

How to Overcome the Challenges Faced to Enhance the Efficiency of Islamic Banking in the Asian Region

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ABSTRACT

Islamic banking (IB) has emerged as an essential part of the global banking network. Despite the rapid rise of Asian Islamic banking, previous research has largely focused on Islamic banks in specific countries. This study aims to fill the gap in the literature by proposing ways to solve the issues faced by Islamic banks in the Asian region. In this study, the methodology employed was qualitative content analysis. Researchers collected qualitative data from scientific literature written by Muslim and non-Muslim authors. This approach systematically analyses textual content, integrating qualitative and quantitative aspects. The paper covered various potential solutions for the betterment of Islamic banks, introducing innovative products, standardizing Sharia governance, modernizing financial policies and marketing strategies, and developing a strong alliance with Conventional banks (CB) and other organizations, which will enhance the effectiveness and growth of Islamic banks. In addition to these solutions, the study acknowledges that other solutions also develop the establishment and expansion of Islamic banking in the region. Identifying and onboarding these solutions will help stakeholders and policymakers in Islamic banking implement effective strategies and policies to address today's most pressing challenges and prepare for and prevent the challenges of tomorrow.

Keywords: Islamic banks, Challenges, solutions, Asia

1. INTRODUCTION

The banking sector is a major part of the global financial market, and Islamic banking (IB) has become an important part of it [1]. IB operates

based on the principles of Shariah law (principles of the Muslim holy book, the Quran). The restriction of interest and the use of profit and loss sharing (PLS) contracts are among these principles [2]. Nonetheless, IB and CB have similar goals of increasing shareholder wealth through profit maximization as profit-oriented banking. To be competitive in the market, IB must aim for efficiency by utilizing resources efficiently [3].

The IB sector has grown in prominence by the end of the twenty-first century, steadily gaining influence in the world's financial sector. According to the Islamic Finance Development Report (2022), Islamic finance assets were depicted with a total amount of \$2.88 trillion, while Southeast Asia (SEA) reached \$685 billion in 2019. 69% of the total assets were constituted by Islamic banking (\$2 trillion) [4].

IB has indeed achieved remarkable success over the past two decades. However, it is important to acknowledge that the organization is currently facing significant challenges. In the financial sector of Asia, IB has achieved a prominent position. However, it is important to explore solutions for the factors affecting adaptability and growth, considering both Muslim and non-Muslim populations. IB faces specific challenges that impede its progress when compared to CB. It is essential to overcome the challenges to promote sustainable development and broader acceptance of IB in Asia [5].

One of the primary solutions for the growth of IB in Asia is public awareness of IB products and services. To promote a better understanding of the IB concept and its products and services and to effectively compete with other financial institutions, IB must focus on product innovation and establish a greater range of solutions that meet the needs of both individuals and companies. These

products must comply with Shariah principles and the country's unique legislative requirements, rules, and regulations [6;7]. Other possible solutions to address the challenges faced by IB are standardization and consistency, product diversification, competition with CB, and regulatory framework. Efforts in these areas will contribute to the growth and success of the IB industry.

The study aims to identify and propose solutions for the challenges preventing the growth of IB in Asian countries. By knowing and implementing these ideas, the research seeks to contribute valuable insights to help enhance the prospects and sustainability of IB in the region.

One Research Question is developed for the study:

- What are the possible solutions for the challenges Confronting IB?

The structure of the paper proceeds as follows. Section 2 presents the study's theoretical framework; Section 3 elaborates on the empirical part and main findings regarding the paper. Section 4 contains some concluding remarks and recommends how to overcome these challenges.

2. THE THEORETICAL FRAMEWORK OF THE STUDY

The challenges faced by IB in the Asian region differ from those faced by conventional banks (CB). Below are some strategies for overcoming these challenges:

Competition often motivates organizations to improve their performance, placing them in a “do or die” scenario. Organizations must enhance their efficiency, boost their productivity, and deliver high-quality products to their customers to remain viable. Its offerings develop new and innovative financial products based on Shariah-compliant principles [8;9;7;10;11;12].

Religion is not a major factor that attracts new users to choose IB. However, other important factors can influence the decision of IB customers, such as improvement and advancement in product quality that can make or break a business, and products and services of

rival banking systems be differentiated, allowing customers to make the best decision [13;14].

Muslims make up most of the population in Asia, and there is a strong possibility that IB in Asia will emerge as a major financial institution in the future. This can be achieved by improving customer service and adopting new technologies to enhance the user experience [15]. It is important for IB to provide efficient and specialized services to Small and Medium Enterprises (SMEs) to ensure their success. This can be achieved by simplifying procedures, reducing turnaround time for lending, and providing customized solutions to SMEs [16]. To increase liquidity and efficiency, IB must provide investment and financial products that align with Shariah principles and can be traded globally [17].

According to an IMF review, IB needs to update the legislative and regulatory framework that governs them, which is based on Sharia standards for Asian IB regions, but only the sections directed solely to IB and to ensure the safety of IB, customers, increase investment and financing opportunities, [18;19;15;20;21].

