



**THE PERCEPTION OF IRAQI PEOPLE ON THE MALAYSIAN  
ISLAMIC BANKING SYSTEM**

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**MASTER OF BUSINESS ADMINISTRATION**

**2013**



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**i**

## DECLARATION

I declare that this thesis entitle “The Perception of Iraqi People on The Malaysian Islamic Banking System” is the result of my own research except as cited in the references. The thesis has not been accepted for any degree and is not concurrently submitted in candidature of any other degree.

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Date : 01 / 03 / 2013

## ABSTRACT

The purpose of this research is to find the challenges and the problems that might face the Iraq banking people in applying Islamic banking based on Malaysian experience in this filed. It also aimed to find the factors that affect the success of Islamic banking in Iraq and suggested applicable model that can be applied in Iraq. The research used quantitative approach through self-administrated questionnaire instrument and the use of secondary data. The target respondents were 97 Iraqi citizens living in Malaysia. The data analysis was done through SPSS version 20.0. The descriptive analysis and Pearson Correlation are used to test the hypotheses. The descriptive analysis is to find the overall Mean value score of the items. The respondents varied between agree and strongly agree on the statements that they were asked to evaluate. The highest overall Mean score value of 4.23 from the role of people of Islamic banks, followed by procedures of Islamic bank at overall Mean score value of 4.20. The other two scales were service quality and trust between Islamic banks and customers and the overall mean value score of the two scales were 4.03 and 4.02 respectively. The hypotheses were tested and accepted. The highest correlation was found to be between trust and successful establishment of Islamic bank at Pearson Correlation of .633 followed by service quality of Islamic banks at Pearson correlation of .566. Similarly, the correlation between people of Islamic bank, procedure of Islamic and the dependent variable successful establishment of Islamic bank were found positive at .562 and .524 respectively.

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Ehab A. Abdulrazzak

## **APPROVAL**

I hereby confirm that I have examined this project paper entitled:-

**“THE PERCEPTION OF IRAQI PEOPLE ON THE MALAYSIAN ISLAMIC  
BANKING SYSTEM”**

By

**EHAB A ABDULRAZZAK**

I hereby acknowledge that this project paper has been accepted as part  
Fulfillment for the degree of Master of Business Administration

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## **CHAPTER 1**

### **INTRODUCTION**

#### **1.1 Introduction**

The establishment of Islamic banks as a new phenomenon in the financial world can be traced back to the mid of the 20<sup>th</sup> century (Warde, 2000). However, the thoughts of applying the Shari'ah law (legal instructions of Islam) in banking activities was for the first time put in practice by the establishment of the rural bank in Egypt in 1963, followed by the establishment of a cooperative bank in Pakistan in 1965. In 1971, Islamic banks have continued to grow in size and numbers. The main mission of these banks has been the achievement of social and economic development through the delivery of financial services in line with the principles and teachings of Islam. The rapid growth of the Islamic banking system in the international banking and capital market was associated with the establishment of the Islamic Development Bank (IDB) in 1975 (Elgar, 2003).



The first commercial Islamic bank to apply full packages of Islamic banking product was Dubai Islamic bank in 1975 (Zaman & Movassaghi, 2001). The Islamic banks apply the Islamic law (the Shari'ah) and use Islamic financing instruments. Islamic modes of financing consist of two basic principles, the first principle is the interest-free financing instruments in the private sector and the second one is the development financing instruments based on both cost and profit sharing (Siddiqi, 1983).

The Islamic banks represent a new era of awakening of the Muslim community. The Muslim community is returning back to the Islamic teachings regarding the trade, transactions, loans and to find solutions for contemporary problems such as the increase gap between rich and poor people and to face the crisis which has been erupted in the capitalism countries (Ebrahim & Joo, 2001). The Islamic banks have proven their reliabilities in the time of crisis, the major banks in the west have collapsed and announced their bankruptcies mainly due to interest based banking system, a good example of the weaknesses of facing crisis is the Lehman Brothers bank and many American banks which could not face the financial crisis in 2008 (Ivashina & Scharfstein, 2010). On the other hands the Islamic bank was an example of success in the time of crisis, the financial crisis affected the Islamic banks slightly. The success of Islamic banks has attracted the attention of conventional banks such as Citibank and Hong Kong & Shanghai Banking Corporation (HSBC). These banks have created special subsidiaries or windows to attend to the demand for Islamic banking products and services (Ariff & Iqbal, 2011).

