

The Ideal of Islamic Banking: A Survey of Stakeholders' Perceptions

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Abstract: Islamic banking has always been proclaimed as an institution different from conventional banking in many respects. The first and most significant difference is the abolition of *ribā* in all its financial transactions. Another distinctive feature of Islamic banks is in respect to their discharge of religious and social responsibilities as reflected in their commercial dealings and other activities. This prohibition, together with the noble vision to promote social welfare, forces banking to adopt new methods of operation based primarily on profit-loss sharing (PLS) arrangements. Yet, evidence on the current practice by Islamic banks worldwide suggests that the majority of financing operations are not based on equity. Rather, Islamic banks have consistently favoured the use of debt-based modes of financing. This creates suspicions amongst unconvinced Muslims and other critical outsiders who observe that Islamic banks in reality are no different from conventional banks since the net result of Islamic banking operations is the same as that of conventional banking. This paper aims to survey the viewpoints of various stakeholder groups on Islamic banking practices in Malaysia. By adopting the stakeholder approach, this study will be of potential relevance to Islamic banks, particularly in their policies and dealings that aim to secure benefits for the widest possible constituency.

I. Introduction

Ideally, the point of departure of interest-free Islamic banking from the conventional system is exemplified by a vision to move from a debt-based financial intermediation to an equity-based and risk-sharing arrangement (principally *muḍārabah* and *mushārah* contracts). In other words, an ideal

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Islamic banking model is reflected through its balance sheet structure that is dominated by profit-loss-sharing (PLS) on both the asset and liability sides. In such arrangements, it is believed that the depositors who share the risk with the bank on the liabilities side will naturally absorb any adverse outcomes on the asset side of the bank's balance sheet. The value of the depositors' funds represents the real assets value of the banks. Thus, Islamic banking theoretically is deemed to be a good alternative to the conventional system due to its robustness and the potential stability that the system may provide (Khan and Mirakhor, 1987; Siddiqui, 2001).

However, there are reasons to believe that the ideal structure of Islamic banks based on PLS principles may indeed prove to be a mirage. This is because only a minuscule portion – generally well under 5% of the assets of Islamic banks consists of financing instruments based on genuine profit sharing or profit and loss sharing (Lewis and Algaoud, 2001). By far, the most common financing methods are the debt-based instruments like *murābahah* (cost-plus sale) and *ijārah* (leasing), which some may argue is a cumbersome form of interest or simply a backdoor to *ribā* (Kuran, 2004).

Despite the scepticism among Muslim economists about the debt-based instruments, their alternative – Islamic banking predominantly structured on equity-based products – is also vulnerable to criticism. One of the known opponents of overemphasis on the superiority of PLS is Ismail (2002). Ismail argues that such a position is not founded on any Qur'anic text and may even be incompatible with the methodology of *Shari'ah* (Islamic law). He further stresses the importance of debt-based contracts in Islamic banking, which are clearly marked as permissible, based on various verses of the Qur'an.

This paper attempts to analyse these views by way of a survey conducted on a sample of 1500 respondents representing seven different stakeholder groups involved with Islamic banks in Malaysia, namely customers, depositors, managers, employees, regulators, *Shari'ah* advisors and local communities. This study should improve understanding of the actual attitudes and perceptions of diverse stakeholders towards the ideal structure of Islamic banking. Not many studies like this are available; one that investigates various stakeholders' opinion of Islamic banking in a dual-banking system like Malaysia should add a useful new dimension to existing information.

The remainder of the paper proceeds as follows. Section II reviews the literature on the ideal structure of Islamic banking. The dominance of debt-based contracts in Islamic banking is further analysed in section III.

Research methods and analysis tools adopted in this study are elaborated in section IV. The findings and discussion are offered in section V, with the conclusion presented in the final section VI.

II. The Ideal Structure of Islamic Banking

There are generally two dissenting views delineating the structure and objectives of Islamic banking. One vision is the framework offered by many mainstream Islamic economists that is designated in this study as 'Chapra's model'. The other (designated as 'Ismail's model') is that of Ismail (2002) and shared by many Islamic banking practitioners who tend to think less theoretically and deductively than the economists. These differing visions will be discussed in turn.

2.1. Chapra's model

This view favours PLS and places greater social welfare responsibilities and religious commitments upon Islamic banks in order to achieve the Islamic economic objectives, including social justice, equitable distribution of income and wealth, and promoting economic development (Lewis and Algaoud, 2001). Many writers on Islamic economics subscribe to this view, among them: Sadr (1982), Siddiqi (1983, 1985), Ahmad (1984), Ahmad (2000), Siddiqui (2001), Haron (1995, 2000), Rosly and Bakar (2003), Haron and Hisham (2003) and Naqvi (2003). These writers even go further to argue that equity-based financing is the only principle representing the true spirit of an Islamic banking system, one that departs significantly from the interest-based system. Although they do not fully negate the use of other *Shari'ah*-permissible debt-based contracts alongside the equity-based contracts, they do assert that the socio-economic objectives including social justice, economic growth, efficiency and stability that Islamic economics seeks to achieve are better served by resorting primarily to equity-based contracts.