Regarding the convergence of Islamic financial practices, Shariah experts must collaborate and establish a uniform central regulatory and supervisory structure. This will help create a coordinated and consistent regulatory environment, which will aid in the convergence of different Islamic financial practices [22;23].

An enabling and supportive legal framework would promote the enhanced development of IB and control and supervise all IB affairs [24;25;26]. When establishing the Shariah Advisory Council, it is crucial to recognize its primary objectives, including advising the Central Bank of countries on IB-related matters [12;27]. To avoid any confusion that could undermine the credibility of Islamic banks, it is crucial to establish Shariah advisory councils at the national level, following the example set by Malaysia and Pakistan. The Central Bank of Malaysia, in the context of IB, maintains its own Shariah Board. This board issues fatwas (legal opinions) on novel financial products and

services, which are subsequently adopted by all IBs within the country. Only accredited Shariah scholars must serve as board members to ensure the credibility of Shariah boards. A prerequisite for such membership should include a master's or Ph.D. in Islamic financial law and basic banking and finance knowledge [28].

IB must modernize its financial policies and marketing strategies. The strategy should emphasize the steps to enhance public perceptions of IB and position it as a distinct and viable system [19;29;30].

IB has introduced a range of financial and investment products; these products should be categorized into different categories like fixed return, variable return, and profit sharing. The fixed and variable return instruments should be widely utilized, and to enhance their financing and investment options, IB should diversify their profit-sharing approaches. This requires strategic marketing efforts at both the consumer and organizational levels, and to streamline processes, the IB sector should minimize documentation requirements [9;16].

To capitalize on the opportunities presented by globalization, IB should proactively enhance its relationships with CB and other organizations, fostering a robust alliance [24;9;20].

While expanding into global markets is not easy, an alternative approach is establishing strategic alliances with other reputable banks. Islamic and conventional banks can benefit from such partnerships, like creating a dual banking system. By collaborating with Western banks, IB can tap into their knowledge, expertise, capabilities, and refined banking techniques. This collaboration enables them to offer enhanced products to customers while mitigating the risks associated with international expansion [17;31;32].

Government support for implementing Islamic banking in Asian countries would yield several advantages. It is essential to adapt existing banking regulations to establish Islamic banking in the region. Additionally, Asian governments should permit conventional banks to open Islamic banking windows, facilitating the early

development of the Islamic banking system [33;15].

The audit practices for IB are still in the developmental stage. IB should strive to establish a robust system to enhance transparency in financial reporting and accounting. Ideally, developing an Islamic version of GAAP (Generally Accepted Accounting Principles) would further promote transparency and consistency. According to IB internal regulations and the guidelines set by the Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), all entities operating within the Islamic Financial Industry must undergo a Shariah Audit at least annually. However, [10;34;17]. Other signs of progress include the existence of robust accounting and auditing systems, as well as the ongoing development of innovative products and services [12].

A significant challenge in the development of IB lies in public awareness. Intensive public education campaigns are essential to understand the concept [35] clearly. While the issue of public awareness regarding the IB can improve over time, proactive steps are necessary. These include organizing public education campaigns, integrating IB concepts into school curricula, incorporating Islamic financing courses within business administration programs, and establishing comprehensive degree programs focused on Islamic financing [19;32].

Educating the public about IB products and services is crucial. A significant percentage of Muslim residents in this country would willingly opt for IB over CB if properly informed [29]. To enhance service quality for clients and improve efficiency, it is essential to establish additional institutions that educate the public about the operations and principles of Islamic banking [24].

Collaboration among the Central Bank of each nation, religious authorities, and IB institutions is essential to address the cultural and religious differences in IB. Their joint efforts should raise awareness about the institutions' objectives, goals, and benefits [36].

The long-term viability of IB depends on having adequately skilled human resources for teaching, training, and research in IB. A deep understanding of Islamic and conventional finance and economics is also essential [37;38;19;39]. IB can benefit significantly from CB, particularly in enhancing managerial skills [33]. The importance of skilled bankers and managers for IB cannot be overstated. To promote their new services effectively, IB has had to hire staff training in CB [40;27].

Respondents mentioned factors regarding customer-oriented IB products include customer convenience and an increase in branch network [10;13]. To ensure that people in rural areas are aware of all the Islamic modes of financing and their importance, it is necessary to implement IB in rural areas as well [39;21].

The IB has witnessed substantial growth in Asia over the last two decades. The increasing Muslim populations in various Asian countries, especially in Southeast Asia, contribute to this trend. As living standards improve, IB becomes an attractive alternative to CB mechanisms. Additionally, investors from the Middle East and Asia seek investment opportunities aligned with their religious beliefs [41].

To ensure the success of the Islamic financial framework, it is essential that all participants have complete trust and confidence in the structure, work with integrity and morality, and have thorough confidence that it is a complete and comprehensive framework over the conventional financial structure [20]. Customers consider factors beyond religious beliefs. According to a study, customers value product features and quality of service as major factors for selecting IB [10].