According to Ebrahim and Joo (2001) the main goals of an Islamic Banking and Financial system are to:

- 1- implement the value system of the Qur'an and the Sunnah (tradition or practice of Prophet Muhammad Peace Be Upon Him (PBUH)) in the realm of the Muslim socio-economic system. According to Islamic teachings regarding business transactions, all activities are permissible unless forbidden by the Quranic revelation (Qur'an) or the practice of Prophet Muhammad PBUH.
- 2- speed up the growth of the economy of Muslim nations by developing financial markets, institutions and instruments. A well-developed capital market, efficient institutions, diverse financial facilities, can reduce the overall cost of capital. It can enhance social welfare by facilitating the acceptance of projects which benefit the society.
- 3- decrease the shocks of extreme economic output by promoting risk sharing instruments whose payoffs are strictly contingent on the profitability of a firm or project at a micro level. Financial facilities with fixed costs can severely strain the resources of borrowers during a slowdown, which lead to bankruptcies and structural impairment of the economy.

## **1.2 Background of the Study**

The growing of the Islamic banking assets has been a remarkable sign of the success of the Islamic finance and Islamic banking. The size of Shari'ah-compliant assets projected to be US\$1.6 trillion in 2012 and expected to grow 10% -15% annually (Ahamad, 2012). The

number of Islamic financial institutions is increasing worldwide. According to Asian banker research group, currently, there are more than 300 Islamic financial institutions in 75 countries worldwide. According to the Malaysian Central Bank or Bank Negara Malaysia (BNM), the world's 100 largest Islamic banks have set an annual asset growth rate of 26.7% and the global Islamic finance industry is experiencing average growth of 15-20% annually (BNM, 2007). Among all the countries which adopt and apply Islamic finance and banking, Malaysia has proven to be a special case in terms of being a pioneer in its experience of Islamic banking and finance. The country has developed a dual system whereby the Islamic banks and the conventional banks co-exist in harmony and peace. (Hallberg & Nettelblatt, 2011).

The 30 years experience in building successful Islamic financial industry has enabled Malaysia to build solid ground in the Islamic financial industry and to turn the country to be leading centre in Islamic banking. The Malaysian Islamic assets accounted to be more than RM334 billion (\$100 billion) and it is growing in a rate of 20% annually (Binmahfouz, 2012).

The success of Malaysia was not a coincidence; it was a result of hard working of the government in establishing successful Islamic banking industry, such as security, stability, infrastructure, legislation and so on. In terms of forming the legal infrastructure, the country has implemented a dual legal system; one is for Muslim and other for non-Muslim, it has also established the National Shari'ah Advisory Council in 1997 with the primary purpose to be the single authoritative body to guide Islamic banks and to assess new products that are being developed within the industry (BNM, 2011).

The dual system in terms of banking systems and in terms of regulations and law concerning the legitimacy of the Islamic banking has pointed Malaysia as the best candidate to be copied by other countries which applying only one system. Many countries admired the experience of Malaysia in Islamic banking and wish to copy this experience. One of these countries is Iraq; a Muslim country in the Middle East, and the Muslim population accounted to be 97% of the population of Iraqi people. The country has gone through many wars starting from the war against Iran in 1982 which lasted for 8 years and aftermath the war with the west which ended in April 2003 by the collapse of the president Saddam Hussein's regime. After the war, the banking industry was absent and the economy was cash economy.

There are many challenges in building a successful Islamic banking in Iraq. The major issue is the security; the country is still not stable politically, economically and socially. In political side, although the new democratic system which based on multi-parties basis was supposed to move Iraq to new democratic stage, the new system has deepening the partition of Iraqi people. The so called democratic system is dominated by religious political leaders who come from different background and beliefs. This situation has worsen the Iraqi political life and resulted in many political crisis in the country (Tarnoff, 2011).

In economic part, the country has lost most of industries and turned to be fully imported country. The only good that is being exported is oil. Despite the huge income that enter the country, basic services still considered as luxury and the country suffer high unemployment rate. People fear of risk preventing them from depositing their money in a bank account and lead them to keep their money in their safes. Foreign investors such as international and

regional banks also have concern about the country security and safety of their investments and that lead them to think twice before entering the Iraqi market. (Tarnoff, 2011)

Socially, the war and the aftermath period have divided the country into two main groups; Sunni and Shi'a. The country has suffered bloody months in 2006 and the impact still until today. During the period 2006-2010 it is rare that a day passes without explosion or any bloody events (Tarnoff, 2011).