These writers almost consistently affirm that the Islamic banking model should be based predominantly on equity in order to be congruent with the spirit of *Shari'ah* and the Islamic worldview. In their opinion, for Islamic banks to be different from conventional banks, they must aim at promoting Islamic norms and values as well as protecting the needs of Islamic society as a whole without undermining its commercial viability.

Al-Zuhayli, a renowned *Shari'ah* scholar, also endorses the socio-economic framework of Islamic financial institutions in his famous book *Al-Fiqh Al-Islami wa-Adillatuh*: "The primary goal of Islamic financial institutions

is not profit-making, but the endorsement of [the] social goals of socio-economic development and the alleviation of poverty” (Al-Zuhayli, 2003: 350; emphasis added). Therefore, for Islamic banks, while making profit from their business is acceptable, the accumulation of profit without utilization for the betterment of the community is forbidden. In promoting balanced economic and social development goals, Al-Zuhayli further asserts that Islamic banks must consistently adhere to *Shari‘ah* guidelines including transparency in the documentation and operation, having sense of accountability to diverse stakeholder groups and respect for the *Shari‘ah* rulings passed by the *Shari‘ah* advisors, even when the rulings are in conflict with their profit-making goal. With this bigger goal, Islamic banks are likely to be sensitive to the needs of society, promote more social welfare programmes and activities, and make more contributions towards the needy and the poor.

For example, the replacement of interest-based financial intermediation by PLS modes of financing inevitably promotes small and medium entrepreneurship or micro-entrepreneurs. Unlike conventional banks with their collateral-based lending and creditworthiness paradigm, favouring established businesses and corporate clients, Islamic banks, with their emphasis on PLS instruments, are compatible with the needs of small entrepreneurs with viable projects that are normally shunned by conventional banks due to insufficient collateral.¹

Therefore, according to Haron (1996), the Islamic banking system will become an efficient model in mobilizing and allocating resources in the economy as a result of the elimination of interest and the spread of profit-sharing concepts. Entrepreneurs, for example, by associating themselves with Islamic banks will become more ethical in conducting their business in such a way that funds will be used properly and the sense of selfishness is reduced considerably (Haron, 1996).

2.2. Ismail’s model

An alternative vision for Islamic banking is proposed by Ismail’s framework. According to this view, an Islamic bank should act as a normal commercial entity that aims at maximizing profits so long as it is done in a manner consistent with Islamic law (Lewis and Algaoud 2001; Satkunasegaran, 2003). This view also stresses the equal importance of other debt-based contracts which have clear permissibility, based on *Shari‘ah* rulings in the *Qur’an* and *Ḥadīth* of the Prophet (peace be upon him). For example, Ismail (2002) quotes from the longest verse of the *Qur’an* (2:282) and translates it

as explaining the procedure and requirement of a debt-based transaction: “When you deal with each other in transactions involving future obligations in a fixed period of time, reduce them into writing...and get two witnesses, out of your own two men”.

The sales contracts which are *Shari‘ah*-compliant encompass *murābahah* (cost-plus sale), *bay‘ bithaman ājil* (deferred payment sale), *bay‘ al-salam* (purchase with deferred delivery), *bay‘ al-istiṣnā‘* (commissioned manufacturing), and *ijārah* (leasing). Hence, the overemphasis placed on PLS modes of financing is argued to be inappropriate and unfounded in any Qur’ānic text and even incompatible with the methodology of *Shari‘ah* (Ismail, 2002).

Furthermore, Ismail’s framework specifies that the bank’s main responsibility is towards its shareholders and depositors and hence it should not to be burdened with other responsibilities. Social welfare responsibilities should be fulfilled by other bodies such as the government. Without doubt, Islamic banks need to pay *zakāh* as part of their ‘social contribution’ while complying with the *Shari‘ah*. However, the use of shareholders’ funds or depositors’ money for other social activities, which are not required by the law may jeopardize the viability of Islamic banking.²

This view is somewhat similar to the Western worldview, particularly Friedman’s concept of corporate responsibility which contends that society is served by individuals pursuing their self-interest (Adam Smith’s invisible hand). Friedman’s famous maxim ‘the business of business is business’ clearly implies that profit maximization is the only legitimate and overriding objective of a commercial institution, provided that it operates within the prescribed rules of the game (Friedman, 1967 and 1996).

Indeed, Friedman’s argument reflects the prevailing worldview of neoclassical economics, which has long been entrenched in the notion of the self-interested economic agent. The crux of this argument is the efficacy of Adam Smith’s invisible hand in harmonizing self-interested behaviour to secure an end that is not a part of anyone’s intention. The argument also depends on the ability of the rest of society to create the conditions necessary for the invisible hand to operate and to deal with the problems of externalities, inequalities, and instability, without the aid of business corporations (Boatright 1993). For example, Adam Smith’s invisible hand argument says that by giving the public a product it wants at a reasonable price, a business unconsciously translates the profit motive into consumer welfare. If a company makes a profit, employees will benefit through higher

wages, and the company will grow, enabling it to employ more people and contribute to the community in the form of taxes (Lantos, 2001). Hence, business and economic activities, in the classical view, are justified partly on the ground that they secure the well-being of society as a whole.

