to collapse in 1998?
6. Conventional banks are starting business units called Islamic windows as an alternate revenue stream. Your thoughts on this?
7. Do the regulatory requirements applicable to conventional banks differ from Islamic banks in South Africa?
8. One of the principles of Islamic banking is not to guarantee a fix rate of return on deposits. Can our systems cater for such a principle?
9. Liquidity requirements and adequacy of capital requirements depend on an assessment of the value of assets of Islamic banks. What methods are used to determine these requirements?
10. What role will monetary policy play in an Islamic system?
11. Can Islamic Banking work in South Africa?
12. How do you analyse Islamic Windows?
13. What are the challenges facing Islamic banking in South Africa?


APPENDIX 4: INTERVIEW GUIDE FOR MUSLIM CUSTOMERS

Questions
1. Name the Islamic financial institutions in South Africa?
2. Are you aware of their product offerings and how they work?
3. Name the products that you have with Islamic institutions?
4. Describe your interaction with these institutions along the lines of professionalism and product knowledge?
5. With an alternative system now available, do you still use conventional banking?
6. Can you describe any limitations with Islamic products that you have experienced?
7. Islamic products are financed over a shorter fixed period than conventional banking products. Do you feel that this makes the product repayments unaffordable?
8. The fact that you cannot settle your loans early, do you consider this inflexible?
9. What feeling has the collapse of the first Islamic bank in South Africa left with you around the concept of Islamic banking?
10. How can Islamic institutions increase comfort levels of Muslim customers?
11. What are your views on Islamic scholars getting involved and been part of the financial institutions as their employees?
12. Would you like to see more marketing efforts from these institutions to educate the customer?
13. Can Islamic Banking work in South Africa?
14. Would you transfer all your products from conventional banks to Islam banks?

APPENDIX 5 – List of Respondents

Name	Position	Business or Institution	Telephone Number	Email address
Ebrahim A Patel	Chief Executive Officer	Wesbank Islamic Finance	(011) 371 5786	epatel@wesbank.co.za
Shabir Chohan	Chief Executive Officer	Albaraka Bank	(031) 366 2808	schohan@albaraka.co.za
Yunus Paruk	Marketing Manager	Albaraka Bank	083 786 2675	yunusp@albaraka.co.za
Ahmed Fazel Ebrahim	Specialist Research Scholar	www.fatwa.org.za	(011) 837 5035	fazel@fatwa.org.za
Ahmed Satharia	Moulana	Jamiat Ulama - Jhb	084 786 1307	amsatharia@telkom.net
Emraan Vawda	Moulana	Daarul Iftaa	083 288 4083	abd@inmail24.com
Siraj Desai	Mufti / Principal	Madressa Maseehul Uloom	084 574 9891	sdesai@telkomsa.net
Fehmida Gathoo	Accountant	Imperial Nissan, Fiat & Renault	(011) 570 8462	fgathoo@impnfr.co.za
Jameel Nagdee	Structured Finance Consultant	Investec	083 601 9930	jnagdee@investec.co.za
Mahomed Laher	Director	Kingfisher Service station	(011) 705 3531	kss1@absamail.co.za
Naeem Hassen	Medical Student	University of Witwatersrand	084 581 2772	naeemoheat@yahoo.com
Rashid Ahmed Sayed	Accountant	Imperial Holdings	082 824 9471	rsayed@ih.co.za
Shahid Johnson	Owner / Member	SORS Construction	082 498 3088	amaanat@mweb.co.za
Shoaib Dawood	Senior IT Manager	IBM	082 468 2928	mohamd@za.ibm.com
Yusuf Kharva	Programmer	Anglo American	083 283 6002	yusufk@hotmail.com
Yvette Singh	Deputy Registrar of Banks	SARB - Bank Supervision	(012) 313 3809	yvette.singh@resbank.co.za


