EXPERIMENTS IN ISLAMIC BANKING: A CASE STUDY OF SAUDI ARABIA AND THAILAND

(ABSTRACT)

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Abstract

In Islamic economic history, emergence of Islamic banking system is a turning point for the Islamic world to liberate itself from the power of domination of Western thought and practice, in modern era, which is essentially based on 'interest'. The financial activities in the globe are almost influenced by interest in various forms. Consequently, majority of Muslim scholars and jurists attempted to profess alternatives for financial transactions in a predominantly Muslim society. Though, the theoretical work on the subject was undertaken in the early nineteenth century, the experiments were initiated, in Interest-free institutions, in the twentieth century which gradually expanded in recent times. In 1960s, Islamic financial institution became a reality but it does not mean that financial activities did not exist in the early Islamic history. There were several financial instruments in existence since the early stage of Islam. The evolution of Islamic banking activity can be divided into three phases. First, began from early year of Islam in Makkah since the Prophet (PBUH) until the companions Caliphates Ar-rashideen period. The second era started from Caliphates era until the Utmaniyah Empire fall and the last is the modern Islamic banking phase which is still evolving. In 1963 the Mit Gamr saving bank in Egypt was a milestone of Islamic bank history and paved the way for other Islamic banks. Subsequently, community support led the bank to be quite successful within a short time. The establishment of the Islamic Development Bank (IDB) in 1975 was the most important development of Islamic banking history which was established by the Organization of Islamic Countries (OIC). After IDB there followed the first private interest-free bank in 1975 named as the Dubai Islamic Bank. In 1977 three more Islamic banks were incorporated, namely Faisal Islamic Bank of Egypt, Faisal Islamic Bank of Sudan, and Kuwait Finance House. It is a brief historical development of Islamic banking which alongside the system of conventional banking is in practice now in various parts of the world particularly in the societies with substantial Muslim population.
The system of Islamic banking at present is visible particularly in the Middle East, Southeast Asia and South Asia etc. At present the largest Islamic bank in terms of assets and volume of operations is in Saudi Arabia.

The present study is a modest attempt to analyze the historical background and development of Islamic banking during the last fifty years or so in Saudi Arabia and Thailand. More specifically the emphasis is on examining the evolution of Islamic banking in the two countries and to ascertain the similarities as well as differences in the operating system between the countries. It is a historical-cum-analytical study and the approach to the issues is basically operational.

In Saudi Arabia, before the discovery of oil and until 1938 there were no banks. The system of financial institution was initiated by Money Exchanger to serve pilgrims in Makkah and Madinah. However, it did not cover other banking activities. Saudi Arabia became an attraction for foreign banks establishing in the Kingdom after the discovery and export of oil. Thus, the Kingdom's first foreign bank was opened by Dutch in 1928. It was followed by several foreign banks to invest in the Kingdom. In 1953, the first Saudi bank was established by a royal decree of King Abdul Aziz named The National Commercial Bank (NCB). In 1952, the central bank of Saudi Arabia was officially established called “The Saudi Arabia Monetary Agency (SAMA)” to undertake and regulate all financial activities in the Kingdom. In 1968, SAMA attempted to convert all foreign banks into Saudi Joint Stock Companies with Saudi Participation of 60%, the foreign bank maintained a 40% equity stake. This phenomenon became a milestone in Saudi bank’s history, it was called “Saudization”.

Thailand is predominantly a Buddhist country; Muslims are a minority in it constituting roughly 10% of the population. The First bank of Thailand was a foreign bank
named as the British-owned Hong Kong and Shanghai Bank which was established in 1888. The first Thai local bank which was the Siam Commercial Bank, presently, known as Thai Commercial Bank established in 1906. The central bank of Thailand named "The Bank of Thailand" was established in 1942.

The present study is a historical -cum- analytical study involving collection and analysis of data about past events. This design is mainly employed to understand the development and to include a time dimension to the data that can be used to identify causal factors contributing to any observed development. The main purpose for collecting retrospective data is that such data provide a means of development for either descriptive or explanatory purposes. Other retrospective studies involve collecting information about the past and comparing that with contemporary information collected from the same cases.

For the comparative study, we apply the general data of Islamic bank in both the countries to compare in various aspects. However, at the end of comparison we use Financial Statement Analysis to analyze statement of Islamic bank's finance of both the countries by using a comparative statement, Trend Percentage and Ratio analysis.

The methods employed in the present study are essentially review literature by various books, Internet Websites, Articles, Reports and semi-official publications. It was brought from materials in secondary data which is collected from different sources and publications. Most data of Islamic bank in Saudi Arabia and Thailand was collected from Annual Reports of the banks such as SAMA Annual Reports and all Saudi banks' Annual Reports as well as the Annual Reports of Islamic bank of Thailand since 2004.

