

## INTRODUCTION OF ISLAMIC BANKING IN ZIMBABWE: PROBLEMS AND CHALLENGES

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### ABSTRACT

Islamic banking provides a great opportunity for the banking sector in developing economies to be efficient. The research's objective was to explore the problems and challenges likely to be faced in introducing interest free banking services in Zimbabwe. The readiness and awareness of such challenges will ensure Islamic banking system to fully utilize its potential. The research found that Islamic banking could not operate with its full efficiency level if it operates under a conventional banking framework. It also revealed that there may be resistance to change as Christianity dominates and Muslims are just a small group. The education and dissemination of information will be hampered by the bureaucratic nature in the organizations expected to spearhead the program. Personal interviews and document reviews were used to gather data for the research. It is still possible to introduce full-fledged institutions with cooperation of the central bank, Ministry of Finance, research institutions, media, and the banking community.

**Keywords:** Islamic Banking; Efficiency; Effectiveness; Problems; Challenges

### INTRODUCTION

The implementation of an interest-free banking raises a number of questions and potential problems, which can be seen from different dimensions. For the introduction of Islamic finance in Zimbabwe, there is need to educate the public on its nature, opportunities, and strength.

The status of the banking system in Zimbabwe requires a different way of doing business. This may go a long way into solving the economic problems faced by the country. With many firms (businesses) having collapsed due to prohibitive high cost of funds, a non-interest system will bridge the gap. The interest rate regime has caused financial disintermediation in the economy contributing to the collapse of the economy and contraction of Gross Domestic Product (GDP) Njanike, 2008). Njanike recommended and explained good reasons and opportunities for the introduction of Islamic finances in Zimbabwe. An Islamic bank is an intermediary and trustee of other people's money, with no interest being charged on loans and deposits (Presley & Dar, 1999). All the activities are done in accordance to the Shariah law.

The Islamic banks in the world have been facing a number of challenges. The implementation of an interest-free banking raises a number of challenges, which can be seen from a number of perspectives. For example, in Bangladesh they have not yet been successful in devising an interest-free mechanism to place their funds on a short-term basis. They face the same

problem in financing consumer loans and government deficits (Sarker, 1999). In Bangladesh, there was also a problem of a lack of legal support of the central bank. They did not have the necessary expertise and trained manpower to appraise, monitor, evaluate, and audit the projects that were required to be finance. As a result, they can not expand, despite having a hge excess of financial liquidity.

In Zimbabwe, problems may include political intervention in selection of borrowers, financial instability, and inability of the government to restore law and order in the country that can have a major influence in the implementation of Islamic finance in investment projects. Potential problems on implementation can be seen from the macro and micro operational point of view; this paper focuses on the macro operations. The paper seeks to answer the following research questions:

- (i) Is the introduction of Islamic finance feasible in Zimbabwe?
- (ii) What are the problems and challenges that Islamic banking faces on its implementation?

## **METHODOLOGY**

Document review and personal interviews were used to gather data for the study. Research papers on Islamic banking, textbooks, magazines, and websites were used to analyze information for this paper. Interview questions were prepared with the help of some banking experts and structured to enable everyone to answering it to contribute something. There was an introductory statement explaining what Islamic finance is all about. Of the total of 40 interviews, 30 were face to face and 10 were via the Internet by using Facebook. Half of the respondents were from countries that have Islamic finance in existence, such as Bangladesh, Malaysia, and Kuwaiti. Among those interviewed include economists, researchers, financial analysts, and bankers.

