Financial Intermediation in Muslim Community: Issues and Problems

Alomar, Ibrahim

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Issues & Problems

by

Ibrahim S. Alomar

Department of Economics

Qassim University

Saudi Arabia, Buraydah

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Abstract

It is widely known that Muslim society inherited an interest based financial intermediation system from others instead of developing their own banking system. However, Muslim Economists and scholars around the world made efforts to have and develop their own financial intermediation since there was no initial working model to act upon, except the belief that interest-based financial intermediation might be replaced by an Islamic one on the basis of profit-and loss sharing. During the last four decades, Islamic financial intermediation industry became a reality that the Muslim society around the world can see and practice. However, the Islamic financial intermediation in the world has been facing numerous problems of challenges. It raises a number of issues and potential problems which can be seen from the macro and micro operational point of view. Developing the Islamic financial intermediation depends on clarifying these issues and presenting them in order to focus on them studying and remedying. This paper aims to cover the ground of issues of Islamic financial intermediation that rose during its short age. Such issues prevent Islamic financial intermediation from its operating with its full efficiency level. Even no attempt to remedy these issues, presenting these issues and problems and classifying them according to their type is very valuable for sustained growth and development of the Islamic financial intermediation. Such work is a valuable contribution to build the Islamic financial intermediation industry on sound theoretical foundations.

1. Introduction

Islamic banking is a growing phenomenon, which came into existence to satisfy the financial needs of Muslims around the world who observe the prohibition of Riba (usury). It has been estimated that Islamic banking has grown not only at the annual rate of 15-20 per cent over the past five years to reach the size of $300 billions but has also been expanding outside its traditional borders of Muslim economies (Al-Rifai, 2003). According to Siddiqi three reasons help explain the continued progress in Islamic banking and finance: deficiencies in the current system that make people search for alternatives, the association of the Islamic financial movement with the recent resurgence in Islamic societies, and the strong moral orientation of Islamic finance (Siddiqi, 2002).

In some countries like Pakistan, and Sudan, all banks and financial institutions operate according to Islamic principles. In others, such as Saudi Arabia, Egypt, Indonesia, Jordan, and Malaysia, Islamic banking operates along with conventional banking.

Many high-level practitioners, regulators, academics, and Shariah scholars in the field of Islamic Finance and Economics have studied the different issues of banking institution in the framework of financial intermediation of ideal Islamic economy in order to study or to contribute positively to the growing phenomenon. Most of the work that has been done is to design and strengthen the Islamic financial architecture by establishing tools and ways to introduce the Islamic Financial intermediation services via pure Islamic Financial Institutions or in the conventional institutions.

So many issues and challenges rose during the past few decades of the Islamic institutional financial intermediation. The challenge is to devise an interest-free mechanism to facilitate moving the funds from surplus units to the shortage units in the economy. While elimination of Riba in all its forms is an important feature of the Islamic financial system, there are many issues and problems to consider prior to dealing with a bank or financial institution. None of the issues will be connected to a specific country. They will go to the general Islamic financial intermediation practiced in the world.

Although a number of studies have looked at many issues and problems, this study will contribute to the issue by attempting to manipulate them toward their solution. However, there will be no attempt to go deeply into these issues to solve them; the target is to raise these issues in order to motivate working on them individually or in congregation via workshops and conferences.

These issues can be classified as theoretical issues and practical issues. Theoretical issues have their practical applications while the practical have theoretical basis. However, this classification is related to the base of the issue. If the issue has been raised before its application on the ground then it should be a theoretical issue. Any type of problem raised after implementation of Islamic financial intermediation application should be counted among the practical issues.

Therefore, the paper is organized as follows; the first section is dealing with the theoretical issues while the second is about the practical issues. Many issues will be discussed and raised in the theoretical part. Figh issues, liquidity issue, legal protection issue, mark-up financing issue, allocative efficiency issue, standardization issue, and risk management issue will be discussed as financial intermediation issues in the muslim community. The practical section will cover many issues like Financial Instruments Issue, murabaha mode issue, profit loss sharing issue, profit margin in Murabaha issue, financing social concerns issue, Islamic banks co-operation issue, financing high-return projects Issue, distributive efficiency issue, legal framework issue, globalization of financial markets issue, ideals and actual practice Issue.