The study has revealed that there are several unresolved issues in Saudi Arabia and conventional as well as Islamic banking is simultaneously practiced. SAMA faces dilemma of how to manage banking activities in Saudi Arabia without violating Islamic code. In Saudi
Arabia, there are 12 commercial banks, 3 banks are wholly owned by Saudis (The National Commercial bank (NCB), Al-Rajhi bank, and Riyad bank). The remaining 9 foreign banks are foreign joint venture with foreigners holding 40% of shares. These are The Saudi British Bank (SABB), Saudi Investment Bank (SAIB), Alinma bank, Banque Saudi Fransi (BSF), Samba Financial Group (SAMBA), Saudi Hollandi Bank (SHB), Arab National Bank (ANB), Bank AlBilad and Bank AlJazira (BJZ). There are ambiguities of SAMA since the inception of Islamic bank’s history in Saudi Arabia which has never allowed Islamic bank’s license. Ali-Rajhi, the largest money exchanger in the Kingdom had succeeded in obtaining permission of Islamic bank’s license. The struggle over Al-Rajhi was lengthy which continued for more than five years. In the end, Al-Rajhi money exchanger was allowed Islamic bank’s license and it became the first Islamic bank of Saudi Arabia and the largest Islamic bank in the world. It means that there is only one Islamic bank’s license in Kingdom and that to on the condition that Al-Rajhi refrained from calling itself “Islamic” in title. It is because if Al-Rajhi was allowed Islamic bank’s license this would imply that the other 11 banks were non-Islamic. Hence, it may result in a political controversy which the government of Saudi Arabia wants to avoid.

It can be summarized that of the 12 banks in Saudi Arabia there is only one Islamic bank and 3 banks (Al-Rajhi, Al-Jazira and Al-Bilad) reported in 2006 that all their operations were conducted in a Shari’ah-compliant manner (full pledged). While 9 other banks conduct a portion of product along Islamic lines, keeping separate from other operations (Islamic Window) to provide Shari’ah-compliant products through many branches. Hence, all banks base their portfolio decision on the advice of internal Shari’ah advisory board. It can be noted that SAMA watched Islamic finance rapid growth every year with further dependent most Saudi’s traditional distrust of Western style bank which were concerned with the
religion reason as well. This is the major SAMA’s question to find out solutions in existence of conventional and Islamic bank issues.

In Thailand, it never had Islamic banking in the country until in 2003 the Islamic bank of Thailand was established. Thai Muslim needed an alternative way to eliminate interest for saving money. Earlier they deposited money in conventional banks. Consequently, Muslim representatives attempt to push the act to the parliament until the act was passed on 2002. Islamic bank of Thailand is supervised by the Ministry of Finance as the state enterprise of government. Ministry of Finance can be holding up to 49% of shareholding and according to regulations, foreign participation is limited to 33%. However, the private sector holding does not exceed 15%. It means that there is only one Islamic bank in Thailand which is rather new and limited in scope and operations. Thailand is a Buddhist country and Muslims are a minority. Hence, the customer target is not only restricted to Muslims alone, but it attempts to target Buddhist customers too. However, the Islamic bank of Thailand has an opportunity and scope to develop itself since Thai’s Muslims are ready to participate in its banking activities. However, Islamic bank of Thailand must solve few primary problems such as customers are suspicious in its operating system, how the bank is working without interest? Hence, the public opinion is very important for its acceptability. The Bank workers lack knowledge in Shari'ah’s principles to explain to their customers. Since, Islamic bank of Thailand is a state enterprise, it lacks encouragement and formation of attractive policies. Loans to entrepreneur should be carefully considered to avoid loss and Non-Performing Loan (NPL). It can be noted that in Thailand there is no Islamic Economics subject in university education. Thus the need of the hour is to introduce it in higher education so that Islamic banking may sustain as well as progress on Islamic principles.

Notwithstanding limitations, Islamic banking in Thailand has a chance to accomplish its objectives if it is managed professionally. Islamic bank of Thailand should be explicit to
explain its operations to the public for greater confidence. The analysis makes it clear that
the branches of Islamic bank in different parts of the country are expanding at a rapid pace
and by and large cover all regions of the country. Thus it can be concluded that the purpose
of establishment of Islamic bank in Thailand to a greater extent has been achieved with the
result that its future is quite bright. However, certain issues listed above have to be sorted
out.