## **LITERATURE REVIEW**

Islamic finance will go a long way into solving problems associated with inappropriate or ineffective interest rate regime (Njanike, 2008). The Islamic-based system of finance has proven itself to be entirely feasible and sound (Khan, 2004). Islam prohibits doing business with “riba”, or usury/interest, with emphasis is on Profit Loss Sharing (PLS). According to Khan (2004) the beauty of equity-based finance is the emphasis on the expected profitability of business ventures. Siddiqui (2003) maintained that the emphasis that ensured that entrepreneurs from all social classes, regardless of their asset-base, can successfully obtain credit. The sharing of risks, the sharing of profits, and the sharing of losses lead to a more equitable outcome for all of society. This is what the structure of the Islamic banking system promotes (Presley & Dar, 2000). Siddiqui (2003) argued that interest based loans (under conventional banking) do not necessarily go to finance projects expected to be most productive (profitable) resulting in inefficiency of the system.

## **PROBLEMS AND CHALLENGES**

According to Sarker (1999), Bangladesh faced a lot of challenges in its infancy. They were not being successful in devising an interest free mechanism to place their funds on a short-term basis. The risk involved in profit-sharing seemed to be so high that almost all of the Islamic banks in Bangladesh had resorted to those techniques of financing, which brought them a fixed

assured return (Sarker, 2000). There was a lot of genuine criticism that these banks had not abolished interest; they had, in fact, only changed the nomenclature of their transactions.

Islamic banks did not have the legal support of the central bank in Bangladesh (Alam, 2000). They did not have the necessary expertise and trained manpower to appraise, monitor, evaluate, and audit the projects that are required to finance. The moral integrity of the entrepreneurs of Bangladesh may be assumed to observe the huge amount of bad debts that have caused serious problems for clean Islamic banking (Ahmed, 2000).

Political intervention in the selection of borrowers, shock of financial instability, inability of the government to restore law and order in the country, especially framing law regarding the recovery of bad debts, and so on have a major influence, causing poor implementation in investment projects (Sarker, 1999).

Problems in India included lack of capital markets and interest-free financial instruments and insufficient legal protection (Khan, 2004). The lack of unified Shariah rulings and the absence of Islamic inter-bank money market can hinder the development of the Islamic banking in its infancy (Yamirudeng & Haron, 2003). Severe competition in the financial sector, economic slowdown, and political situation of the country affected the development of Islamic banking in Bangladesh (Anouar, 2002). The lack of inter-country study on the practical operations of Islamic banking, as well as coordinated research work on Islamic economics, banking, and finance may also hinder the success of Islamic banking in an economy (Nordin & Hamid, 2001).

## RESULTS

The table below shows the professions of the interviewees from within and without Zimbabwe.

**Table 1: Profile of respondents**

<b>Respondents</b>	<b>Total</b>	<b>F</b>	<b>Z</b>
Economists	10	3	7
Researchers	12	10	2
Financial Analysts	4	1	3
Bankers	6	6	0
Others	8	0	8
	40		

F-Foreigner Z-Zimbabwean

## RELEVANCE

After explaining the background, issues, and relevance of Islamic background, a question was asked whether Islamic banking would be relevant to a developing country, such as Zimbabwe. The majority of the respondents (96%) agreed that Islamic

banking would help solve some problems being faced by the economy. Only 4% of the respondents thought that it's not necessary, as the present banking system is capable of solving other problems. They also pointed out the need to address other factors affecting the economy, rather than changing or introducing a non-interest based system.

On the issues related with the interest rate regime problems, 90% of the respondents agreed that Islamic banking will solve many of these problems. They pointed out that as many firms (borrowers) could not borrow, due to prohibitive interest rates, this certainly was the only way to boost and resuscitate production in the economy. On savings, the non-interest banking system would be boosted, according to the majority (84%) of the respondents. The current conventional banking system has discouraged savings, due to negative real returns, causing financial disintermediation in the economy.

Seventy-five percent of the respondents believed that the introduction of Islamic banking will see improvement or growth in Gross Domestic Product (GDP). Forty-eight percent noted that the manufacturing sector would be the greatest beneficiary, especially in the infancy stages with progress being made in other sectors with time. The agriculture sector, as many pointed out, had heavy reliance on direct government sponsorship or funding for most of its activities and projects. Thirty percent of the respondents agreed that with the vast opportunities in the agriculture sector, Islamic banking would be a great booster.