Some of these are issues related to the newness of the Islamic financial intermediation, while some others are related to the fact that the Islamic financial intermediation operate under a conventional banking framework or at least side by side with it which causes a lack of efficiency.

This paper provides these issues believing that discussing them and solving them can lead to the improvement and development of the Islamic financial intermediation. The third section is dealing with possibility of future improvement of financial intermediation efficiency in the Muslim community. This section is being followed with the conclusion.

2. Theoretical Issues

2.1 Preamble

The importance of financial intermediation in the economy in general has received great attention since the financial system became an important part of the economy. However, when it comes to the Islamic financial intermediation deeper solicitude is needed. Islamic financial intermediation proves during the past few decades that eliminating forbidden transaction from financial intermediation is possible. The process of establishment of Islamic financial intermediation raised a number of different challenges and issues. Some of these issues are related to the Islamic rules while others are related to the new Islamic institutions themselves, while the rest are related to implementation of the Islamic rules on financial intermediation by the new Islamic financial intermediation institutions.

In this part of the paper, a focus on the theoretical issues leaving the practical issues to the next part. Among theoretical issues, figh issues are the beginning where there is no such agreement about the base of the Islamic financial intermediation which is figh issues. Maintaining high efficiency with enough liquidity is the second issue being discussed in this part. Legal support of the central bank and other government institution is one of theoretical issues that will be discussed in this part of the paper. Also other issues like Mark-up Financing, allocative efficiency issue, standardization, and risk management will be discussed in this part of the paper.

2.2 Figh Issues

One of the important issues that Islamic financial intermediation is facing is related to the great differences between scholars regarding the different economic issues. It is very useful and helpful to reach an understanding to the Islamic rules of all banking transactions. However, the different fiqh streams make it difficult to have an agreement upon the different financial intermediation issues. Second, financial intermediation is not constant regarding the place and time. It improves day by day, country by country, and institution by institution. In addition, transactions figh is unlimited in Islamic figh. These are the sources of the scholar's opinion disagreement, while the unity of the source of the shariah drives toward the unity.

Many Muslim countries and a great Muslim population all believe in the sources of Islam Koran and Sonnah and have the motivation to apply them to financial institutions that they have. Two kinds of policies have been followed. One of them adopted Islamic banking principles on whole system while other countries operated Islamic banking alongside conventional banking. In both cases no common understanding of shariah applied to the Islamic financial intermediation. In the first, differences between these countries while in the second disagreement even in the country itself related to the stream of figh that being followed.

In recent time and because of the Islamic financial intermediation expanding, Islamic banking is increasingly expanding outside the traditional borders of muslin countries into western economies in Europe, US, and East Asia. This adds to the problem since there is no complete Islamic Institution act for controlling, guiding and supervising the Islamic banks and Islamic financial intermediation.

So many different transactions in the financial intermediation have faced not only different opinions but also opposite opinions because of not having a common figh regarding them Usmani, 2000). The transactions figh is so wide in the Islamic figh. Also there are many different streams for this figh. The fast growing in the banking transactions makes it more difficult to have a common figh.

The Islamic rule depends on a composition of understanding the Shariah matters and the transaction matters (Al-Dareer, 1985). The first falls in the domain of the Shariah scholars while the second in the domain of the experts in the respective fields. The gap between the first and the second exists and causes more difficulty of having a common figh about the different issues of Riba, Gharar, Jahalah, Maysir, Mudaraba, Wakalah, Tawarug, Musharaka, Ijarah, Salam, Istisna, etc.

In this case seeking an agreement between scholars and experts about the different issues of financial intermediation is inconceivable which makes it an important issue in the Islamic banking industry (Tahir, 2003).

