A COMPOSITION OF ISLAMIC PERSONAL FINANCING IN ISLAMIC BANKS AND CONVENTIONAL BANKS AND THE PRODUCTS OFFERED

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Abstract: *Islamic personal financing (IPF) has now effectively been a part of the Malaysia Islamic banking industry providing alternative to traditional loans, which are in the form of Shariah acceptable contacts. But few studies have been conducted on the dissimilarity of the structure, disclosure and growth of personal financing between conventional and Islamic banks. The paper is an attempt to compare the personal financing in the two financial systems (Islamic and conventional), taking into consideration the kind of products on the market and the kind of contracts used. This study analyses annual reports of the Islamic and conventional banks and publications of the Bank Negara Malaysia on a timeframe of 2018 to 2023. The results indicate that the conventional banks have depended more on fixed interests on loan system the Islamic banks used mostly Tawarruq, then Murabahah, and Bay al-Inah with high level of variations on reporting transparency. This study concludes that despite the structural difference in products provided by Islamic banks, a majority of them remain similar to traditional financing in practice, which should encourage greater Shariah-based innovation as well as greater consistency in reporting.*

Keywords: Personal financing, Islamic banks, Conventional banks, Personal financing products

1. Introduction

The Islamic personal financing (IPF) has gained popularity in the Islamic banking industry in Malaysia as it provides Shariah compliant alternatives to the conventional personal loan product. These products are organized in the form of contracts, like Murabahah, Tawarruq, and Bay al-Inah, which do not represent riba (interest) and offer ethical finance services. Nevertheless, with expansion of the industry, there has been suggestion that it is not accurate to say that these structures actually match the settings of Islamic finance since in practice, many of them end up just replicating the results of conventional loans. The impact of the COVID-19 pandemic of 2020 was a test not only on Islamic financial institutions but conventional ones as well. Although Islamic banks provided moratorium and restructuring when it was as per the Shariah, use of debt-based contract such as Tawarruq earned them the concern. Little research has been done as to how Islamic personal financing in Malaysia has been affected by the pandemic in terms of individual and collective trends on the part of Islamic banks. Comprehending such changes is crucial to the regulator and institutions that would enhance Islamic finance and maintain its relevance and resilience.

This paper intends to analyze the contents of Islamic personal financing against the traditional personal financing in Malaysia with regards to products offered, Shariah contract employed and their structural variability. It also examines the evolution of these offerings, pre-pandemic, during-pandemic, and post pandemic. Covering the gap of recent comparative analysis, the research aims at leading to more genuine, effective and competitive Islamic financial practices.

2. Literature Review

The guiding principle of having the dual banking system in Malaysia is the coexistence of both the Islamic and conventional bank where each type provides different financial products based on their guiding beliefs. The traditional personal finance works on interest-based agreements where financial institutions benefit on the offer of loans at interest rates, irrespective of the loanee performance. Conversely, Islamic personal financing is organized based on the forbiddance of riba (interest), gharar (uncertainty) and maysir (gambling). It aims at offering financial solutions which are acceptable by the Islamic jurisprudence or Shariah besides being economically effective. Murabahah (cost-plus profit sale), Bay al-Inah (sale and buy-back agreement), and Tawarruq (commodity murabahah) are the most popular Shariah-compliant structures that each entails distinct operation mechanics and consequence (Yusoff et al., 2016).

The Islamic personal financing usually uses Murabahah and Tawarruq as default contracts. As an illustration of this, in the Tawarruq case, the bank, buys a commodity and sells it to the customer at a higher price after which the customer sells the commodity in the marketplace to get cash. This is referred as liquidity equivalent of a typical loan, but it is the underlying Asset purchases and sales that satisfy the Shariah requirements. This may mean that technically the Islamic principles are observed, but the critics will claim that the substantive objectives of Shariah (maqasid al-Shariah) are seldom achieved when practicing contracts only imitate conventional regulations (Asni, 2022; Ahmad et al., 2020). Bay al-Inah which is an old-time common terminology in Malaysia has gradually paved way to Tawarruq because of the fear of the seniority of Shariah scholars based in other parts of the world. Notwithstanding, a few banks continue to use Bay al-Inah especially where local regulatory authorities allow its use.

