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TABLE OF CONTENTS

AUGUST

COVER STORY

22 PROF. DR. DWIA TINA PULUBUHU

Rector of Hasanuddin University, Makassar, Indonesia

TALKING POINTS

08 SMART CONTRACTS - THE FUTURE OF ISLAMIC BANKING

Nida Khan

12 REVITALIZATION OF WAQF FOR SOCIO-ECONOMIC DEVELOPMENT AND MOBILITY

Dr Salman Ahmed Shaikh

73 MAINSTREAMING THE ISLAMIC ECONOMY FOR SUSTAINABLE ECONOMIC DEVELOPMENT FOR THE NEW GAMBIA

Almami Fanding Taal

ISFIRE REVIEW

16 IMF ENDORSED IFSB CORE PRINCIPLES: GAME-CHANGER FOR ISLAMIC FINANCE

Dr. Jamshaid Anwar Chattha

82 CAPACITY BUILDING IN ISLAMIC BANKING & FINANCE FOR SUSTAINABLE COMPETITIVE ADVANTAGE

Dr. Abdus Sattar Abbasi

46 ISLAMIC FINANCE IN JERSEY – CURRENT AND FUTURE TRENDS

Trevor Norman, Director, VG

52 SHARI'A ANALYSIS OF BITCOIN, CRYPTOCURRENCY, AND BLOCKCHAIN

Mufti Muhammad Abu Bakar

POINT OF VIEW

30 BAD LEADERS, GOOD LESSONS

Hessa Al Ghurair

102 PRACTICALLY IRRELEVANT? ACADEMIA VS THE REAL WORLD

Noor Azizi Ismail

88 SHARIAH CRYPTOCURRENCY?

(Mufti) Ismail Ebrahim Desai

90 WILL SHARI'A ROBO-ADVISORS REPLACE SHARI'A ADVISORS?

Yousuf Sultan

08 3 GREAT WAYS TO STAY RELEVANT IN YOUR JOB

Mujassum Butt

PERSPECTIVES

37 MAKING LIFE DECISIONS: HOW TO DECIDE BETWEEN TWO GREAT OPPORTUNITIES

42 8 LESSONS ENTREPRENEURS & DREAM CHASERS CAN LEARN FROM "THE EGYPTIAN MESSI" MO SALAH!

Abd Elmohaimen Mansi

94 WHAT MODEST FASHION MEANS TO MUSLIM WOMEN

ISFIRE PERSONALITY

66 ISFIRE INTERVIEW WITH MOHAMMED KATEEB

LEADING IDEAS

106 HOW CAN ISLAMIC FINANCE HELP THE GOVERNMENT OF PAKISTAN TO SOLVE ITS WATER AND ELECTRICITY CRISIS: A PROPOSED MODEL OF WAQF-SUKUK

Ehsanullah Agha

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CAPACITY BUILDING IN ISLAMIC BANKING & FINANCE FOR SUSTAINABLE COMPETITIVE ADVANTAGE

DR. ABDUS SATTAR ABBASI

Despite irrevocable consensus on prohibition of riba in Muslim communities, outreach of Islamic banking and finance (IBF) is far less than the expectation. It is utter surprise that masses in Muslim societies are still not convinced that IBF operations are Shari'a-compliant. We can observe global agreement on exploitative dynamics of existing financial system. There is even a stronger belief that contemporary financial system is absolutely in contradiction to Shari'a principles.

The obvious outcome with the advent of IBF would have been instant massive popularity in Muslim communities with overwhelming clientele. However, despite professionally groomed IBF operations, they are still unable to capture significant market share in many Muslim societies. In Pakistan, for example, market share of Islamic banks in terms of assets and deposits is less than 15% of total market.¹

One can hardly identify any shortcomings while visiting IBF institutions. The industry has successfully managed to constitute professional structure to provide modern-day banking services. If an institution is providing contemporary services according to prevailing professional standards with additional advantage of complying religious obligations, they should become the first choice for all Muslims.

1. IBB (2018), Islamic Banking Bulletin January-March 2018, State Bank of Pakistan. Retrieved on July 18, 2018 from: <http://www.sbp.org.pk/ibd/bulletin/2018/Mar.pdf>

But IBF institutions are struggling for sufficient share in Muslim majority societies, let alone in countries where they are a minority. Emerging movements in Western countries such as Socially Responsible Investing (SRI), Environmental, Social and Governance (ESG) models and Ethical Finance; all sharing several fundamental values with Islamic finance; are indicative of global desire for alternative financial system. It was expected and expressed by experts that eventually this mode of banking and finance will replace the conventional banking structure.