In addition, most experts in Islamic law, the fuqaha use analogical reasoning and try to make past rulings their guide to a rule for today. Most economists, on the other hand, argue in terms of socio-economic consequences and seek rules that would bring in the desired state of the world. fuqaha are trained to arrive at new rules governing a situation that is wholly or partly novel mostly by analogical and deductive reasoning.

For example, two issues are attracting considerable attention (Zarqa and Elgari, 1991). First is how to deal with delays in payment of debts resulting from sales on credit, while second is permissibility of securitization and sale of debts resulting from murabaha and other credit transactions.

Those who care more about fair dealings and social justice are more concerned with avoiding any involvement with riba/interest, whose prohibition is the first threshold of keeping away injustice and unfair practices. Those who tend to care more for efficiency usually give different rules.

Improving situations is hardly in focus. However, having a common figh will help in many perspectives:

- The relationship between Islamic institutions needs standards of Islamic financial intermediation benchmarks to facilitate the transactions between them.
- The relationship between Islamic institutions and the conventional financial intermediation institutions needs it too.
- The regulation of the governments and the central banks depends on clear Islamic opinions toward the different type of transactions.
- Improving and innovation financial intermediation tools depend on a clear figh.
- Stability of the economy is in need for having knowledge about different issues of the financial intermediation in an Islamic economy.
- All of Islamic financial intermediation transactions depend on clarity of the Shariah matters.
- The authenticity of the Islamic financial intermediation in Muslim community and then the development of the economy can be improved in a better way and faster movement.

In summary, Islamic financial intermediation based on a common figh can be useful to reach better understanding of the Islamic financial intermediation and banking industry. By doing so, effective supervisory norms can be developed to have good and real competition for all countries at all points in time.

2.3 Liquidity Issue

Conventional financial intermediaries emphasize the need for maintaining liquidity and hence require an adequate amount of reserves while seeking the highest returns possible on loans and securities. They try to accomplish these goals in many ways. Conventional financial intermediaries accomplish these goals by seeking borrowers who will pay high interest rates, purchasing securities with high returns and low risk, diversifying their assets to lower risk, and managing the liquidity of its assets so that it can satisfy its reserve requirements without bearing huge costs (Mishkin 1998).

Islamic financial intermediaries are in need for maintaining liquidity more than the need of conventional financial intermediaries. Most of the Islamic financial intermediation uses the real sector in facilitating and providing liquidity. In this case, Islamic banking and financing expose to an extra liquidity risk. It would conceivably require higher liquidity and reserves. This is because of its nature of investment in assets having lesser divisibility and reversibility. That means, reserve ratios for interest-free banking are to be calculated on the basis of risk calculation in various forms of investment.

The complex problem in measuring liquidity is that liability management in the conventional banking system has been gradually replacing asset management to fund liquidity needs. At present, no such facilities exist under the Islamic banking system. As a result, these banks have to depend on their central bank to supply cash. The liquidity ratios required by the banking laws on demand and time deposits differ from country to country. In some countries, the supervisory authorities reserve the right to impose different ratios on different banks according to their location. At present, the liquidity ratio range from 15-35% of demand and time liabilities in some Muslim countries (Mangla & Uppal 1990).

The existing operations of conventional bank's lending activities for definite maturity are based on the doctrine of 'anticipated income theory,' where bank loans are not self-liquidating in the sense of 'commercial loan theory.' These loans are paid off out of the future earnings of the borrower, and are liquid according to their nature, guarantee, and marketability. Since Islamic banks are not based on the same principle, but are investing in assets represented by commodities, shares in companies or working capital of companies, the theoretical probability of these assets becoming liquid is more difficult to ascertain than in conventional banks. Also, greater fluctuations in the liquidity ratio due to the still largely agrarian nature of these economies will significantly affect the ability of Islamic banks to provide credit to private sector. This requires special attention when fixing liquidity ratios for each type of deposit and each kind of investment in order to allow a degree of liquidity higher than conventional banks ((Tahir 2003).