When we make a comparison between Islamic banking in Saudi Arabia and Thailand,
it is amply clear that the stability of Islamic bank of Thailand is less than Al-Rajhi bank
because of more experience and a large paid up capital with Al-Rajhi. Al-Rajhi is the largest
Islamic bank in the world. However, Islamic bank of Thailand has an opportunity to grow. It
is noted that it is growing rapidly even though in the early stage it suffered losses in net
profit due to the fact that Islamic finance is relatively new to the Thailand market and its
business operations are in a preliminary stage. The network is quite large with substantial
operational costs. However, there are similarities as well as differences in general in both the
countries. Due to differences of School of thought (Mazhab) in each country, the financial
instruments have differences too. For example Islamic banks in Saudi Arabia apply
Tawarruq’s principle to provide a financing for entrepreneur while Islamic banks in Thailand
employ Bai-Inah’s principle. Although, there are many differences in banking due to
controversy in Mazhab but the important point for the all Islamic bank systems in the world
must be in accordance with Islamic law (Shair’ah) which is directly derived from Al-Quran
and Sunnah. Further Islamic banking in Saudi Arabia has special products to offer services
while Islamic bank in Thailand is not ready to provide their customers due to many factors
such as Ladies Account or Ladies Bank, Takaful (Insurance), Stock Market Exchange
Services, IBAN and Credit Card. However, this is the target plan of Islamic bank in Thailand
to develop their products and find out new products to offer their customers as soon by
exploring the possibility for Islamic bank of Thailand to grow its volume of activities and services.

To sum up, the operation of Islamic banking in any part of the world must be in accordance with Shari'ah-compliance which is derived from Al Quran and Sunnah. However, some Islamic banks have a difference in instruments with each other due to the difference of Fiqh School thought for example Saudi Arabia and Thailand. Islamic bank can be established in a non-Muslim country provided such laws are enacted in these countries which permit banking in accordance with Islamic laws. Islamic bank of Thailand to a greater extent has achieved a success with certain issues still to be sorted out. The Islamic bank of Saudi Arabia and Thailand are quite different in instruments due to the Fiqh School thought and Islam bank of Thailand is not ready to launch those instruments.

The study has been divided into seven chapters that can be summarized as under:

Chapter 1: Introduction: Historical Background

It introduces the topic of research in a proper perspective and focuses on a brief history of Islamic Banking, general background and related issues. It underlines the general important aspects of history and evolution of Islamic Banking system from early Islamic period to Modern Islamic Banking era. In a chronological order it also outlines the main objectives and the methodology employed to pursue and test the hypotheses stated therein. In brief this chapter provides an overview of the subject and sets the tone for further analysis and investigation.

Chapter 2: The Concept and Functioning of Islamic Banking System

The main focus of this chapter would be to deal with the Concept of Islamic Banking comprising the Definition, Theory, Model Type, Objective, Strategy Function, Business practice, Stabilities, Efficiency, finance structure, Prospect, Feasibility, challenges and main
problems of Islamic Banking as well as distinguishing features of Islamic Banks and Conventional Banks for in depth examination in the subsequent chapters.

Chapter 3: The Islamic Financial Transactions

This chapter is basically devoted to the review of various Shari’ah Compliant Financial Instrument with conformity to principles of Islamic jurisprudence such as Mudarabah, Murahahah, Musharakah, Istisna, Takaful, Ijarah, Qarz-e-Hashanah, Bai-al-Salam, Bai-al-Muajjal etc. as well as various aspects of Islamic Shari’ah and several aspects of controversy among Modern Ulama (Jurisprudents) in the Arab World.

Chapter 4: Islamic Banking of Saudi Arabia

This chapter would examine in some depth the evolution and historical background of Islamic Banking in Saudi Arabia as well as its structure. It would also deal with the Regulatory Framework of Islamic Banking in Saudi Arabia such as The Saudi Arabian Monetary Agency, The Capital Markets Authority, factors behind the expansion of Islamic Banking etc. The evolution of Islamic financial products, the implementation of Shari’ah in the retail banking Industry, the Stock Market shall also be analyzed for a comprehensive understanding of the banking system in the country.

Chapter 5: Islamic Banking of Thailand

This chapter would mostly deal with characteristics of the Islamic Banking of Thailand. What are the objectives and purposes of the bank as well as the structure and plan process in Islamic Banking in Thailand, and it would also study the opportunities to expand the branches all around the country as well as developing plans of Islamic Banking in the near future.
Chapter 6: Islamic Banking Systems of Saudi Arabia and Thailand: A comparison

This chapter would deal with a comparison of performance between Saudi and Thailand in Islamic Banking with various details in several aspects of Islamic Banking in both countries such as geography and climate, population and language, government, currency and foreign exchange regulations, economic aspects, inception of banking, Central Bank, banking structure, commercial banks, Islamic Bank, objectives of Islamic Bank, shareholders, capitals, customers target and officer, financial instruments practiced, the similarities and differences in Islamic financial instrument, distinguishing products of Saudi Arabia, network Branches, financial performances and financial statement analysis.

Chapter 7 Summary and Conclusion

This chapter would give a concise picture of the study by summarizing the main findings of the study and drawing conclusions for policy implications in order to assess the effectiveness between Islamic Banking of Saudi Arabia and Thailand. It also deals with the relationship between the two countries for coordination and success of the banking system which is still evolving.