APPENDIX 6– Website Front Page of Islamic Banks or windows in South Africa









ALBARAKA BANK

- Home
- About Us
- Financial Information
- Islamic Banking
- Products & Services
- Frequently Asked Questions
- Contact Us
- Search
- Annual Reports
- Financial Statements
- Prohibition of Interest
- Financial Planning
- Legal Information
- Contact Form

▶ SEARCH

<p>Welcome to the World of Banking the Islamic Way!</p> <p>Albaraka Bank is dedicated to promoting growth and development through providing high quality products and service based on Islamic economic principles.</p> <p>With over 17 years of Islamic banking experience in South Africa, Albaraka Bank has developed a wide range of shari'ah compliant products and services to cater for all your investment and finance needs.</p> <p>To experience banking the Islamic way simply submit your details to us and we will contact you... Or contact any of our branches ...</p> <p>Let us help you experience a unique and innovative approach to banking... the Albaraka Way !</p>	<p style="color: red; font-weight: bold;">Latest News . . .</p> <ul style="list-style-type: none"> - EXCITING NEWS! We have launched an Online Statement System allowing you to access your statements at your leisure- please click here to register http://www.albarakaonline.com/ - Are you FICA compliant ? Ensure that you comply to avoid minimal inconvenience. - Albaraka South Africa now a member of AAOIFI ! - Send us an e-mail on the address below to receive updates on the latest at Albaraka: http://www.marketing@albaraka.co.za/ 	
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Islamic Banking

At Absa we recognise that the Muslim community has unique banking requirements, which is why we created Absa Islamic Banking.

As an alternative financial system to conventional banking, each of the products within Absa Islamic Banking is managed and administered in accordance with Shariah law under the guidance of the Absa Shariah Advisory and Supervisory Board (SASB). SASB is an independent board that specialises in Fiqh Almu'amat (Islamic Commercial Jurisprudence) and is entrusted with the directing, reviewing and supervising the Bank's Islamic Service offerings to ensure they are compliant.

- [Islamic Cheque Account](#)
- [Islamic Savings](#)
- [Absa Islamic Target Save](#)
- [Islamic Vehicle and Asset Finance](#)
- [Frequently Asked Questions](#)
- [Media Release](#)



For information relating to this product please address your e-mail to service@islamicfinance.co.za or icassim@wesbank.co.za.

You can also contact our Islamic Finance call centre on

0861 786 788.

JazaakAllah for your enquiry.

GLOSSARY OF TERMS

Amana means trust, trustworthiness, faithfulness, reliability and honesty. It includes the overall concept of a transaction in which one party keeps another party's funds or property in trust.

Bai al-Inah (Sell and Buy Back Agreement) is where the financier sells an asset to the customer on a deferred payment basis and then the asset is immediately repurchased by the financier for cash at a discount. The buying back agreement allows the bank to assume ownership over the asset in order to protect against default without explicitly charging.

Bai al-salam or Salam (future delivery) one of the basic conditions for the validity of a sale in Shariah law is that the commodity intended to be sold must be in the physical or constructive possession of the seller.

Bai Bithaman Ajil or bai muajjal (Deferred Payment Sale) is a concept that refers to the sale of goods on a deferred payment basis at a price, which includes a profit margin agreed to by both parties. This is similar to Murabahah, except that the debtor makes only a single installment, on the maturity date of the loan. By the application of a discount rate, an Islamic bank can collect the market rate of interest.

Fatwa's are legal pronouncements of Islam issued by a specialist scholar (Mufti) on the topic. It is typically an instrument used when part of the fiqh (Islamic jurisprudence) is open to interpretation, or is unclear.

Fiqh is Islamic jurisprudence.

Gharar is uncertainty. With *riba* (interest) and *maysir* (gambling), the three forbidden elements of Islamic finance. The prohibition of *gharar* is based on certain aspects of financial transactions such as chance or risk.

Halaal is used to describe anything that is permissible under Islamic law.

Haraam is something that is forbidden by Islam and indeed anything that is prohibited by the faith.