With regard to the elements comprising the liquid assets of Islamic banks, it would be necessary to allow these reserves to be held in the form of financial instruments. Similarly, the bank capital requirements under Islamic banking would be higher to protect the depositors against unexpected losses, if any, on the investment portfolios. Increasing the requirement of legal and loss reserves could provide additional safety cushion.

As the Bank of International Settlements has noted, innovation in three areas is crucial: liquidity enhancement, risk transfer and revenue generation. In its early days, Islamic finance had to focus on revenue generation, as it had to compete with conventional finance and show comparable returns. Times have changed. The need to enhance liquidity and therefore to move toward greater securitization of assets is an important issue.

2.4 Legal Protection Issue

A comprehensive system of Islamic banking requires legal protection. That means a thorough review of all relevant laws having a bearing on banking transactions is needed. At present Islamic banks are working in many Muslim countries without proper legal cover. Therefore, Laws relating to companies, commerce, investment and the courts and legal procedures need to be reviewed and reformulated to suit the requirement of the efficient functioning of Islamic banks (Timberg, 2003).

For instance, in all of the countries, company law contains bonds and interest regulations while ignoring participation deeds and profits. Investment promotion laws should accommodate rules regulations which permit Islamic banks to apply their profit loss sharing modes so that they can participate in partnership businesses either in the form of Musharaka or direct investment.

Also, most of the central banks do not allow banks to deal in the real sector buying or selling while most of Islamic financial intermediations mean purchasing and reselling, two trading transactions. There is also need for special legal cover in order to facilitate and implement musharakah (partnership) agreements by Islamic banks (Chapra, 2000).

Another issue that will continue to be relevant in the foreseeable future is prospect of Islamic banks working in the prevalent interest-based framework. It is obvious that Islamic financial instruments and their documentation and accounting requirement would be different. Therefore, the room for putting Islamic financial norms into practice in the existing framework would be limited.

This, in turn, implies that Muslim countries should consider providing separate legal cover for Islamic financing (Tahir, 2003).

2.5 Mark-up Financing

Islamic mark-up combines the features of a deferred payment sale and a mark-up on price. A bank buys from the market to sell it to clients on a mark-up on the purchased price. The client, in turn, pays in installments.

There is wide apprehension that little difference can be found between mark-up practiced by Islamic banks and conventional banks. However, though not considered strictly interest-free by many Muslim scholars, mark up was seen by the banks as a tool to facilitate the transition to Islamic banking without disrupting the system. Because the ultimate objective of Islamic banking is toward investment-oriented long-term financing, the transition from mark-up to equity finance would also require a larger spread between rates of return to the banks and to their depositors (Timberg, 2003).

It has been argued by a number of writers that real substitute of interest in an Islamic financial system is the mode of profit loss sharing along with Qard Hasana. While the other techniques like Murabaha, Bai-Muajjal, Ijara and Ijara wa Iqtina can not be of equal significance in achieving Islamic socio-economic objectives (Ahmad 1994). The reasoning employed is as follows. Islam disallows the interest system because intrinsically it is a highly inequitable system. The feature that makes the interest based system inequitable is that the provider of capital funds is assured a fixed return while all the risk is born by the user of these capital funds. Justice demands that the provider of capital funds should share the risk with the entrepreneurs if he wishes to earn profit. Financing techniques like Murabaha, Bai-Muajjal, Ijara and Ijara wa Iqtina, which involve a pre-determined return on capital, can not be regarded as commendable substitutes for interest, and should only be used when absolutely needed (Attiyah, 1990).

2.6 Risk Management

The risk management is widely believed in its importance for both financial intermediation systems. It is argued that Islamic banks may suffer a loss of value of their assets in the absence of a fixed positive rate of return. Further, without the provision of insurance Islamic banks may face trouble in making their system stable and avoiding liquidity crises. So far, under Islamic banking, no such insurance system exists (Tahir, 2003).

Theoretically, Islamic banks are likely to face a dual risk: (a) the 'moral' risk due to lack of honesty and integrity on the part of the borrower of funds in declaring a loss, (b) the 'business' risk arising from unexpected market behavior. The deposits under a profit and loss sharing system are conceptually more akin to a mutual fund's share certificate. These deposits would share in both the realized as well as unrealized gains and losses on the investment of Islamic banks (Timberg, 2003).