Obviously, there is no significant difference between the two models, only in degree and emphasis. Both essentially argue that Islamic banks ought to be socially responsible – one explicitly and the other implicitly. While Chapra's model puts greater emphasis on direct social commitment of Islamic banks, Ismail's view asserts that social objectives can be attained indirectly by the banks being continuously profitable, viable and sustainable.

With these two dissenting models of Islamic banking, Lewis and Algaoud (2001) argue that a probable consequence of the difference is that modes of operation will likely vary between banks in the alternative systems. Obviously, those who subscribe to Ismail's view will certainly be more concerned with making profits to ensure that the institutions remain viable and sustainable in the long-run. The question remains whether such endeavour is commendable from *Shari'ah* and stakeholder perspectives especially looking at the current trend of Islamic banks that are perceived as institutions operating with no obvious difference from their counterparts. On the other hand, the proponents of Chapra's model conjecture a financial system based on PLS instruments that will ensure the realization of the socio-economic objectives envisaged by Islamic economics. An examination of the actual workings of Islamic banking in practice should therefore be studied with these distinctions in mind.

III. Ideal versus Reality

Despite the strong tendency in the literature, especially amongst the proponents of Chapra's model to emphasize the theoretical superiority of Islamic banking based on equity over conventional banking, the practices of Islamic banks are found to diverge in important ways from the intellectual doctrines underpinning their role in the economy. Almost all Islamic banks across the globe today resort to the second line fixed return techniques or debt-based instruments.

Observers point out that the use of PLS instruments, namely *muḍārabah* and *mushārah* financing, have declined to almost negligible proportion (Lewis and Algaoud, 2001; Kuran, 2004; Yousef, 2004; Iqbal and Molyneux, 2005). In many Islamic banks' asset portfolios, short-term financing, notably *murābahah* and other debt-based contracts account for the great

bulk of their investments. Yousef (2004) refers to the strong and consistent tendency of Islamic banks to utilize debt-like instruments in the provision of external finance as ‘*murābaḥah syndrome*’. Table 1 provides the evidence on the dominance of mark-up instruments which are heavily emphasized by Islamic financial institutions worldwide.

Table 1: Evidence of the Supremacy of *Murābaḥah* Modes of Financing

	Share of <i>Murābaḥah</i> in Total Financing (%)	Share of mark-up instruments in Total Financing (%)
Middle East and North Africa	67.0	85.6
East Asia	44.7	70.4
South Asia	67.5	92.2
Sub-Saharan Africa	48.4	55.7

Source: Yousef (2004)

Many writers, such as Siddiqi (1983), Obaidullah (1999), Chapra and Khan (2000), Khan and Ahmed (2001) and Dar and Presley (2000), outline some of the salient reasons for the lack of using PLS. It is realized that large scale resort to PLS instruments could pose many more serious risks and hazards to the Islamic banks since the ultimate return to the banks of their investments is greater. This is due to the inherent vulnerability of PLS contracts to agency problems (moral hazard and adverse selection problems) given that the banks are unable to monitor the actual performance of the borrowers. This exposes the banks to exploitation and deception by entrepreneurs who might have disincentives to put in effort and have incentives to use unethical accounting practices to conceal true profits. The restrictive role of shareholders (investors) in management – to the extent of having no voting rights – further accentuates the risk exposure of Islamic banks.

Other issues related to PLS that make them less attractive or prone to failure if used include: property rights which are not properly defined or protected in many Muslim countries; the non-existence of secondary markets for trading in financial instruments, particularly *muḍārabah* and *mushārakah*, which leads to inefficiency in financial resources mobilization;³ and the unfair treatment in taxation which further hampers the use of PLS instruments (Dar and Presley, 2000).⁴

Under these circumstances Islamic banks cannot afford to increase their risk exposure to any large extent, especially in the face of severe competition from well-established conventional banks. This environment encourages Islamic banks to resort to debt-based contracts which have some desirable features such as simplicity, convenience and safety (Iqbal and Molyneux, 2005). Although debt-based instruments create difficulties of their own, especially when the repayments are on a deferred basis and there are unresolved *Shari'ah* issues pertaining to late-payment penalty, asset possession, rebates, benchmarking, *etc.*, it is widely thought that such instruments are relatively less risky than the equity-based contracts.

Nevertheless, the tendency of Islamic banks world-wide to structure their balance sheet largely on debt-based assets has received much criticism. Siddiqi (1983, 2001), Ahmad (1994), Rosly and Bakar (2003), Warde (2000, 2004) and others argue that a financial system built dominantly around the debt-based modes of financing can hardly claim superiority over an interest-based system on grounds of equity, efficiency, stability and growth. Such modes of financing cannot be expected to remove the injustices of the interest-based system since they actually mimic the standard debt contract in the conventional banking system.