On the attraction of investors, all respondents agreed that it will attract investors seeking halal(Muslim Law compliant) investment distinctions for their funds. Of the 20 people out of Zimbabwe interviewed, all agreed that Islamic finance would attract surplus funds in the oil rich countries, who are seeking diversification of their funds. Ninety percent of the foreign interviewees pointed that as Islamic banking would be introduced, it will attract more players in the financial sector, thereby increasing competition in the sector. All agreed that efficiency would increase, improving the effectiveness of the sector in the economy.

All respondents agreed that with proper policies and guidelines, the Islamic banking system will go a long way into turning around the fortunes of the economy. Half (50%) of the respondents pointed out a number of problems and challenges, that can be encountered on the introduction of Islamic banking. The problems and challenges pointed out are micro and macro, in nature. This paper focuses mainly on the macro problems and challenges encountered from the implementation stage up to the full operational stage in an economy.

## **PROBLEMS AND CHALLENGES**

All respondents pointed out that the political intervention in the selection of borrowers may hinder the progress of Islamic banking in the economy. A directive of the government to lend to a priority sector may reduce the flexibility and innovativeness of Islamic banking. One respondent gave an example of where the bank is forced to lend to a certain group or sector with low yields at the cost of high yielding (more profitable) projects.

Sixty-eight percent noted the issue of shock of financial instability associated with the introduction or the initial stages of Islamic banking in the economy. However, seventy percent believed that the inability of the government to restore law and

order in the country, especially on framing law regarding the recovery of bad debts, may hamper Islamic banking to achieve in achieving its objectives. Law should not be selective and no one should be immune to prosecution, as there is a problem of bulldozing by political heavyweights in countries such as Zimbabwe.

About ninety percent noted that there may be resistance from the banking community because of the conventional banking dominance. Christianity dominates in Zimbabwe and nothing with another religion attachment may be easily welcome. It was also pointed out that there may also be disruptions from the existing conventional banking institutions for fear of competition in the country. The fear of competition from international banks bringing in a new philosophy of doing business may make the entrance of new players very difficult.

A majority of the respondents (60%) pointed out the lack of infrastructure for information dissemination to the public as one of the problems likely to be experienced by the development of Islamic banking in Zimbabwe. With many systems having degenerated with the need for reconstruction or resuscitation of most of them, it may not be easy to penetrate the market. All respondents pointed out that the immature introduction of Islamic banking in Zimbabwe before economic recovery may not only lead to slow development, but to a total failure.

The regulations and laws governing the Islamic banking institutions may be an uphill task for the monetary authorities of Zimbabwe who have made numerous blunders in the past. More than fifty percent of the respondents had no confidence in the monetary authorities, judging from the management and formulation of policies in the period of 2000 to September 2008, when this paper was written. The lack of consistency in policy making and implementation of the fiscal and monetary authorities may be a major problem/challenge to be faced by the Islamic finance institution in Zimbabwe. It was also noted that the divided attention on the current and new Islamic banking in the economy may be enough for the leadership in the central bank to resist it. Only 10% of the respondents noted that the coexistence of the different banking systems may not be the best environment for optimal performance of Islamic banking.

The controlling and supervision by the central bank of Islamic banking on the basis of Islamic law or Shariah, by people with no background of Islamic finance, may be a big problem in the running of affairs of these institutions. The majority also pointed out that judging from the way the central bank has been conducting its business, it may be a daunting task for the authorities.

More than eighty percent pointed out that the absence of Islamic interbank money market may be an obstacle in the trading or success of Islamic banks. When a single institution is running in the country, there will be no other counterparties to trade with in Islamic (non- interest) accepted short and long term securities. This may hinder the success or quick penetration of the market by the Islamic banking system. It was also noted that the absence of supportive and link institutions may hinder the development of the non-interest banking system in Zimbabwe. They also highlighted the absence of Islamic studies in the local academic institutions. This may slowdown the development of Islamic banking in Zimbabwe. The lack of skilled and trained manpower in Islamic banking will certainly hinder progress.