Ijarah (leasing) is a medium term mode of financing referring to an arrangement under which the lessor leases equipment, a building or other facility to a client at an agreed rental against a fixed charge, as agreed by both parties. It involves purchasing and subsequently transferring the right of the use of the equipment and machinery to the beneficiary for a specific period of time.

Istisna (work in progress) is a medium term mode of financing. Refers to a contract of sale and purchase of assets by specification or order where the price is paid in advance, but the assets are manufactured or produced and delivered at a later date. Also similar to a retainer. For istisna to be valid the price must be fixed with the consent of the parties and the necessary specification of the commodity (intended to be manufactured) fully settled between them.

Kafala (guarantee) refers to the guarantee provided by a person to the owner of the good, who had placed or deposited his good with a third party, whereby any subsequent claim by the owner for his good must be met by the guarantor and the third party.

Mudarabah (Profit Loss Sharing) is an arrangement or agreement between a capital provider and an entrepreneur, whereby the entrepreneur can mobilise funds for its business activity. Any profits made will be shared between the capital provider and the entrepreneur according to an agreed ratio, where both parties share in profits and only capital provider bears all the losses if occurred. The profit-sharing continues until the loan is repaid.

Murabahah (Cost Plus) is a concept that refers to the sale of goods at a price, which includes a profit margin agreed to by both parties. The purchase and selling price, other costs and the profit margin must be clearly stated at the time of the sale agreement. The bank is compensated for the time value of its money in the form of the profit margin. This is a fixed-income loan for the purchase of a real asset (such as real estate or a vehicle), with a fixed rate of interest

determined by the profit margin. The bank is not compensated for the time value of money outside of the contracted term (i.e. the bank cannot charge additional interest on late payments), however the asset remains in the ownership of the bank until the loan is paid in full.

Musharakah (Joint Venture) is a concept normally applied for business partnerships or joint ventures. The profits made are shared on an agreed ratio, while losses incurred will be divided based on the equity participation ratio. This concept is distinct from fixed-income investing (i.e. issuance of loans).

Qardhul Hassan (Benevolent Loan) is a loan extended on a goodwill basis, and the debtor is only required to repay the amount borrowed. However, the debtor may, at his or her discretion, pay an extra amount beyond the principal amount of the loan (without promising it) as a token of appreciation to the creditor. In the case that the debtor does not pay an extra amount to the creditor, this transaction is a true interest-free loan. Some Muslims consider this to be the only type of loan that does not violate the prohibition on riba, since it is the one type of loan that truly does not compensate the creditor for the time value of money.

Riba (interest) is any return of money made on lending money, whether the interest is fixed or not, simple or compounded, and at whatever rate. Riba is prohibited under Islamic law.

Shariah is Islamic law that governs every aspect of a Muslim's life, which is derived from the Holy Quraan and Sunnah.

Sukuks (Islamic bonds) is similar to conventional bonds, with the difference of being asset backed to comply with no-gharar rule. A sukuk represents proportionate beneficial ownership in the underlying asset. The asset will be leased to the client to yield the return on the sukuk.

Takaful is Islamic insurance. It is characterised by a charitable collective pool of funds based on the idea of mutual assistance. This form of insurance is designed to avoid elements of conventional insurance that are forbidden for Muslims.

Tawarruq is reverse murabaha. As used in personal financing, a customer with a genuine need purchases goods on credit from the bank on a deferred payment basis and then immediately resells it for cash to a third party in order to obtain cash. In this way, the customer can obtain cash without taking an interest based loan.

Ujr (fee) refers to commissions or fees charged for services.

Wadiah (safekeeping) is an understanding whereby a depository (a person or a bank) is designated as a keeper or trustee of an asset in the form of a guaranteed trust. The depository guarantees refund of the whole amount of the deposit, or any part of the outstanding amount, at the point when the depositor demands it. The depositor at the bank's discretion maybe rewarded with a gift as a form of appreciation for the use of funds by the bank. It is based on trust.

Wakalah (Agency) is a concept that occurs when a person appoints a representative to undertake transactions on his/their behalf, similar to a power of attorney.