Numerous literatures have pointed to the differences in operations of Islamic and conventional banks based on financial ratios, asset structure and risk exposure. According to Zineldin (1990), as cited Arafat et al. (2021) Islamic banks tend to have larger cash-to-asset and cash-to-deposit ratio, which is indicative of a more conservative use of liquidity. These financial techniques help the systemic stability of Islamic banks especially during the economic crunches like the COVID-19 pandemic. The capital adequacy ratios (CAR) of Islamic banks are also found to be above the conventional banks implying that Islamic banks are more adequately capitalized and less shaken by financial bad news. This strength that is based on Islamic financial principals of equity and social influence is what separates it as an attractive and appealing feature to an increasing market of ethically sensitive consumers.

Another area of comparison is the consumer preference trends. An analysis of the uptake of Islamic personal financing showed a remarkable change in terms of Islamic personal financing, given that the rate of growth would be 42 percent between 2018 and 2023 against 19 percent of the growth of conventional personal loans (Ismail and Kamarulzaman 2021). This trend is on an upward rise showing the growing demand and confidence to Shariah-compliant financial products. Some of the factors that influence this inclination are religious belief, morality, and fairness of risk sharing conceptions. Moreover, it is estimated that, this is because, most consumers perceive that Islamic banks are more tolerant and compassionate particularly in cases of hardship, because the ethical root of the Shariah promotes compassion and adaptation when it comes to temporary considerations of its financial transactions.

The literature also investigates on the way Islamic banks match the financing products with the values of those clients. In comparison with the traditional loans that are transactional and profit-oriented, Islamic banks are supposed to make sure that the financing process has a wider goal of wealth circulation, fair access to resources, and society well-being. There have, however, been critics of such overuse of debt-based contracts such as Tawarruq which is similar in nature to a normal loan but just different in form. According to Yusoff et al. (2016), these practices erode uniqueness of Islamic banking and create concerns regarding whether banks are undertaking Shariah-based goals or simply beautifying traditional products by wrapping them in a Shariah-friendly manner.

In addition, the Islamic personal financing tends to go through more scrutiny and compliance tests since it is a religious matter. To have continued compliance, Islamic banks must seek approvals offered by Shariah advisory councils and review frequently the product structures to achieve the same. This is unlike in conventional banks whereby the compliance is restricted to regulatory and financial regulations and religious considerations are not involved. Nevertheless, Islamic banks have succeeded in providing competitive and innovative products of personal financing, which has narrowed the distance between religiously conscious and customers in need of stable financing products, which are quite different in terms of conventional products.

3. Methodology

The research method used in the study was qualitative research in the secondary data analysis, by use of inductive analysis. The study considered the structure of Islamic personal financing in relation to the traditional financing by referring to official reports published by Bank Negara Malaysia, annual reports of the sixteen most important Islamic banks and previous scholarly research. The research design was based on the Saunders Research Onion model, where it was decided to use a cross-sectional time frame within 2018-2023. The sample size included 16 Islamic banks that are allowed to operate in Malaysia, namely full-fledged Islamic banks (such as Bank Islam, Bank Muamalat and MBSB Bank) and Islamic subsidiaries of conventional banks (such as Maybank Islamic, CIMB Islamic and RHB Islamic). Information was also carried out by preparing and examining financing data from annual reports and Bank Negara Malaysia's reports, type of contracts used from banks' Products Disclosure Sheet (PDS), and the arrangement of products in the Islamic institutions alongside the conventional institutions.

4. Analysis & Findings

The survival of Islamic and traditional personal financing in Malaysia over 2018-2023 comparative analysis bears some interesting trends, structural mismatches, and implications on the general financial landscape. The initial important observation is the difference in growth of Islamic and conventional personal finance. The growth of Islamic personal financing (table 1; figure 1) increased in which implies a strong and increasing demand of the Shariah compliant alternatives, particularly in times of the COVID-19 pandemic and subsequent times. It was found that consumers have been taking to Islamic financing not just on religious motives but because it was seen to be stable, ethically oriented and flexible in repayment schemes in crisis situations. A structural difference between the two systems is also seen through the kind of contracts adopted. The contracts allow the banks to offer cash liquidity without using riba and therefore, remain Shariah compliant. An example is that the MBSB Bank, Bank Islam, Bank Rakyat, as well as CIMB Islamic exclusively use Tawarruq as their personal financing service. Traditional banks on the other hand employ a more streamlined and traditional loan agreement that pays a fixed rate of interest which is simpler in form and less costly in its management but consists of an inherently non-Islamic product. Such a distinct difference in the composition of products determines the way the two systems serve their clientele and embrace diverse tastes and demands.