During face-to-face interactions in Pakistan (where 95% of the population is Muslim), I have observed explicit reluctance of conventional banking officials to convert to Islamic banking due to the lack of pragmatic business proposition.

Series of meetings with business owners clearly indicated their desire to opt for Shari'a-compliant financial services. There are businesses who maintain their massive operations on cash transactions to avoid riba. Numbers of business owners maintain their personal accounts in Islamic banking, however, their corporate accounts are maintained by conventional banks. They believe that they are responsible only for their own earnings as shareholders but are hesitant to convert complex business operations. Likewise conventional banking officials also indicated difficulties in converting each and every account holder to IBF.

Based on these observations, one wonders how to answer questions such as:

Where is the missing link? Despite conducive circumstances, why there is so much delay in the transformation? Why people cannot distinguish between Islamic banking transactions and conventional banking products? Why employees do not exert pressure to their employers and bankers to provide them Shari'a-compliant financial services? Why people still don't believe in Shari'a compliance of IBF? Why conventional banks don't consider Islamic finance a business proposition?

There is substantial progress in developing Shari'a framework and operational structures of IBF. Probably these developments couldn't get across effectively to all relevant stakeholders. Otherwise, we would have been at par with conventional banking in terms of volume with the journey we have completed. Share of IBF is still far below our expectations. Frontline employees of Islamic banking and financial institutions are responsible for transmitting these developments to the people. We really need to determine if they have the ability to create competitive advantage for Islamic banking and financial institutions.

This article examines the capacity of frontline officials of Islamic banking and financial institutions to communicate conceptual and practical underpinnings of Islamic finance to all relevant stakeholders and decision makers.

It also attempts to explain how capacity building can lead to sustainable competitive advantage for Islamic banking and financial institutions.

CAPACITY BUILDING

Capacity is multi-dimensional and is made up of components such as foundational components (information, culture, values), competencies (knowledge, behaviours, skills, motivations) and capabilities (professional skills). Capacity building enables an organization to improve performance to achieve successful outcomes. However, building individual capacity is an integral part of this process for sustainability.²

2. O'Rafferty S, Curtis H, O'Conner F (2014), Mainstreaming sustainability in design education – a capacity building framework, International Journal of Sustainability in Higher Education, 15(2), pp 169-187.

3. Stevens, C. (2008), OECD Work on Competencies for Education for Sustainable Development, OECD, Paris.

Competencies can thus be classified around four themes including subject (facts, definitions, concepts, rules, systems), methodological (fact-finding, analysis, problem-solving), social (working inter-actively, communicating, citizenship) and personal (thinking, reflecting, ethics, moral judgements).³



It is also suggested that a framework of competencies required within an organization is the ability to sense and understand market dynamics, absorb new knowledge & information, integrate existing infrastructure and innovate & develop new products and services.⁴ Building on these perspectives, we can outline key competencies for IBF professionals such as:

- Knowledge of basic prohibitions in financial transactions
- Conceptual clarity about riba and business transactions
- Sufficient knowledge of IBF products
- Dynamics of contracts in Islamic financial transactions.
- Adequate ability to determine and explain the difference between Islamic and conventional financial transactions

Essentially, capacity building implies that people take the opportunity to do things differently, to learn new skills and to generate more effective practices.⁵ Capacity building must be systemic if it is going to make a performance difference.⁶ Hence, it should be broad including every IBF institution and deep for every IBF employee.

Collective capacity, on the other hand, refers to resources and processes which include qualification and development of staff, quality of management & leadership, internal & external networking and so on. Collective capacity can be increased, developed or built mainly by actions taken by those with the responsibility of management and leadership.⁷ As such organizational capacity can be classified into three forms as capital including intellectual, social and organizational. Intellectual capital, what is often called human capital, consists of the totality of the knowledge, skills, competences and expertise.

Social capital has two sides. One is the degree of trust among members of organization and between them and any external people. The other is the extent or reciprocity between those in trusted relationship. Trust and reciprocity combine in social capital to bind people into networks. Organizational capital is a distinctive component of organizational leadership and consists of the capability of the leaders to deploy organizational potential intellectual and social capital.