However, the Iraqi market is a promising market. Iraq can be described as a major producer and exporter of oil and its Gross Domestic Production (GDP) is comparatively high at \$115 billion. Security can be enhanced and opportunity of rebuilding the Iraqi infrastructure is attracting all investors in the region and in the global level. The country lacked infrastructure and has limited experience in Islamic banking regarding the regulations which has to be enacted and need to amend the law. This is because the country also has conventional banks and its experience within the Islamic banking field can be traced back to few years particularly after 2004. Applying and implementing Islamic banking in Iraq is a wise choice for the government to make. Islamic banks can push the wheel of the economy and speed up rebuilding of the infrastructure. Therefore, in order to shorten the way towards dual systems and not to reinvent the wheels, it is more advisable that the country benefits from the pioneer of the Islamic banking industry and starts its experience with Islamic banking from where the pioneer ends. The Malaysian experience is unique and can be translated into steps, therefore, it can be applied to the Iraqi banking industry. Thus applying the experience of Malaysian Islamic banking in Iraq will be more fruitful and cost effective.

In the Iraqi banking industry, the Iraqi Central Bank (ICB) is the main bank, which in charge of organizing of banking industry. Under ICB there are seven states owned banks, twenty three private banks, eleven Islamic banks, seven foreign banks are operating in the Iraqi market (ICB, 2012). The Iraqi experience in implementing and operating Islamic banking is still in infancy stage. The first Islamic state-owned banks started operation in the beginning of the year 2012. In this study, the researcher explores the possibilities of adopting the Islamic banking system of Malaysia to the Iraqi banking industry. The study mainly focuses on examining the Malaysian experience and identifies the success factors in applying and implementing Islamic banking, and suggests a good model of the Islamic banking system to be implemented in Iraq.

### **1.3 Problem of the Study**

The Iraqi experience in Islamic banking is still in its infancy stage, the first Islamic state owned bank to open was in early of 2012 (Iraq business news, 2012). There is also shortage in the literatures regarding the Islamic banking industry in Iraq. According to statistics from the ICB, the numbers of Islamic banks which have been established recently are 11 banks, whereas the numbers of conventional banks are more than 30 banks (ICB, 2012). The development of Islamic banking industry and most of other industries were slowed down due to long years of instability and United Nation (UN) sanctions which were imposed on Iraqi government by accusing Iraq for having nuclear weapons (Milton, 2001). Such actions have slowed down the development of Islamic banking. Iraq population is nearly 27 million and as it is mentioned previously, the majority of the population is Muslims. However, the country is

looking to implement Islamic banking practices and it is targeting to operate dual systems where Islamic and conventional banks can operate and co-exist (Iraq Business News, 2011).

There is a need for Iraq to adopt a successful experience in Islamic banking based on Malaysian model, rather than to reinvent the new system. The adoption of the Malaysian experience is cost-effective yet beneficial for the Iraqi banks and government. The Malaysian experience in the Islamic banking has proven its successfulness and reliability in this field and this sector account for more than 25% of the general asset of the Malaysia, the sector also provides job for huge number of citizen and can foster the development of the economy (BNM, 2011). Furthermore, Malaysia was one of the few countries which could survive in the time of the financial crisis in 2008 because of the dual systems (BNM, 2011). Western countries admired the ability and the flexibility of the Islamic banks in the time of crisis when most of their conventional banks affected and more than of 200 banks collapsed as a result of the crisis, while on the other side, the Islamic banks have witnessed increase in profitability (Hallberg & Nettelblatt, 2011).

Adopting the Malaysian experience in Islamic banking is advisable; however, there are some challenges to be confronted. These challenges include the legal infrastructure. There is a need for laws to be implemented regarding the Islamic banking and its activities. Another challenge is the limited offer of Islamic product and services, a positive point of the Malaysian experience is the ability to be innovative in creating more Islamic products and services such as leasing. Additionally, Islamic banks reject interest based transaction and that might represent a challenge for a system has been working on interest basis for long time (Rosly & Abu Bakar, 2003).

Applying only one system is proven to be a poor application of the banking industry. In Iraqi community the interest-based is forbidden and that prevent people from dealing with the banks because they are afraid that their transactions are unlawful (Haram) based on Shari'ah law. These practices prevent them from depositing their money in the bank; rather they put their money in their own safe.

Building weak Islamic banking system can destroy the reputation of Islamic banks and lead the customers to boycott these banks. Therefore, Iraq needs to adopt successful experience of Islamic banking system like Malaysian banking systems which is proven to be successful and adaptable. Adopting this experience will lead the Iraqi banking sector to survive and thrive.

#### **1.4 Questions of the Study**

This research aims to answer few questions regarding the adoption of Malaysian Islamic banking system to the Iraqi banking industry. The questions of the research are:

- 1- What are the problems or challenges that the Iraqi banking system face?
- 2- What are the factors influence the success of Islamic banking adoption and implementation in Iraq?
- 3- How could the Malaysian Islamic banking experience be implemented in Iraq?