Rosly and Bakar (2003) further define ethics in banking as the conduct of business in such a way that it favours a system of distribution embracing risk-sharing and value-addition by participating agents. From this perspective, the taking and receipt of interest in Islam is considered by them as immoral since it secures a future stream for the lender which negates uncertainty. Hence the modes of financing like *murābaḥah* and *ijārah*, which resemble interest-based financing, are regarded as immoral because they actually operate in a similar fashion.

Islamic banks are also criticized for not giving priority to long-term development projects over short-term projects aimed at quick profits. This attitude is similar to that of conventional banks which prefer short-term investments – since banks work on the basis of small reserves, they have to be able to liquidate their assets fairly quickly, if the need arises. The short-term structure of Islamic banks' assets is even more pronounced with the predominance of debt-based contracts or fixed return modes like *murābaḥah* and leasing on the asset side of Islamic banks' balance sheet. A structure of deposits on the liabilities side which is not sufficiently long-term further accentuates the reluctance of Islamic banks to get involved in long-term projects. Moreover, the predominant use of debt-based contracts

in lending encourages Islamic banks to focus on financial criteria such as collateral and creditworthiness, much like the conventional banks; as a result they pay little attention to non-financial considerations (Kuran, 2004). In short, from a substantive standpoint, Islamic banks do not operate very differently from their conventional counterparts.

According to the critics, debt-based instruments, despite gaining approval from *Shari'ah* scholars, should be kept at a minimum. At the same time, the number of equity-based contracts should be gradually increased if the overall social welfare objectives as envisioned in Islamic economics are to be realized. This move will also reduce scepticism amongst the public, especially the unconvinced Muslims, as well as outside critics, who observe that Islamic banks are, in reality, little different from conventional banks since the net result of Islamic banking operations is the same as that of conventional banking

IV. Research Methodology and Hypothesis

4.1. Hypothesis development

As shown, there are many conflicting expectations of Islamic banking practices. This exploratory study attempts to fill the gap in current Islamic banking literature by providing insights into diverse stakeholder groups' perceptions of Islamic banking characteristics and operations. This is done by eliciting stakeholders' perceptions towards five statements listed in Table 2. These characteristics were identified and adapted from the literature of Islamic banking as discussed in the preceding sections.

On the basis of these statements, the study aims to investigate the following main hypotheses:

H_1 : There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of agreement that the profit-loss-sharing principle is the only principle representing the true spirit of the Islamic banking system.

H_2 : There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of disagreement that Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to designate those products.

H_3 : There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of agreement that Islamic

banking must adopt a profit maximization principle in order to survive in the competitive business environment.

H_4 : There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of disagreement that social welfare issues should be left to the government and other non-profit organisations, not Islamic banks.

H_5 : There is no significant difference among various stakeholder groups of Islamic banks in Malaysia on the degree of agreement that the goal of Islamic banks is not limited to maximization of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community.

Table 2: Description of Statements

Statement Number	Description	Literature
1	The Profit-Loss-Sharing principle is the only principle representing a true spirit of the Islamic banking system.	Siddiqi (1983,1985); Ahmad (1984), Chapra (1987, 2000b); Ahmad (2000); Siddiqui (2001); and Rosly and Bakar (2003)
2	Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight those products.	Ahmad and Haron (2002) and Siddiqui (2001)
3	Islamic banking must adopt a profit maximization principle in order to survive in the competitive business environment.	Ahmad and Haron (2002)
4	Social welfare issues should be left to the government and other non-profit organizations, not Islamic banks.	Lewis and Algaoud (2001), and Satkunasegaran (2003)
5	The goal of Islamic banks is not limited to maximization of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community.	Sadr (1982); Siddiqi (1983,1985); Ahmad (1984); Ahmad (2000); Siddiqui (2001); Haron (1995, 2000); Rosly and Bakar (2003); Haron and Hisham (2003); Naqvi (2003) and others

4.2. Instrument

The data were collected by ordinary mail as well as self-administered questionnaires distributed by hand to seven stakeholder groups of two fully fledged Islamic banks in Malaysia, namely Bank Islam Malaysia Berhad and Bank Muamalat Malaysia Berhad. The stakeholder groups were financing customers, depositors, branch managers, employees, *Shari'ah* advisors, regulators (Bank Negara officers) and local communities (those who have no banking relationship with any Islamic banks). The choice of these diverse groups was based on the grounds that they represent the primary groups of stakeholders of Islamic banks in Malaysia. It follows closely the widely quoted definition of stakeholders, which is "any group or individual who can affect or is affected by the achievement of the firm's objectives" (Freeman, 1984: 21).

The questionnaire contains two sections: the first section was designed to gather information about the sample's personal, demographic and economic characteristics. In the second section, the respondents were asked to indicate, on a five-point Likert-type scale, ranging from 'strongly disagree' to 'strongly agree', the five statements pertaining to Islamic banking operation. Initially, a list of ten statements was gathered from past studies. Before the final questionnaire was sent out, a pilot study was conducted to determine the appropriateness and relevance of these statements in the instrument. A total of 41 respondents were invited and participated in this trial run. Based on the respondents' feedback, the list of statements was reduced to five.