In the backdrop of above discussion, the following deductive findings are presented based mainly on observations during capacity building program in collaboration with State Bank of Pakistan (SBP) for the reflection of relevant stakeholders:

4.

Hou, J.-J. (2008), Toward a research model of market orientation and dynamic capabilities, *Social Behavior and Personality: An International Journal*, (36)9, pp. 1251-1268.

5.

Harris, A. (2011), System improvement through collective capacity building, *Journal of Educational Administration*, 49(6), pp.624-636

6.

Sharrat, L. and Fullan, M. (2009), *Realization: The Change Imperative for Deepening District Wide Reform*, Corwin Press, Thousand Oaks, CA

7.

Hargreaves, D.H. (2011), System redesign for system capacity building, *Journal of Educational Administration*, 49(6), pp.685-700



- IBF employees mostly have a weakly developed concept of individual and organizational capacity.
- IBF leaders generally underestimate the nature and potential of intellectual and social capital and/or lack the knowledge and skills to mobilise these as a way of capacity building.
- Generally IBF leaders are unable to build organizational capital.

COMPETITIVE ADVANTAGE

Battle of competition in any domain or industry is the confrontation for benefits to create and maintain strategic advantage. Therefore the strategy of the organization has to be focused on creating new advantages that will lead to increased customer satisfaction and asymmetry compared to that of the competitors. By doing so, the held advantage may extend, while also diminishing or eliminating the advantages of the competitors.⁸

A company is said to have a competitive advantage when it can create more economic value than other rival companies. Economic value is the difference between perceived benefits gained by a buyer who purchases goods or services of a company and the economic cost of these products and services. Therefore, the size of a company's competitive advantage is the difference between the economic value that the company makes and that of its rivals.⁹

Sustainable competitive advantage lies in occupying a superior position in the market. Islamic finance has inherent characteristic of occupying specifically superior position in Muslim communities and in all societies in general due to the spirit of circulation of wealth, mobilization of resources and the intent of welfare behind every financial or commercial transaction.

However, it seems that IBF probably failed to exhibit the character to be considered as a superior option available to the mankind for their financial needs and the onus of this failure lies on the shoulders of human resource which is bearing the flag at the frontline to give necessary understanding of IBF products and procedures.

Another type of competitive advantage is the one that results from a successful brand, which suggests that successful brands "offer reliable guarantees in terms of high quality products and services."¹⁰ Competitive advantage based on brand creates serious entry barriers for potential new competitors. Competitive advantage can be obtained only if a business system creates superior value for buyers. A company must be able to provide a more suitable product/service for customers than those produced by rival companies. In IBF, we have probably failed to establish superior value for both:

- Muslims, that IBF offers a superior value not for this life but hereafter and
- Non Muslims, that IBF discourages accumulation of wealth and ensures equitable distribution of wealth in the society.

8.

Popa I, Dobrin C, Popescu D and Draghici M (2011). Competitive Advantage in the Public Sector. Theoretical and Empirical Researches in Urban Management 6(4), pp. 60-66

9.

Barney, J. and Hesterly, W. (2006). Strategic Management and competitive advantage, Upper Saddle River: Pearson Education

10.

Popa I, Dobrin C, Popescu D and Draghici M (2011). Competitive Advantage in the Public Sector. Theoretical and Empirical Researches in Urban Management 6(4), pp. 60-66

ISLAMIC FINANCE AWARENESS SURVEY

Capacity building programme brought several insights in identifying reasons of relatively low pace of expansion of IBF. With fewer bases growths are always impressive, it is probably due to this reason that Islamic finance as a sector usually celebrates sparkling growth figures. If we relate existing size of Islamic finance with aspirations of people at gross root level to embrace riba free financial structures, it is not difficult to detect weaknesses of practitioners and institutions in IBF in displaying and explaining existing framework of Islamic finance to the masses. This lack of intellectual capital resulted into the huge loss of social capital of IBF.

Intellectual capital of those who developed and established this parallel financial system is praiseworthy. However, there are several concerns about those who are now acting as a face of Islamic finance on front desks of IBF institutions. They actually communicate with public to explain Islamic financial products and transactions. Social capital of IBF is dependent on these frontline practitioners.