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The problem associated with proper valuation of Islamic banks' assets has important implications from the point of view of bank safety and bank regulation. Any specification of reserve or provision requirements laid down by the regulatory agencies will have to consider how far the gains (losses) on banks' investments are passed on to the depositors. If in the extreme case, these gains and losses are fully reflected in the value of the deposits, the banks probably would be passing on all the risks to their depositors.

Another problem in determining the profit or loss to be distributed to the depositors of the Islamic banks relates to the periodic evaluation of their assets, especially in case of long term investments, such as Mudaraba, or Musharaka (Ausaf, 1995). In the case of participation term certificates (PTCs), market values could be observable if an active market in these instruments exists. Such a market for the PTCs is not fully developed in countries experimenting with the interest free banking system. The value of long-term investments would fluctuate with the changes in the expected cash flows as well as the opportunity cost of capital. In the absence of an active market in these investments, the valuation process could be very imprecise and costly.

Nature of Islamic financial instruments implies that Islamic banks face not only the traditional commercial credit risk of their clients but also other risks associated with the instruments. For example, market risk for profit-lose sharing financing or potentially damaging claims due to ownership of assets in lease financing. Several such risks can be addressed through design of financial contracts.

Islamic banks are likely to have advantage in risk management as compared with their interest-based counterparts who can make recourse to only the first and the third option.

3. Practical Issues

3.1 Preamble

The purpose of this chapter is to discuss the practical issues of Islamic financial intermediation. The process of establishment of Islamic financial intermediation raised a number of different challenges and issues. There seems to be a gap between the ideals and actual practice of Islamic financial intermediation. The existence of conventional financial intermediation based on interest forces Islamic bankers and scholars to strive for establishing a just financial intermediation institutions with no Riba or forbidden acts during the financial intermediation process. So many issues raised on the ground during implementation of the Islamic financial intermediation. The issues will be discussed in sequence are

3.2 Ideals and actual practice

The ideal reputation of the Islamic financial intermediation in the theoretical work of the Islamic bankers and scholars is facing a great challenge by actual practice of the Islamic financial intermediation institutions. There seems to be a gap between the ideals and actual practices of Islamic banks while a little difference between the banking operations of Islamic banks and that of their conventional counterparts. According to the ideal Islamic financial intermediation, Profit Loss Sharing (PLS) is the main mechanics of the financial intermediation while in practice PLS is rarely being used.

PLS dominates the theoretical literature on Islamic finance. Broadly, PLS is a contractual arrangement between two or more transacting parties, which allows them to pool their resources to invest in a project to share in profit and loss. Most Islamic economists contend that PLS based on two major modes of financing, namely *Mudaraba* and *Musharaka*, is desirable in an Islamic context wherein reward-sharing is related to risk-sharing between transacting parties. Almost all theoretical models of Islamic banking are either based on Mudaraba or Musharaka or both, but to-date actual practice of Islamic banking is far from these models. Nearly all Islamic banks, investment companies, and investment funds offer trade and project finance on mark-up commissioned manufacturing, or on leasing bases. PLS features marginally in the practice of Islamic banking and finance.

Whatever is the degree of success of individual Islamic banks, they have so far failed in adopting PLS-based modes of financing in their business. Different explanations exist for this lack of PLS (***Humayon and Presley,*** 2000). First, PLS contracts are inherently vulnerable to agency problems as entrepreneurs have disincentives to put in effort and have incentives to report less profit as compared to the self-financing owner-manager. In contrast, put an emphasis on the productivity of capital and, hence, show reluctance to bear any losses incurred in production process. This yields from the capitalists' part unwillingness to bear capital risk. So, an entrepreneurs' tendency to exclude others from sharing profits and unwillingness to bear capital risk from other side result in a less favorable response to PLS from the financial and business community (Choudhury, 1998).. Also, PLS contracts require well-defined property rights to function efficiently. As in most Muslim countries property rights are not properly defined or protected, PLS contracts are deemed to be less attractive or to fail if used. *Third*, Islamic banks and investment companies have to offer relatively less risky modes of financing. *Forth*, equity financing is not feasible for funding short-term projects due to the ensuing high degree of risk (i.e., the time diversification effect of equity). This makes Islamic banks and other financial institutions rely on some other debt-like modes, especially mark-up to ensure a certain degree of liquidity.