The other problem that was cited by more than eighty percent of the respondents was the association of the term “Islamic”, which many may associate with terrorism or spate of terrorism attacks in the world. The challenge is to change the perception of people on Islamic economics and emphasize on the relevance of the concept, itself.

All respondents pointed out the current economic and political situation as the major hindrance in the development of Islamic banking in Zimbabwe. Unless the situation improves, the current situation does not warrant new business or attract any international investors. The majority of the respondents also pointed out that there is a problem of default culture that will certainly hinder the development of Islamic banking in Zimbabwe.

### **Discussion**

Islamic banks can provide efficient banking services to the nation if they are supported with appropriate banking laws and regulations (Sarker, 1999). For distributional efficiency, the task is more challenging for Islamic banks, as they have to promote it from all dimensions, together with profitability. On establishment, Islamic banks have to be converted into profit-loss-sharing banks by increasing their percentage share of investment financing through Profit and Loss (PLS) modes. The Islamic banks, to do that, can be selective in choosing clients for financing under PLS modes. They should establish direct functional relationship between the income of the depositors and the income of the bank and the entrepreneurs.

For the Islamic financial institutions to withstand competition, the challenge will be to promote the image of Islamic banks. Strategists have to be carefully devised so that the image of Islamic character and solvency as a bank is simultaneously promoted. Pilot schemes, in some selected areas or projects, should be started to test innovative ideas with profit-loss-sharing modes of financing as major component. Islamic banks would clearly demonstrate their actions that their banking practices are guided by profitability criterion, thereby establishing that only Islamic banking practices ensures efficient allocation of resources and provide true market signals through PLS modes. Islamic banks should continuously monitor and disseminate through various means the impact of their operations on the distribution of income, primarily between the bank and two other parties: the depositors and the entrepreneurs, and then on different income groups of the society. These presuppose establishments of a fully equipped research academy in each Islamic bank (Nordin & Hamid, 2001).

Islamic banks, with a view to facing the growing competition either from fellow Islamic banks or from the conventional banks, which have launched Islamic banking practices, will have to adapt their functioning in line with modern business practices, through improvement and expansion of the range of dealing in the banking sector. It will be necessary for them to provide comprehensive banking and investment services to clients and simultaneously to take advantage of modern technological breakthrough in areas, such as electronics, communication, and computerization. According to Khan (2004) the banking industry is changing fast. Khan stated that the following factors are believed to be responsible for the changing dynamics of the industry: changing client needs for financing and investment; cost reduction strategies and technologies; emerging new potential markets with different demographic and social characteristics; technology based financial services products; and regulatory reforms to align with financial modernization. It was argued that each one of these factors is

contributing dynamism in the industry and, hence, introducing a new competitive environment and making the environment more and more challenging for the Islamic banking movement.

There seems to be a gap between the ideals and actual practice of Islamic banks in many countries that it is in existence. In their reports, booklets, bulletins, and posters, banks express their commitment to striving for establishing a just society free from exploitation. This study showed that a little progress has been achieved so far in that direction. Although this failure is mainly attributed to the pervasive influence of the conventional banking system, itself, lack of vigilance of the promoters of Islamic banking, in realizing the objective, is no less to blame. In such cases, there should be a thorough review of policies being pursued by the institutions. Points of departure have to be identified to redesign their course of actions.

The problem of allocative efficiency can be improved by satisfying social welfare conditions in the following manner (Sarker, 1999). First they should allocate a reasonable portion of their investible funds in social priority sectors, such as mining, agriculture, small and medium enterprises, and export-led industries, like garment manufacturing. Secondly, when the percentage shares of allocation of investible funds are determined among the sectors of investment financing, profitability of projects should be the criterion for allocating investment funds. The criterion would be best satisfied if more and more projects were financed under PLS modes.