In this realm, an instrument was developed to gauge fundamental knowledge, competencies and expertise of working IBF professionals to determine the reliability of intellectual capital that is actually in-place and responsible for providing sustainable competitive advantage to the sector. The instrument determines primary understanding of those employees of banks and IFIs who interact with masses on several fronts from customer services to corporate finance. Underlying spirit in the development of subject instrument remains that IBF professional while dealing with people should be able to speak language of Islamic banking and finance. These professionals have to develop expertise with basic prohibitions, types of Khiyar, conditions for valid 'offer & acceptance', elements of 'aqd and so on, to convince and attract clientele for IBF. They should be able to explicitly differentiate conventional and Islamic financial products.

Result of the survey from selected branches of Islamic banks and financial institutions in Lahore, the second biggest city of Pakistan with more than 11 million population, is given below for the observation of readers.

FINDINGS

When respondents were asked about types of riba, only one third were familiar with both al-Fadl and al-Nasihah. While none of the respondent marked all given types of Khiyar including al-Shart, al-Majlis, al-Wasf & al'ayb, suggesting lack of understanding about Khiyar despite the fact that there is hardly any training of IBF which concludes without mentioning or through discussion about Khiyar. Responding to the conditions for valid contract only a few could manage to indicate all three given options including 'aqd, mube'e & thaman, with the majority missing at least one of these.



“
PRODUCT KNOWLEDGE CAN HELP UTILIZE UNIQUE SELLING POINTS (USPs) OF ISLAMIC BANKING AND FINANCE TO ESTABLISH SUSTAINABLE COMPETITIVE ADVANTAGE.

It was surprising to see that even with reasonable experience in Islamic banking all respondents couldn't managed to point out Bai' as 'exchange of commodity and price', they usually confused Bai' with 'offer and acceptance'. It was sheer disappointment to notice knowledge of participants about prohibited transactions in IBF.

Misconception of masses while considering Ijarah and lease as one and the same thing was evident by the responses in this survey where employees of Islamic banks indicated Ijarah as 'selling an asset on instalments'. Only 40% respondents could indicate Murabaha as 'selling on mutually agreed profit', while majority couldn't opt right options for Salam and Istisna. Knowledge about takaful and sukuk was also not appreciable. Interestingly all participants responded well about Musharakah and selected 'd' from following options:

- shirkah al-awwal
- shirkat ul 'aqd
- sharing of pro rata profit & loss
- all of the above
- none of the above

Gharar is one of important concepts which differentiate IBF from conventional banking system. Only one third of respondents were not aware of the notion.

However, caution may be taken in generalising the conclusion of this survey as this is an assessment of only one city and cannot be generalized to entire country or the sector. Nonetheless, it is sufficient to alarm bells about focusing towards the capacity building of IBF professionals.

CONCLUSION

Product knowledge brings confidence in an individual. The knowledge of sources of development of a product/service, knowledge of the recipes of contracts, knowledge of possession and ownership, knowledge of permissibility & prohibition and so on can enable a banking professional to present and promote products of Islamic banking and financial institutions accurately and persuasively. The knowledge of IBF products/services may not be enough rather ability of comparing and qualifying Islamic banking and financial products is essentially required to help end-users to decide conveniently to opt Islamic banking and finance.

Product knowledge can help utilize unique selling points (USPs) of Islamic banking and finance to establish sustainable competitive advantage. USPs of Islamic banking and finance are usually in favour of the end-user but somehow our customers are mostly unable to grasp this intrinsic peculiarity of Islamic banking and finance. If an employee of Islamic banking or financial institution cannot comprehend transparency of Murabaha, dynamics of Khiyar, spirit of Takaful, rights and responsibilities in case of default, soundness of Musharaka and dependability of Mudaraba, then how will she or he be able to transmit these USPs to concerned stakeholders for appropriate decision making to patronize Islamic banking and finance.

Sound knowledge can lead to conceptual clarity to develop dynamic capabilities in Islamic banking and finance through learning, integration and transformation to enrich individual and organizational ability. Pursuing strategic direction of becoming dependable alternative, Islamic banking and financial system still requires aiming prolific human resource development. Sustainability of competitive advantage of Islamic banking and finance depends on sufficient competence of human resource to make sure that parallel movements can't readily imitate inherent advantage of Islamic banking and finance.

Making Islamic banking and finance a superior brand and ensuring superior economic value for all stakeholders requires unshakeable capacity of IBF professional. We all have to join hands to build required capacity for long-term success of the sector.

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