3.3 Financing high-return projects

Islamic financial intermediation institutions fail to appropriate high profit from high-return projects since the owners of these projects prefer borrowing from conventional banks where cost of borrowing turns out to be lower. That means, only the projects with rates of return equal to or below the market rate of interest are left with the Islamic banks. At this situation, Islamic financial intermediation institutions are not able to invest on the projects having rates of return below the prevailing rate of interest thereby limiting their capacity to utilize investment opportunity to the level of their conventional counterpart. This leads to limiting the application of profit-loss-sharing modes such as Mudaraba and Musharaka. In other words, Islamic financial intermediation institutions, at that situation, switch over to other modes of financing such as Murabaha, hire purchase, leasing, etc (Mahmood, 2004).

3.4 Excessive Resort to the Murabaha and debt Mode

The repeated criticism against Islamic financial intermediation institutions, which is valid in many counts, is that it takes recourse to excessive use of Murabaha mode in financing investment. Yet it is not a violation of Shariah as long as the Murabaha contract is correct from Shariah viewpoint and is free from intentional or nominal deception (Sarker, 2000).

The objection is for many reasons. The first is considering Murabaha to be the same as pre-determined rate of return i.e., rate of interest. From point view of shariah, Murabaha is different from interest-based mark up as long as it has its conditions and satisfies its requirements. However, its way of practice and its effect on macro basis is similar to pre-determined rate of return (Siddiqi, 2002). In addition, most of the banks violate the condition that the goods should be in physical possession of the bank. Thirdly, by this movement from PLS system to Murabaha, a lack of Islamic financial intermediation efficiency is expected. This movement is shifting to conventional banking framework even if the work is lawful from shariah view. Any shift from profit-loss-sharing modes leads the system break the direct relationship between the incomes of the entrepreneurs, the bank and the depositors. The inefficiency of conventional banking exists in Islamic banking in this case.

3.5 The relative inefficiency

Many studies like (Akkas 1996, Ausaf 1995, Siddiqi 2002) showed that Islamic financial intermediation system could be the most efficient system if it were allowed to operate as a sole system in an economy. However, when it starts operation within the conventional banking framework, most of its efficiencies are lost. The study demonstrates that it is not the inherent shortcomings of Islamic banking system that is responsible for its relative inefficiency. Rather it is the continuation of legacies of the conventional banking system that jeopardizes an efficient operation and functioning of Islamic banks in the economy. The policy implication is not that Islamic banks should never be floated within the conventional banking framework. Rather it is the conventional banking system whose operational mechanism needs to be reviewed into PLS-system considering beneficial impact of the latter on the economy. However, as long as Islamic financial intermediation institutions are to operate within the conventional banking framework, most of its hoped efficiencies are lost.

3.6 Financing Social Concerns

Islamic financial intermediation institutions are accused of following the same course of line as pursued by conventional banks as regards financing of social aspects. These banks are usually found to be interested in extending credit facilities to well-established commercial establishments, which often obtain credit facilities from both conventional as well as Islamic banks without real commitment or attempt to free them from the prohibited means of finance (State Bank of Pakistan 2004). In this way, Islamic financial intermediation institutions have in general become a figure that is added to the number of traditional banks, which do business in the country concerned.

Giving concern to the social respect and the comprehensive development concept involves financing those who have no property, providing employment opportunities to all categories of people, and facilitating financing low income people. The noticeable issue is that these remained outside the area of interest of Islamic financial intermediaries. Moreover, Islamic banks did not pay much attention to the development of banking services in some socially desirable directions, except in very rare cases. Neglect doing so as the theoretical approach of Islamic financial intermediation institutions is an important issue which must be raised and discussed.