The questionnaire was originally prepared in English and then translated into Malay by using back-translation method with an assistant from an expert in both languages to reduce translation bias and error. Only minor discrepancies were observed between the original instrument and its back-translated version, which were easily resolved by the translator.

4.3. Data collection

The mail survey was used in the study primarily on branch managers, employees, regulators and *Shari'ah* advisors of the respective Islamic banks. For the fieldwork survey, the drop-off approach was conducted in such a way that data were collected through self-administered questionnaires distributed by hand to individuals, namely customers, depositors and local communities at 52 Islamic banks' branches in the four selected states representing four main regions of Malaysia; namely Kelantan (Eastern),

Johor (Western), Penang (Northern) and Kuala Lumpur (Central). This was done deliberately in order to seek a wide representation of bank stakeholders.

Respondents were randomly selected from Islamic banks' financing customers, depositors and local communities who visited the sampling locations during the chosen time intervals, in order to eliminate sampling frame errors and to ensure the representation of the population under study in the sample units. Following data collection procedures outlined by similar banking studies the questionnaires were distributed during various working hours of the same day (morning and evening), as well as various days of the week, to reduce any potential bias owing to high concentration of bank customers during certain hours of the day, or certain days of the week or month (Creyer and Ross, 1997; Gerrard and Cunningham, 1997; Metawa and Almosawi, 1998; Naser *et al.*, 1999; Owusu-Frimpong, 1999; Jamal and Naser, 2002; Abbas *et al.*, 2003; Sureshchandar *et al.*, 2003).

Table 3: Target Groups, Response Rate and Methodology Used

Target Groups	Distributed Questionnaire	Usable returned and completed Questionnaire	Response Rate (%)	Methodology Adopted in Distributing Questionnaire
Customers	400	367	92	By Hand (fieldwork)
Depositors	400	383	96	By Hand (fieldwork)
Local Communities	400	280	70	By Hand (fieldwork)
Employees	400	335	84	Mail Questionnaire
Branch Managers	134	100	75	Mail Questionnaire
Regulators	36	25	69	Mail Questionnaire
Shari'ah Advisors	10	10	100	Mail Questionnaire
Total	1780	1500	84.27	

About 20 to 40 respondents were approached at each Islamic bank's branch. The researcher counted every seventh bank customer who had completed a transaction. They were politely approached, and the purpose of the study was explained. Then they were asked if they would be

prepared to fill in the questionnaire. Once they had agreed to participate, the researcher then handed over the designated questionnaire to the participating respondents to be answered either in English or in Malay according to their preferences. The researcher then left the respondent alone to answer the questionnaire and did not interfere in any way, so as to avoid any potential bias such as the respondents feeling intimidated, threatened or being influenced by the researcher. Once completed, the respondent either returned the questionnaire to the researcher or to any of the bank staff. Table 3 shows the number of distributed questionnaires; the number of usable returned and completed questionnaires (the response rate), the overall response rate and the strategy used in distributing the questionnaire for each group.

In general, from the total of 1780 questionnaires distributed, 1541 were returned, out of which 1500 were usable (completed), yielding a response rate of 84%. This response was considered large enough and sufficient for statistical reliability and generality (Tabachnick and Fidell, 1996; Stevens, 2002). The high response rate undoubtedly improved the validity and reliability of the survey since the greater the response rate, the more accurate are the estimated parameters in the population sampled (Pallant, 2002). Hence, no further attempt was made to increase the sample size.

4.4. Analysis

Presumably not all stakeholder groups would homogeneously express the same degree of agreement or disagreement towards the various statements of Islamic banking operation and characteristics. It is fair to assume that different stakeholder groups may differ in their expectations and perceptions of Islamic banking. To investigate the perception of different stakeholder groups of Islamic banks, the Kruskal-Wallis Test was applied.

Kruskal-Wallis is a non-parametric test also known as a distribution-free test which requires a less strict assumption about underlying population and the type of data to be analysed (De Vaus, 2002). Unlike the parametric test (such as F-test) which requires data to be measured on interval levels and that samples be drawn from normal distribution populations, non-parametric tests do not require the shape of the underlying distribution to be specified, though samples do need to be selected at random (Norusis, 2004). It is also more suitable for treating samples made up of observations from several different populations, and when measurement of the variables is in an ordinal scale. Although it is not as powerful as a parametric test,

increasing the sample size can increase its power to that approaching parametric equivalents (Sekaran, 1992).

This study also adopts a simple descriptive statistical approach, *i.e.* mean and standard deviation. Using this approach, the study hopes to look for lines of consensus among respondents in their views and understanding on the objectives and ideal structure of Islamic banks. A similar methodology was used effectively in a previous study to analyse the perception of respondents on various issues on Islamic banking operations (see for example Rosly and Seman, 2003). A high mean with low standard deviation on the given statement would imply a consensus among the respondents. It is generally acknowledged that, as a measure of central tendency, the mean only pinpoints the centre of the data (Kachigan, 1986). Using the mean alone can be meaningful only if the dispersion is small. If the dispersion is large, this is an indication that the data are not clustered closely and that the mean is not representative of the data. The responses were also tested for internal consistency and reliability using Cronbach alpha tests.

