

Measuring the Readiness of Conventional Banks to Shift into Islamic Banks: A Case Study of the Commercial Banks in Libya.

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Abstract

This paper aims to identify the readiness of conventional banks in Libya to shift into Islamic banks. It has discussed the readiness of a sample of six main traditional banks in Libya with respect to their experience of Islamic banking instruments, acceptance of managers, staff and bank customers for the idea of transforming their bank systems into the Islamic system, and also with regard to the internal bank regulations that can support the transformation into the Islamic system, and also with respect to the current computer system existing in banks and their readiness for the implementation of Islamic banking operations with respect to time and effort needed for bank's transformation, and finally to the idea of Islamic bank's possibility of providing Shariah supervisory board.

In this study, a questionnaire was developed in order to find out information and data related to the topic. Some statistical methods such as the weighted mean, standard deviation, ANOVA test, and Post Hoc test were used in order to discover the readiness level of conventional banks to shift into Islamic banks.

This study found that there was a statistically significant difference between some of the Libyan banks surveyed with relation to training of their staff on Islamic banking instruments. It also found that there was a statistically significant difference in the internal regulations for supporting the idea of transforming into Islamic banks.

Keywords: Islamic banks, Conventional banks, Libya.

Introduction:

Islamic banking is regarded as an interest free system, based on profit and loss sharing principles. It began in the late twentieth century and has long been drawn out enormously in the last 20 years (Akbar et al, 2012, 353). With the fast growth of the global economy along with the increasing economy of Islamic countries, Islamic banking is evolving to play an essential role in the world. Exponential development in the last decade has resulted in Islamic banks' expansion in over 53 countries with a total of 400 banks (Butt et al., 2011, pp. 259-260). Islamic banking is an area that has burgeoned to become progressively substantial part within the global financial market. It has been known as a practical and competitive form of financial intermediation, not only in Muslim countries but also outside the Muslim world, contributing and offering a wide range of financial products and services (Dusuki, 2008, p. 132). To comprehend Islamic banking in its entirety needs full understanding and knowledge of its aims and objectives as well as its philosophy. As a Shariah-oriented business entity, an Islamic bank is strongly expected to be guided by the philosophy of Islamic business (Dusuki, 2008, p. 134).

The Islamic banking system, which is considered as the backbone of the Islamic financial system, plays a significant role in mobilizing deposits and providing financing to assist economic growth. In recent years, financial institutions have practised a dynamic, fast-paced and competitive environment at a cross-border scale. One of the most growing parts is the new paradigm of Islamic Banking, which has remarkably taken the interest of both Islamic and modern economists. Despite the fact that most Islamic Banks are originated within the Emerging and/or Middle-East countries, many worldwide banks in developed countries have started to value the enormous request for Islamic financial products (Sufian, 2007. P. 17).

Al Nasser and Muhammed (2013, p. 80) define Islamic banking as “a banking system that is based on the principles of Islamic law (also known Shariah) and guided by Islamic economics. Two basic principles behind Islamic banking are the sharing of profit and loss and, significantly, the prohibition of the collection and payment of interest. Collecting interest is not permitted under Islamic law”. The Islamic banking system and activities are based on Islamic law (Shariah) which mainly differs from the conventional banking system in the financing activities on profit-and-loss sharing arrangements (PLS) or the buying and resale of goods and services to form the foundation of contracts. In addition, Islamic law forbids usury, which is called *riba* (Beseiso, 2014, p. 7).

Al-Omar and Abdel-Haq (1996, p. 27) indicate the responsibility of Islamic banks towards the society in which they work by providing a clear expression outlined in the public statement of the International Association of Islamic Banks: The Islamic Banking system involves a social suggestion which is essentially linked to the Islamic order itself, and signifies a special characteristic that differentiates Islamic banks from other banks based on other philosophies. In exercising all its banking or development activities, the Islamic bank takes into major consideration the social implications that may be brought about any decision or action taken by the bank. Profitability despite its importance and priority is not therefore the sole criterion or the prime part in assessing the performance of Islamic banks, since they have to connect both between the material and the social objectives that would assist the interests of the community as a whole and help accomplish their role in the scope of socially mutual guarantee. Social objectives are understood to form an inseparable component of the Islamic banking system that cannot be dispensed with or neglected.