Table 1: Total Islamic personal financing and Conventional personal loan

Years	Total Islamic Personal Financing (RM)	Total Personal Loan (RM)
2018	561.503.00	168,626,20
2019	633,386.70	186,845.10
2020	658,524.10	207,511.80
2021	688,098.70	203,650.80
2022	755,559.80	196,794.60
2023	797,065.70	200,500.10

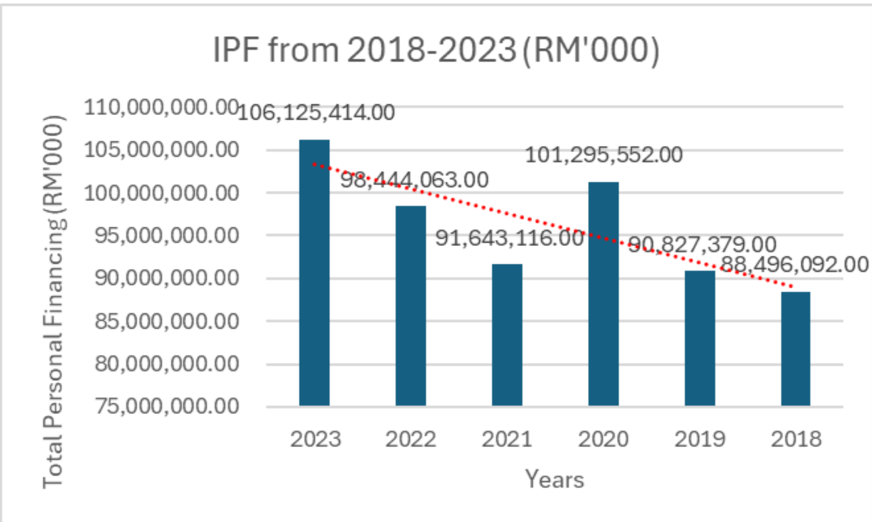

Figure 1: Total Islamic Personal Financing for Each Year

In the case of Islamic banks in Malaysia since 2018, there has been inconsistency in reporting personal financing data as well as transparency. Some of the banks exhibited annual sustainability in disclosure between the year 2018 and 2023, include: Affin Islamic Berhad, Al Rajhi Bank, Alliance Islamic Berhad, AmBank Islamic, Bank Islam Malaysia Berhad, Bank Muamalat Malaysia Berhad, Kuwait Finance House, Maybank Islamic Berhad, MBSB Bank, Public Islamic Bank, RHB Islamic Bank and Standard Chartered Saadiq. This brings transparency, instils stakeholder trust and aids in long-term performance analysis. It is notable that over the last six years, Affin Islamic Berhad portrayed a positive growth in terms of both financial achievements and data transparency in its good governance and Shariah conformity. On the contrary, CIMB Islamic has disclosed numbers only until 2020, 2021, and 2022 but not prior and after that, which restricts the ability to evaluate the trends and question the consistency of reporting. In the same way, Hong Leong Islamic only reported the figures to 2021 to 2023 which left out the time between 2018 and 2020, limiting the past research. Most problematic is the total absence of information about personal financing by HSBC Amanah, OCBC Al Amin, which covers all the financial years 2018 to 2023, and creates doubts regarding their participation in the financing of people, and transparency issue. These differences in reporting activities shows the need to report the financial result consistently, particularly in the assessment of the efficiency and the stability of Islamic personal financing.