V. Results and Discussion: Comparing Stakeholder Groups' Perceptions

Table 4 provides the results of the Kruskal-Wallis (K-W) Test to investigate whether any significant differences exist in the perceptions of multiple stakeholder groups about different statements posed to them. The general null hypothesis reads:

H₀: There are no significant differences in the various stakeholder groups' opinion when distinguishing various statements about Islamic banking.

The K-W Test above reveals that there is a significant disagreement among stakeholder groups pertaining to 3 out of 5 statements about Islamic banking characteristics and operation. Except for statement 4 and statement 5, the chi-square values for the three other statements (χ^2 = range from 59.11 to 189.02) are higher than the tabulated chi-square value, $\chi^2 = 12.59$ at 0.05 confidence interval with 6 degrees of freedom. The observed significance level for the three variables is evidently lower than the 0.05 confidence level implying that the variations between the seven stakeholder groups in perceiving the three statements about Islamic banking are likely to hold in the population. Hence hypotheses H_1 , H_2 and H_3 can be rejected.

Table 4: Kruskal-Wallis Test to Compare Different Stakeholder Groups' Perceptions

Variable	Stakeholder Groups	N	Mean Rank	Chi-Square (χ^2)	Asymp. Sig. (p)
Statement 1 The Profit-Loss-sharing principle is the only principle representing the true spirit of Islamic banking system.	Employees	332	815,79	$\chi^2= 59.11$	0.000
	Customers	361	772,01		
	Depositors	378	746,94		
	Local Communities	278	717,77		
	Regulators	25	540,56		
	Managers	99	523,05		
	Shariah Advisors	10	366,90		
Statement 2 Islamic Banking products and services available in Malaysia are similar to that of conventional banks, except that the banks use different names to highlight those products.	Depositors	378	853,80	$\chi^2= 189.02$	0.000
	Customers	362	840,80		
	Local Communities	277	819,36		
	Regulators	24	671,10		
	Employees	334	542,76		
	Managers	100	480,51		
	Shariah Advisors	9	262,67		
Statement 3 Islamic banking must adopt a profit maximisation principle in order to survive in the competitive business environment.	Managers	100	927,87	$\chi^2= 64.84$	0.000
	Employees	332	842,13		
	Shariah Advisors	10	831,70		
	Customers	363	711,72		
	Depositors	376	689,07		
	Local Communities	279	678,20		
	Regulators	25	640,06		
Statement 4 Social welfare issues should be left to the government and other non-profit organisations, not Islamic banks.	Customers	363	705,28	$\chi^2= 7.44$	0.282
	Managers	99	794,88		
	Local Communities	280	769,60		
	Employees	332	749,46		
	Depositors	377	746,77		
	Regulators	25	697,74		
	Shariah Advisors	10	684,90		
Statement 5 The goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community.	Shariah Advisors	9	844,17	$\chi^2= 11.486$	0.074
	Regulators	25	813,90		
	Local Communities	279	768,44		
	Customers	358	763,06		
	Depositors	378	745,25		
	Employees	331	695,51		
	Managers	100	685,09		

An inspection of the mean ranks for the stakeholder groups suggests that employees, customers and depositors were positioned at the highest mean rank for both Statement 1 and Statement 2, while managers, employees and *Shari'ah* advisors scored the highest mean rank for the Statement 3

variable. To delineate the pattern of response more clearly, the frequency results are presented in Table 5 below.

From Table 5, the mean for Statement 1 is 3.99. It implies that, in general, the respondents agree with the view that PLS is the only principle representing the true spirit of the Islamic banking system. This is confirmed by the majority of respondents (77%) who agree with the statement. This particular finding substantiates assertions made by Rosly and Bakar (2003) and other earlier Islamic economists (e.g. Siddiqi 1981, 1983, 1985; Chapra 1985, 2000b; Ahmad 2000; Siddiqui 2001, and others) who strongly argue that, unless Islamic banking institutions resolve to move to PLS financing instruments, socio-economic justice as envisaged by the Islamic banking system cannot be achieved. Only a minority (10.1%) disagree with Statement 1 and follow the line of argument advanced by Ismail (2002), who staunchly defends the use of other Islamically permissible financial instruments such as deferred contracts of exchange or fixed-rate instruments like *murābahah*, *bay' istiṣnā'*, *ijārah* etc.

