Islamic Banking windows Vs Islamic Banking Subsidiary: Educators’ Opinion In Bahrain

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Abstract: Since its inception in the late 1960’s, Islamic banking industry has been growing significantly and now has been spread all over the world both in Muslim and non-Muslim majority countries. In addition, there are many countries interested in introducing Islamic banking in their banking systems. In order to do so, they are considering two approaches namely Islamic banking windows and Islamic banking subsidiary. This study aims to compare the two approaches in terms of their advantages and disadvantages using literature/library based method which is a kind of qualitative research approach. In addition, structured interviewed with 3 Islamic finance educators in Bahrain were made to gather their opinion about the subject matter. Based on the available literature and results of the interview, the study finds that there are advantages and disadvantages of both approaches. In terms of efficiency and other economic benefits, an Islamic banking windows is found to be preferable especially in the early phase of Islamic banking industry development. However, in term of shariah compliance, an Islamic banking subsidiary is found to be better than Islamic banking windows. This study is expected to help banking regulators and market players in countries that are interested to establish and develop Islamic banking industry in their jurisdictions by providing them with beneficial inputs to make decisions. This study can also be used by Islamic finance educators as a source of reference for them in the teaching and learning process.

Keywords: Islamic banking windows, Islamic banking subsidiary, advantages and disadvantages, Islamic banking and finance educators.

1. Introduction

Islamic banking and finance has been growing significantly since its inception in the late 1960’s. For example, during 2009-2013, the industry grew at cumulative annual growth rate (CAGR) of 16.94% which is considered impressive (Bank Negara Malaysia, 2014). The industry is now becoming a global phenomenon since more and more countries want to implement Islamic banking in their jurisdictions. There are actually two approaches that can be used by any countries in order to implement Islamic banking in their jurisdictions namely Islamic banking windows and Islamic banking subsidiary (Sole, 2007). Some countries like Malaysia and western countries allow conventional banks operating in their jurisdictions to have Islamic banking services through Islamic banking windows while countries in the Middle East prefer an Islamic banking subsidiary. For example, Qatar banned conventional banks in the country from offering Islamic windows in 2011 (Farook, 2011).

Islamic banking windows are simply defined as special facilities offered by conventional banks to provide Islamic banking services to customers who wish to deal with Islamic banking. On the other hand, Islamic banking subsidiary is defined as Islamic banking products and services offered by subsidiaries of conventional banks, but the operation and management of the two are clearly separated (Sole, 2007). It is clear from the definitions that both alternatives are different in nature.
Therefore, this study attempts to analyze the advantages and disadvantages of those two approaches. This study can be used as inputs for the regulators, market players and other stakeholders who wish to establish Islamic banking operations in their respective countries. This study is also expected to add value to Islamic banking and finance literature that can be used as an input by Islamic finance educators in their teaching and learning process.

2. Literature Review

Review of literature reveals that there are several studies that discuss the issue of Islamic banking windows and Islamic banking subsidiary. Iqbal (1997) considers Islamic banking windows and Islamic subsidiary as two market trends within Islamic financial systems. The article highlights some advantages and disadvantages of both approaches. In term of advantages, Islamic banking windows are seen to offer efficiency since the current infrastructures of conventional bank can be used to offer Islamic banking services. On the other hand, Islamic banking subsidiary is seen as a better way to penetrate potential Islamic markets since it is well perceived by Muslim depositors.

Rosly (2005) is in the opinion of favoring Islamic banking subsidiaries over Islamic banking windows. He highlighted some disadvantages of Islamic banking windows that can be addressed by Islamic banking subsidiary such as mixing reserves between Islamic and conventional banking operations and financial reporting issue especially with regards to capital adequacy and full disclosure of Islamic investments. However, Rosly (2005) also highlights some challenges that need to be addressed in opening Islamic banking subsidiary such as higher overhead expenses and smaller marketing network. Sole (2007) identifies several advantages of offering Islamic banking services through Islamic banking windows such as the bank can use its existing infrastructure and network to offer Islamic banking products. Thus efficiency is an advantage. However, possible comingling of funds has been identified as a disadvantage of Islamic banking windows.

Abdul-Majid and Hassan (2011) compares the efficiency of Islamic banking windows, Islamic banking subsidiaries and full-fledged Islamic banks in Malaysia during 2006-2008 period. Using a stochastic frontier approach (SFA), the study found that conventional banks with Islamic banking windows are more efficient in overall than conventional banks with Islamic subsidiaries and even full-pledged Islamic banks. Farook (2011) evaluates the decision taken by Qatar Central Bank (QCB) that banned conventional banking to participate in Islamic banking using Islamic banking windows scheme in 2011. The study identifies several disadvantages created by the decision such as limiting the access of Islamic banking to the international capital markets, lowering the efficiency and limiting competition. On the other hand, the study also identifies several disadvantages of Islamic banking windows such as weak shariah governance and leaking of Islamic funds into the conventional system.

Farrar (2011) highlights the experience of several countries such as Hong Kong, Malaysia and Singapore in offering Islamic banking services either through Islamic banking windows or Islamic banking subsidiary as references for Australian regulators and market players in accommodating Islamic banking and finance in Australia.