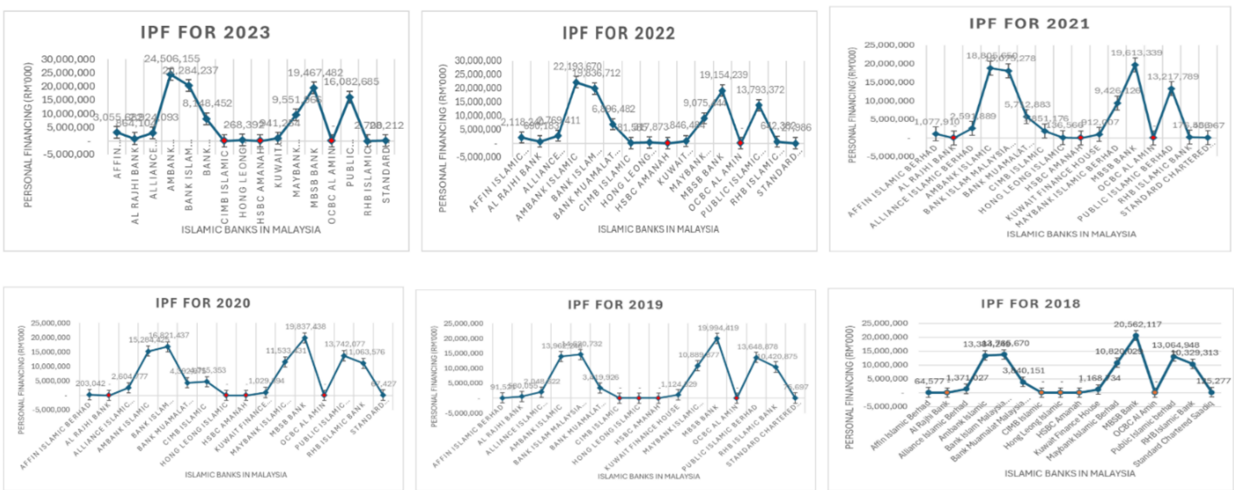

Figure 2: Islamic banks performance by year

The comparison of Shariah contracts that is applied in the Islamic Personal Financing (IPF) across the Malaysian Islamic banks is presented in table 2; where rows refer to the banks and columns contain contracts according to which they are used such as Tawarruq, Bay al-Inah, Murabahah, and Wakalah. Tawarruq becomes the most attributed one, the main framework of which is the most significant by banks, such as Affin Islamic, Alliance Islamic, CIMB Islamic, and Standard Chartered Saadiq. AmBank Islamic integrates the use of Tawarruq and Murabahah, where it includes the latter under the already existing system of Tawarruq like Maybank Islamic does. Bay al-Inah, which is seen as controversial because it is close to interest-based lending is continued to be practised by the Bank Islam Malaysia Berhad and MBSB Bank. Interestingly, MBSB has discussed both, Tawarruq and BBA, in the annual reports, but the official MBSB Product Disclosure Sheet (PDS) refers to Tawarruq as the contract IPF where there seems to be a switch or even a dual implementation. Qard contracts are reported in the Al Rajhi Bank and Kuwait Finance House (KFH), but whereas their reports refer to Murabahah and Qard, their PDS states that Tawarruq is the main IPF structure, followed by the other ones used on a backend basis. Tawarruq is also used by Al Rajhi Bank through Murabahah. Profit sharing contracts such as Mudarabah and Musyarakah hardly feature in IPF; though the latter is used by HSBC Amanah and Public Islamic Bank to non-IPF need. What is most rarely used, based on agency, is wakalah, and it has been seen in a range of limited locations, e.g., at Affin Islamic, HSBC Amanah, and RHB Islamic Bank but not as such in IPF.

Table 2: Contacts offered by Islamic Banks

Banks	**Contracts offered**			
	Tawarruq	**Bai al-Inah**	**Murabahah**	**Wakalah**
Affin Islamic Berhad	IPF			
Al Rajhi Bank			IPF	
Alliance Islamic Berhad	IPF			
AmBank Islamic	IPF			
Bank Islam Malaysia Berhad	IPF			
Bank Muamalat Berhad	IPF			
CIMB Islamic	IPF			
Hong Leong Islamic	IPF			
HSBC Amanah	IPF			
Kuwait Finance House	IPF			
Maybank Islamic Berhad	IPF			
MBSB Bank	IPF			
OCBC Al-Amin	IPF			

Public Islamic Berhad		IPF		
RHB Islamic Bank	IPF			IPF
Standard Chartered Saadiq	IPF			

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