Table 5: Stakeholders Perceptions of Islamic Banking Operation

Statements	Disagree (%)	Do not know (%)	Agree (%)	Mean	Std. Dev.
1. The Profit-Loss-Sharing principle is the only principle representing a true spirit of the Islamic banking system.	10.1	12.5	77.4	3.99	0.961
2. Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight those products.	53.7	12.4	34	2.71	1.25
3. Islamic banking must adopt a profit maximisation principle in order to survive in the competitive business environment.	12.7	3.2	84	3.99	0.953
4. Social Welfare issues should be left to the government and other non-profit organisations, not Islamic banks.	74	6.8	19.3	2.34	1.039
5. The goal of Islamic banks is not limited to maximisation of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community.	4.4	3.6	92.1	4.21	.759

Note: 1 = strongly disagree; 5 = strongly agree

The results of the K-W Test in Table 4 also showed that there were significant differences in the opinion of the stakeholder groups on the statement. Employees, customers and depositors were ranked higher than other stakeholder groups in perceiving the importance of Islamic banks realizing the ideal of the Islamic banking based on PLS instruments. On the other hand, *Shari'ah* advisors, managers and regulators assigned lower ratings to the idea that PLS is the only principle representing the true spirit of Islamic banking system. The result of this analysis may be explained on the grounds that *Shari'ah* advisors, bank managers and regulators were generally more concerned with the viability and sustainability aspects of the banking business, given the ever-increasing pressures on the Islamic banks to be more competitive especially in a country (Malaysia) with a dual banking system. Since PLS modes of financing are generally perceived as high risk products, Islamic banks therefore resort to debt-based instruments to maintain their viability and competitiveness in the market.

Additionally, Statement 2 examines the perception of respondents of the current practice of Islamic banking in Malaysia. The statement states: "*Islamic banking products and services available in Malaysia are similar to the products and services of conventional banks, except that the banks use different names to highlight their products*". The responses (see Table 5) obtained from the respondents are mixed. The mean score for Statement 2 is 2.71 and the standard deviation is 1.25. Approximately 54% of the respondents disagree, while 34% agree with the statements. Another 12% are indifferent. Examining the K-W Test result (Table 5) also reveals that there is a significant difference in the opinion of the seven stakeholder groups. Again, depositors and financing customers are ranked higher than other stakeholder groups.

This is, however, not a surprising result since there has been much scepticism in public opinion, especially amongst the unconvinced Muslims, about the authenticity of Islamic banking practices (Henry and Wilson, 2004). Even the Muslim economists – amongst them, Ahmad (1984), Chapra (1987, 2000b), Ahmad (2000), Siddiqui (2001) – observe that the extensive use of fixed-return financing techniques *i.e.* *murābahah*, *bay' bithamanil ājil* (BBA), *ijārah* etc. instead of PLS instruments (*muḍārabah* and *mushārahah*) resembles conventional interest-based financing techniques. This will subsequently ignite cynicism amongst the general public as they view the net result of Islamic banks' transactions as similar to that of conventional banks. In this regard, Siddiqui (2001) asserts the difficulty in arguing the case for Islamic banking especially before common people, who might feel

that it is nothing but a matter of twisting documents or changing product names. Hence, it is important for Muslims and non-Muslims alike to be assured and continuously reminded that Islamic banks actually operate strictly on Islamic principles, so that Islamic banking is not only genuinely Islamic and legitimate from the *Shari'ah* point of view but also enhances their confidence and trust in Islamic banks.

Next, Statement 3 examines the perceptions of respondents on the importance to Islamic banks of the profit maximization principle. From Table 5, even though a vast majority (84%) of the respondents agree that Islamic banks should adopt a profit maximization principle in order to survive in the competitive business environment, the K-W test reveals that there is a significant difference in the opinion of diverse stakeholder groups. Consistent with our earlier findings, branch managers, employees and *Shari'ah* advisors were again ranked higher than other stakeholders. This implies a strong emphasis for Islamic banks to operate in a manner that can generate profits and become more competitive as compared to their conventional counterparts. This outcome of the analysis is also consistent with Ahmad and Haron (2002), who conducted a similar study on corporate customers of Islamic banks in Malaysia.

Statement 4 examines the perception of the respondents about the issue of social welfare. The respondents (see Table 5) seem to hold quite similar views regarding this matter. The mean for Statement 4 is 2.3406, while the standard deviation is 1.03976. This is further confirmed by the result obtained earlier (see Table 4), where no significant differences were observed among the stakeholder groups on the statement. Therefore it can be deduced that stakeholders are in consensus that social welfare issues should also be seriously taken into account by Islamic banks. This proposition is consistent with the earlier assertions made by Haron (1996), Ahmad (2000), Haron and Hisham (2003), Rosly and Bakar (2003), who argue that the objective of Islamic banking is much more than the elimination of interest; rather, it needs to fulfil its socio-economic and ethical responsibility of serving the *ummah*. The particular findings appear to reject Ismail's view asserting that Islamic banks are a normal commercial entity, whose main responsibility is to shareholders and depositors alone, while social welfare objectives are to be met by other bodies such as government (Lewis and Algaoud, 2001).