To improve the perception of Islamic products and services, IB must deal directly with Small and Medium Enterprises (SMEs) instead of third parties. SMEs are considered one of the sources of innovation, productivity, and dynamism in many countries [16].

3. THE EMPIRICAL PART OF THE RESEARCH: THE MAIN FINDINGS

This study examines the initial stage of empirical research on IB in the Asian region. For this paper, the authors applied qualitative content analysis; this method entails analyzing and interpreting text fragments extracted from scientific literature. The primary objective of this analysis is to explore the various solutions for the challenges faced by IB in the Asian region.

A possible solution to overcome challenges faced by IB

To respond to the research question "What are the possible solutions for the challenges Confronting IB?" authors identified and formulated the following solutions:

1. Introducing Innovative products and services: IB can hamper its ability to introduce new and develop existing products and services to compete effectively in the financial market. Innovations like technological advancement, advanced features, and new ideas in products and services attract customers and differentiate the product from existing offerings in the market.
2. Standardizing Sharia governance for IB: The Sharia governance framework should include a central advisory board at a regulatory level to oversee the standardization of IB practices. The limited availability of qualified Shariah experts within IB can impact their ability to ensure compliance with Islamic principles.
3. Modernizing financial & Marketing strategies: By developing a unique value proposition, creating a comprehensive marketing plan, and leveraging influencers, IB can differentiate itself from competitors and drive growth.
4. Developing a strong alliance with CB and other organizations: Some countries lack sufficient support from the government and central bank, hindering the growth and development of IB. IB may face difficulties in securing adequate support and funding.

5. Ensuring Individual accountancy and audit: Advanced and standardized accounting and audit practices in the IB can lead to consistency and ease in assessing IB's financial performance and stability.
6. Enhancing Public education: Many individuals, both Muslims and non-Muslims, are unaware of the products and services offered by IB, as well as the various modes of IB.
7. Organizing Proper training for employees: Insufficient Staff Training and Financial Literacy: The lack of proper training for IB staff and low financial literacy among customers pose challenges to the IB advancement.
8. Increasing Number of branches: IB needed to expend their operations in both urban and rural areas.
9. Strengthening Confidence on IB structure: Transparency, risk management, collaboration, innovation are important for the growth and sustainability of IB.

The frequencies of these categories are given in Table 1.

Table 1
Frequency table of IB challenges solutions

No.	IB Challenges solutions	Freq.
1	Introducing Innovative products and services	33
2	Standardizing sharia governance for IB	27
3	Modernizing financial & Marketing strategies	22
4	Developing a strong alliance with CB and other organization	20
5	Ensuring Individual accountancy & audit	15
6	Enhancing Public education	14
7	Organizing Proper training for employees	13
8	Increasing Number of branches	10
9	Strengthening Confidence on IB structure	05

The top four categories with the most frequent occurrences are, Introducing Innovative products and services, Standardizing sharia governance for IB, modernizing financial policies and marketing strategies and developing a strong alliance with CB and other organization, these solutions constitute the core of IB, as highlighted in Table 1.

Addressing these challenges is crucial for the advancement of the IB industry.

Furthermore, other categories play a vital role in shaping the development and growth of IB. These factors collectively influence the overall landscape and effectiveness of IB.

To obtain a more thorough knowledge of these solutions, a survey of IB scholars, experts, and clients from different Asian nations will be conducted as a part of the empirical portion of the project.

Moreover, the survey offers an excellent chance to delve deeper into and broaden the scope of these solutions. Scholars, experts, customers, employees, and the public may identify more solutions not explored in existing scientific literature. This broader perspective will provide insightful observations and empower IB to tackle new solutions effectively.

Survey participants' suggestions and feedback will contribute to developing product and service innovation, enhancing the shariah governance framework, updating financial and marketing strategies, and building effective alliances with CB to address challenges effectively. Subsequently, this effort will contribute to IB's long-term expansion and prosperity in Asian countries and beyond.

4. CONCLUSION

In conclusion, our research provided significant solutions to Islamic banking (IB) 's challenges in the Asian region. These solutions are "Introducing Innovative products and services," "Standardizing sharia governance for IB,"

"Modernizing financial & Marketing strategies," and " Developing a strong alliance with CB and other organizations." These solutions are significant for the development and growth of IB.

The first step toward these solutions is to implement them effectively in IB in the Asian region. More research and collaborative efforts can be devoted to putting these answers into action and encouraging the growth and stability of IB.

To overcome the challenges and develop IB, it is required to spread awareness and educate public regarding IB, develop individual regulatory system, proper support from government and central banks, capital market, human capital with expertise, and improved products and services all over the Asia to attract more customers and policymakers encouraging their active involvement in the development of Islamic banking.

Policymakers play a critical role in creating a consistent framework of rules and regulations that promote a favorable environment for the growth of IB in the region. Collaborative efforts by stakeholders and policymakers to tackle these challenges will advance the growth and prosperity of IB in Asia.

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