Hidayat (2015) compares the advantages of Takaful Islamic windows and Takaful subsidiary. The article lists several advantages of Islamic windows in terms of distribution channels, less time to achieve break event point due to the ability of the company to capitalize on its current infrastructures. However, the article also highlights several disadvantages of Islamic windows such as comingling of funds and creating misunderstanding in the public with regards to the differences between Takaful and conventional insurance since both services are offered under a single roof.

3. Research Methodology

This study employs literature/library based method which is a kind of qualitative research approach. This methodology has been used
by Sole (2007) and Farrar (2011). In addition, structured interviewed to 3 Islamic finance educators in Bahrain were made matter to get their opinion about the subject. The 3 Islamic finance educators are currently attached with higher institutions in Bahrain that have Islamic finance programs. The interview results and the information gathered from the available literature are used to structure the discussion on the subject.

4.1 Islamic Banking Windows Vs Islamic Banking Subsidiary

The discussion on the advantages and disadvantages of Islamic banking windows and Islamic banking subsidiary will be arranged into (i) advantages of Islamic banking windows; (ii) disadvantages of Islamic banking windows; (iii) advantages of Islamic banking subsidiary and ; (iv) disadvantages of Islamic banking subsidiary. The discussion was developed based on extensive review of available literature (Iqbal, 1997; Rosly, 2005, Sole, 2007; Abdul-Majid and Hassan, 2011; Farook, 2011, Farrar, 2011; Hidayat, 2015) and the interview results which were meant to gather the opinion of Islamic finance educators in Bahrain about the subject.

4.1 Advantages of Islamic Banking Windows

Review of literature and interview results reveal the following advantages of Islamic banking windows:

1. Implementation of Islamic banking windows requires less effort and more efficient than establishing an Islamic banking subsidiary. Thus, it is an effective and efficient way of increasing the number of institutions offering Islamic banking services.

2. Islamic banking windows are also a faster and easier way to attract customers since Islamic products and services can be promoted using the same channel of distribution as its conventional counterpart.

4.2 Disadvantages of Islamic Banking Windows

Review of literature and interview results reveal the following disadvantages of Islamic banking windows:

1. Islamic banking windows are purely on commercial objectives. Priority of the management and board of directors of the conventional banks is to maximize profit and not the spirit of benefiting the society at large (maslahah) and compliance with the requirements of shariah.

2. Difficult to compare the performance and ensure adherence to shariah. The performance of Islamic banking windows may be largely contributed by the overall performance of the bank itself. To comply with shariah principles is also not an easy task because of ignorance and lack of understanding of the employees about shariah principles.

4.3 Advantages of Islamic Banking Subsidiary

Review of literature and interview results reveal the following advantages of Islamic banking subsidiary:

1. From the Islamic point of view, Islamic banking subsidiary would promote and provide the true/ ”real” spirit of Islam since there is no commingling of funds. Thus, it is more shariah compliant than Islamic banking windows.

2. In terms of man power, the employees of the subsidiary are more focus on Islamic financial services as a whole as compared to Islamic banking windows, where they are also responsible for the conventional services. In fact, this will create a larger pool of banking personnel that are conversant and competent.

4.4 Disadvantages of Islamic Banking Subsidiary

Review of literature and interview results reveal the following disadvantages of Islamic banking subsidiary:

1. In establishing the subsidiary, it takes more time to develop sufficient infrastructures to support the whole structure of the Islamic banking subsidiary, it needs to amend regulatory requirements and build customer base and earn customer loyalty.
2. Establishing Islamic subsidiary is costlier than Islamic banking windows. This is because, to have a separate banking subsidiary that operating on its own rather than in one roof will involve duplication of resources. In other words, the bank needs to invest more in technology, human resources, bank branches as well as capital, whereas, in Islamic banking windows the same technology and the same expertise can cater for both Islamic and conventional banking services.

Based on the literature review and Islamic finance educators’ opinion gathered through interview, it is found that both approaches have advantages and disadvantages. While Islamic banking windows offer better efficiency and operational effectiveness, Islamic banking subsidiary offers better compliance with shariah.

5. Conclusion and Recommendations

Comparing Islamic banking windows and Islamic banking subsidiary, it is found that Islamic banking windows are a good approach at a preliminary stage of Islamic banking development. However, in term of shariah compliance, an Islamic subsidiary is found to be better than Islamic banking windows. Therefore, if Islamic banking windows approach has to be used, it should only be on a provisional basis as a stimulus for the development of the industry. Once the market has accepted Islamic banking, spin-off should be highly encouraged. The discussion on Islamic banking windows and Islamic banking subsidiary in this study should be incorporated in Islamic banking and finance courses such as “Theory and Practices of Islamic Banking and Finance” course in order to be well understood by Islamic finance students. This will help the students to better understand the differences between the two approaches. This study like other studies has some limitation that can be addressed by future studies. First, this study is developed based on available literature and the opinion of 3 Islamic finance educators in Bahrain. Exploring the opinion of Islamic finance educators in other countries as well as the opinion of industry practitioners will enhance the discussion about the issue of Islamic banking windows vs Islamic banking subsidiary. Second, the study uses qualitative research approach, employing quantitative research approach will complement the discussion on the subject. Finally, further study can analyze the impact of Islamic banking windows “spin off” into financial performance of the new Islamic banking subsidiary and the parent company.

References