The market for Islamic finance in Africa remains severely underdeveloped and counts only 116 providers from 21 countries. Islamic banking providers in Africa remain uncommon and represent less than 10% of commercial banks functioning in the 21 African countries offering Islamic financial services. Furthermore, Islamic banking has been developed applying 2 different types in Africa. The first covers setting up fully fledged Islamic banks while the second type consists in setting up windows dedicated to Islamic finance within conventional banks (Faye et al, 2013, p. 137).

Several arguments have been put forward to clarify why Islamic finance is not more prominent in North Africa. First, most North African countries are newcomers to the Islamic finance market. Until recently, the economic leaders in most North African countries have been overlooking Islamic finance because they did not see a vital potential in this type of finance. They were also attempting to defend the politico-religious equilibrium and stop entry points for Islamic fundamentalism and terrorism which Islamic finance was thought to help. Only recently

did local authorities become aware of the necessity and opportunity to tap into resources from the GCC to fund the growing demand for investments (Faye et al, 2013, p. 139).

According to Gait (2009) cited in (Faye et al, 2013, p. 139) Libya does not count any institution offering Islamic banking. This is definitely not a reflection of lack of interest from banks to offer such services. A survey of Libyan banks conducted in 2007–2008, revealed that two-third of surveyed Libyan banks are eager to offer Islamic finance products and services. The recent interest in Islamic finance from Libyan banks and consumers for instance reflects largely the growing need for funding to support economic development rather than religious beliefs. Second, most of the Muslims in the region (Libya) are from Malikite obedience. As such, they turn out to be moderates in comparison to their peers from the Middle-East. Interestingly, a significant part of the population in North Africa does not consider interest payment as Riba. Therefore, retail banking and credit to consumers keep flourishing. In addition, the unsuitable regulatory and tax frameworks in the country made Islamic finance more expensive than conventional products and therefore less attractive to consumers.

Research questions

There is much debate among bankers in Libya regarding the willingness and readiness of conventional banks to be shifted into Islamic banks, especially after bringing to a halt, practicing conventional banks for non-Islamic operations. The main argument is that the banks in the country need more time to be ready to provide Islamic services. The essential problem for this study can be formulated as follows:

“Are conventional banks in Libya equal in readiness for the transition into the Islamic banks?”

Furthermore, this study tries also to answer the following questions:

1. Have the conventional bank staff the required experience for functioning Islamic banking system?
2. Do managers, bank staff, and bank clients accept the idea of adopting Islamic banking in Libya?
3. Does the transition from the conventional banking system into the Islamic banking system require more time and high cost?
4. Can the computer system currently provided in banks implement and make the Islamic banking operations function?
5. Can the current conventional banks provide Shariah supervisory boards if they decide to switch into Islamic banking system?

Research hypotheses:

This research is based on the following hypotheses:

“There are no statistical significant differences for the readiness of conventional banks to be shifted into Islamic banks”.

- $H_0: \mu_1 = \mu_2 = \mu_3 = \mu_4 = \mu_5 = \mu_6$ H_1 : Not all the means are the same

Research objectives:

Such studies can be used as criteria to evaluate the progress of these banks in the field of Islamic banking, demonstrating to the decision makers of conventional banks their competitive position in this area. The main objectives of this research are:

1. To understand the principles, history and origins of Islamic banks in Libya, and the laws and regulations for conversion to Islamic banking.
2. To investigate the readiness of the Libyan banks to shift from the conventional banks into Islamic banks.

Sources of data collection:

The study relies primarily on secondary sources obtained from books and research papers. It also depends on primary sources and data collected through a questionnaire which is prepared for the purpose of this study. In addition, descriptive statistics were used in order to analyze the collected information and data.

The design of a questionnaire is not fixed and there is no universal design that would be acceptable for all circumstances. In this study, the questionnaire was carefully designed in order to achieve its aim and the objectives of the study as well as to obtain high answer rates.

The sample for this study was drawn from the banking sector in Libya, particularly from six conventional banks in Sirte city - Libya. These banks were: Wahda bank, Wahda university bank, Commerce & Development bank, Sahara bank, North Africa bank and Commercial bank. These banks were chosen because they were the key, largest banks in Sirte - Libya, and also because they had long investment experience in the Libyan banking system.

200 copies of the questionnaire were distributed to the staff in the banks surveyed. Out of this total, 166 copies were returned fully answered and were chosen for the analysis, which represents about (83) per cent of the total number distributed, this return rate being reasonable and useful for the purpose of analysis. 6 copies were not completed properly and were, thus, excluded from the analysis, while 28 copies were not returned at all.