A highly wanted assurance to the growth of Islamic banking is the establishment of training institutions in the countries where they are working (Institute of Islamic Banking and Insurance, 2008). The professional investment training is costly and there has to be a huge government capital investment support for the program to be a success. Some efforts of the Muslim countries to create a riba-free Islamic society have largely not been successful due to some people who are selfish and greedy. They will borrow on non-riba basis and not disclose profits completely. The problem is compounded when other honest people see such people earning much better returns than they earn under their non-riba system, their dissatisfaction coupled with the confusion on whether present day interest is riba or not, tends to attract them to the riba-based system. For profits and transparency in firms benefiting from Shariah loans, the introduction of profit-related pay for managers and employees shared ownership plans will increase public confidence in the system. Islamic banks should play a role similar to that of institutional investors. This requires adequate changes in business operations and investment strategies of the Islamic banks to accommodate their dual role of investors and shareholders in the business of the borrowing firms. Banking regulations would need serious overhauling. Regulations in Zimbabwe prohibit banks from taking controlling rights in corporation or structured so that managers of the borrowing firms control their decision-making. The name “Islamic” can be done away with for its development worldwide as it becomes acceptable. Islamic banking products used different names for their product and it has caused several difficulties and misunderstandings by customers. Some claimed that it is a religious product and only meant for Muslims, and others just find it too difficult to learn the names, therefore they stay away (Nordin & Hamid, 2001). In its introduction in Zimbabwe, the Islamic banker should ensure that things become easy for customers. There is nothing wrong in using product names that are more acceptable to the rest of the world.

In Bangladesh, two professional bodies, the Islamic Economics Research Bureau and the Bangladesh Islamic Bankers Association, took practical steps for imparting training on Islamic economics and banking to a group of bankers. They were also involved in arranging some national and international seminars/workshops to mobilize local and foreign people and attract investors to come forward to establishing Islamic banking in that country. The moral integrity of the entrepreneurs of Bangladesh may be assumed to observe the huge amount of bad debts that have caused serious problems for clean Islamic banking.

For investment, Islamic banks should take position only after the technical, economic, and financial viability has been examined and appraised. A professionally equipped Islamic bank needs to invest in assets, providing a return in excess of the cost of the funds tied up. For this purpose, it is important to ascertain the cost of capital, which is equivalent to the required rate of return. Below which a company may not undertake investment without producing its present net worth and the wealth of its owners or equity shareholders.

## **CONCLUSION**

What was discussed are some of the burning problems confronting the Islamic banks in all countries that they are operational in. However, for Zimbabwe, it is felt that much operational work and in-depth research work has to be undertaken to allow the Islamic banks to flourish with highest quality and strength. The government of Zimbabwe should think actively for the promotion of Islamic banking in the country, considering its pro-development role. It should amend existing financial laws, acts, and regulations to create favorable environment conducive to smooth operation of Islamic banks. A commission may be entrusted to draft an Islamic Banking Act. The government should also allow establishment of Islamic insurance and other subsidiary companies in order to facilitate their operation. The Reserve Bank of Zimbabwe would have to develop some Islamic monetary and saving instruments, create a separate window for transactions with the Islamic banks, and a full-fledged Islamic banking department for analyzing, supervising, monitoring, and guiding purpose, thereby facilitating Islamic banks for their smooth development in Zimbabwe. The world is becoming weary of the instabilities, inflation, and poverty that are a gift of the present economic system. The non-interest system gives us an economic system for sustainable development. Slowly and gradually, without realizing it, the world is moving towards discovering the concepts that form the bases of Islamic economics. Finally, the problem that may arise in the name, "Islamic" but it's in the concept. We could find that only if we do enough research and use the intellect and wisdom that was gifted to us, these problems and challenges will be overcome.

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