To investigate whether there is a consistency in responses, Statement 5 was posed to gauge the true perception of respondents about the Islamic banking philosophy and objectives. Statement 5 states that: "*The goal*

of Islamic banks is not limited to maximization of shareholders' wealth, but also includes enhancement of the standard of living and welfare of the community". Table 5 indicates that most of the respondents (92%) agree with the statement while only a small minority (4%) disagree, with the remaining 3.6% of respondents seemingly indifferent. With high means and low standard deviation of 4.2107 and 0.75892 respectively, this implies that a strong consensus has been reached by the respondents on the statement. This is further supported by the results of the K-W Test (Table 4), where no significant differences were observed among the stakeholder groups on this statement.

Again, this result supports our earlier finding that respondents have a high expectation with respect to the social-welfare commitment of Islamic banks. This expectation certainly goes beyond the traditional capitalistic view perceiving corporations as having the sole purpose of maximizing profits and protecting shareholders' interest while ignoring the interest of society at large. Hence, it signifies the importance of Islamic banks as *Shari'ah*-based institutions concerned about their social-welfare commitment and not merely following the trend of their counterparts' strict concern to maximize profits.

VI. Conclusion

This paper has presented the findings of a survey conducted on the multiple stakeholders of Islamic banks with the aim of gauging their opinion and understanding of the overall performance and operation of Islamic banking in Malaysia. The result reveals that the majority of stakeholders of Islamic banks regard Islamic banking institutions as entities with distinctive characteristics distinguishing them from their conventional counterparts. Apart from the prevailing perception of Islamic banks as interest-free institutions, Islamic banks are equally perceived as organizations characterized by ethical norms and social commitments without undermining the commercial aspects of doing business.

Clearly, while there is a consensus that Islamic banks should adopt a profit maximization principle to remain competitive and sustainable, the vast majority of respondents feel that social welfare issues should also be taken into account by the Islamic banks. These findings corroborate Chapra's model which sees Islamic banks as having a dual purpose, i.e. to realize both social and economic objectives. This finding is also in line with propositions made by many Muslim economists, such as Sadr (1982), Siddiqi

(1983, 1985), Ahmad (1984), Ahmad (2000), Siddiqui (2001), Haron (1995, 2000), Rosly and Bakar (2003), Haron and Hisham (2003), Naqvi (2003) and others, who see Islamic banks as organizations that are not solely profit-oriented, but aim to promote Islamic norms and values as well as protecting the needs of Islamic society as a whole.

Apart from balancing profit and social commitments, the respondents also expect Islamic banks strictly to observe *Shari'ah* guidelines in their operations, gradually moving to PLS mechanisms, which are perceived to be nearer to the ideals of Islamic banking. Islamic banks are expected to display Islamicity in terms of providing high quality and satisfactory services, protecting the interest of their stakeholders, and most importantly, continuously improving their products and services to bring them more in line with the precepts of *Shari'ah* so that any doubts about their legitimacy are alleviated.

All in all, it is not impossible to achieve an ideal model of Islamic banking that balances profit-orientation with commitment to social welfare. This necessitates an active involvement and cooperation of those behind the scenes of Islamic banking, including practitioners, policy-makers and regulators, to ensure that Islamic banks stay focused on becoming a perfect model of Islamic institutions. Without doubt, the government also plays a major role in formulating and promoting necessary strategies and appropriate policies to ensure realization of this ideal.

NOTES

1. Al-Harran (1993) contends that the ideal operation of the Islamic bank is to emphasize the project viability and usefulness together with the intrinsic trustworthiness of a person while placing collateral at a very minimum significance. As such, the small saver, investor, trader and producer become more important, rather than individuals who are financially well-off or with collateral worthiness. For example, the experience of Sudanese Islamic Bank (SIB) in implementing the *musharakah* financing concept to small rural farmers in Sudan has proven without doubt that such profit-loss sharing technique is applicable and can bring benefits to the rural community. For details, see Al-Harran (1990).
2. Dr. Abdul Halim Ismail's position on this matter was confirmed through an interview conducted on 19th July 2004. Dato' Dr. Abdul Halim Ismail, formerly with Bank Islam Malaysia Berhad, is also known as 'the Father of Islamic Banking of Malaysia'. Presently he serves with BIMB Securities Sdn. Bhd. as the Executive Director. He was also recently appointed as a member of the National Shariah Council of Bank Negara Malaysia.
3. The non-existence of secondary markets for equity-based products exposes banks to the problem of liquidity. Furthermore, equity financing is not feasible for funding

short-term projects due to the ensuing high degree of risk. This makes Islamic banks rely on other debt-based instruments, especially mark-up instruments, to ensure a certain degree of liquidity.

4. The current treatment in taxation does not provide an incentive for banks to offer equity-based products. For example, with the current practice of *bay' bithaman ājil* (deferred cost-plus sale), banks immediately transfer ownership to clients who have to bear all the taxation expenses. Whereas, in diminishing partnership or *mushārahah mutanāqishah* contracts, the bank needs to bear a certain amount of tax expenses proportionate to its equity ratio. Interest payments are recorded as expenses in income statements of firms, before arriving at the taxable income. Dividends are nevertheless deducted from the after-tax income. Accordingly, the higher the interest expense, the lower the tax liability; but the tax liability remains the same irrespective of the dividend amounts. This further justifies the argument for favouring debt over equity.

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