3.7 Co-operation among the institutions

In spite of good intentions, Islamic financial intermediation institutions are blamed for their lack of mutual co-operation among them. There was a great hope that the International Association of Islamic Banks or the International Islamic Bank would help bringing the Islamic banks together and establishing co-operation between them. However, not all-Islamic banks are members of the International Association of Islamic Banks. Therefore, the Association has neither been able to unify their regulations, nor build bridges of confidence and promote understanding among Islamic financial intermediaries.

As a result of absence of such co-operation, Islamic funds continue to sneak out by hundreds of millions into investment houses doing business in the West yielding that funds of expatriates from Islamic countries do not find their way back to their own countries to contribute to the development of their original homelands while they are in need for them.

Also, trade among countries of the Muslim world is completely paralyzed as the Islamic financing system goes along with the traditional trend in financing imports from foreign countries without giving any preference to products of the Muslim world. Only the

Islamic Development Bank has been paying due attention and care to the need for preferential treatment for the products of Muslim countries.

3.8 The Globalization of Financial Markets

In recent history, money moves across national boundaries costlessly and instantaneously. In principle, this change should be favorable to Islam which never much cared for national boundaries. In practice, however, it does pose problems for the Islamic financial movement, for two different reasons. Firstly, the home base of this new trend is in the Middle East and South and Southeast Asia, where the economies are small and the financial systems less sophisticated than in the developed countries. Secondly, Islamic financial institutions suffer from smallness in size and very few of them operate in more than one country as the major players do. The situation has changed with the entry of some major conventional financial institutions into the field. But this has also made things more difficult for the older Islamic financial institutions, obliging them to consider mergers and consolidation.

Globalization has increased the volatility of almost every financial variable, especially the exchange rates. It has also reduced the efficiency of national economic macro-management. Redress can only come through international agreements curbing speculation and regulating financial markets. In this regard, the insights of the Islamic financial movement concerning sharing modes of finance, commodity-linked financing such as murabaha, PLS, and reducing the role of debt have great potential. Also, Islamic financial intermediaries, with a view to facing globalization and the growing competition either fellow-Islamic banks or the conventional banks which have launched Islamic banking practices, will have to adapts their functioning in line with modern business practices, though improvement and expansion of the range of dealing in the banking sector. Thus, it is necessary for them to provide comprehensive banking and investment services to clients and simultaneously to take advantage of modern technological breakthroughs in areas such as electronic communication, computerization etc.

4. Conclusion

Islamic banking is a growing phenomenon, which came into existence to satisfy the financial needs of Muslims around the world who observe the prohibition of Riba. Therefore, Islamic financial intermediation exists and develops day by day. However, Islamic financial intermediation has been established mostly on micro basis as individual financial intermediation institutions barring Pakistan, Sodan, and Iran. That means Islamic financial intermediaries do not operate as a sole system in their economy. Working with conventional banking or under conventional banking in addition to newness of the Islamic financial intermediation raised many issues and problems.

This study aimed to clarify and classify these issues. The cornerstone in such study then was bringing these issues for more discussion and analysis in order to be solved. Some of the issues mainly could be classified as theoretical issues while others could be practical issues. First part, focused on the theoretical issues. Five different theoretical issues starting with the figh issues were being discussed in the first part. The second were about the practical issues. The seven different issues starting with issue of the gap between ideals and actual practice were being discussed.

No attempt in this study to remedy these issues but to discuss them and raise them for more research. It is clear that there is a need for Re-organization of the whole financial system. For better result, Islamic financial intermediation should never be floated within the conventional banking framework. Rather it is the conventional banking system whose operational mechanism needs to be re-examined and converted into Islamic financial intermediation system considering.

Comprehensive studies about other financial intermediation issues in Muslim community are being needed to provide more information and solutions. Moreover, some of these issues such as monitoring, pooling risks, efficiency, and easing transactions need to be modeled theoretically and tested practically. Policy and regulations as a great part of financial intermediation should be also a part of future work by scholars.

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