Different levels (Head of Dept., managers, supervisors, etcetera), and various departments and administrations (such as, loans dept., current accounts dept., foreign currencies dept., etcetera) in each bank were targeted. The reason behind that was to include in the survey the entire workforce and to guarantee that any findings were based on data coming from as wide a range as possible of parties concerned.

Furthermore, as the study examines the readiness of conventional banks to be shifted into Islamic banks, it was necessary to review some issues related to this topic, such as regulations, conditions, and rules in the country itself. It is for this reason that the researcher visited the targeted banks, in order to acquire a clear understanding of the rules and regulations governing Islamic banking in Libya and other issues that might be considered as a barrier for establishing these types of banks in Libya.

Data analysis and discussion:

This study followed the descriptive analytical method. This method is considered as the best way among other research methods of studies. This method was chosen, simply because it is an easy method for collecting data from research sample. The data gathered from the questionnaires were

entered into the computer and analyzed by the Social Package for Social Sciences (SPSS). Via this program the researchers used the weighted means and standard deviations to answer the research questions and to understand the significance for each statement of research dimensions. In addition, the test results of variances and the hypothesis test of different mathematical circles for several separate communities were also used.

Furthermore, Cranach's Alpha test was used to test the consistency of the questionnaire. (Sekaran, 2003) stated that $\alpha \geq 0.60$ for the applied aspect of Management and Arts Sciences is considered to be acceptable indicator for the reliability of questionnaires. Therefore, the result of this test indicates that the coefficient Cranach's is about (0.749), which is high and positive, and confirms the reasonable sincerity and consistency of questionnaire questions.

Table (1): weighted means, standard deviations and hypothesis test regarding the aspects of the readiness of conventional banks to shift into Islamic banks

N.	Statements	Mean	Std. Deviation	Rank	Grade	Test of Variances	ANOVA Test	
							F	.Sig
1	Staff has expertise in Islamic banking.	3.1228	1.11915	8	Medium	0.229	0.978	0.440
2	Staff has training courses on Islamic banking.	2.8772	1.32382	9	Medium	0.908	3.404	0.010
3	Your bank regulations support shifting into Islamic banking.	3.1228	1.03631	8	Medium	0.250	2.598	0.026
4	Management in your bank support shifting into Islamic banking.	3.3333	1.09109	4	Medium	0.195	1.563	0.178
5	Staffs in your bank support the idea of shifting into Islamic banking.	4.0351	0.92514	2	High	0.382	1.896	0.111
6	Customers support the transformation into Islamic banking.	4.2456	.085106	1	High	0.217	1.219	0.314
7	The costs of switching into Islamic banking are high.	3.2982	0.88570	5	Medium	0.473	1.894	0.112
8	Time is considered as a barriers for shifting into Islamic banking	3.1579	1.13057	6	Medium	0.013	1.560	0.188
9	provide Shariah supervisory board.	3.5965	1.03267	3	Medium	0.210	0.991	0.432
10	The current computer system in your bank can run Islamic banking operations.	3.2807	.0979601	7	Medium	0.099	0.981	0.438

As it can be seen from table (1) the weighted mean of respondents' answers ranged from (2.8772) to (4.2456), with a general mean average of (3.4070) according to the five-level Likert scale used. In addition, the standard deviation of all statements according to the same scale ranged from (0.85106) to (1.32382). This shows that the convergence of the respondents' answers, it also indicates that most respondents agree in general in accepting the idea of introduction and shifting their bank activities into Islamic banks.

According to table (1), the statement related to “customers support to the idea of transformation into Islamic banks” came first and considered to be high among the listed statements with a weighted mean about (4.2456), and with a standard deviation of almost (0.85106). Moreover, the statement concerned with the “staff support to the idea of shifting into Islamic banks” placed in the second rank and regarded to high as well with weighted mean of about (4.0351) and a standard deviation of almost (0.92514). This indicates that the level of adopting the idea of shifting into Islamic banks was highly accepted from both concerned parties (staff and customers), and this can pave the way for commencing and implementing policies and strategies for Islamic banking.

In contrast, the statements which obtained the medium grades in the scale were in sequence order: “providing Shariah supervisory board”, which came third with a weighted mean of about (3.5965) and standard deviation of almost (1.03267). Followed by the statement “management support shifting into Islamic banks”, which achieved the fourth place with a weighted mean of nearly (3.3333) and standard deviation of about (1.09109). Next came the statement “the costs of switching to Islamic banking are high.” with a weighted mean of almost (3.2982) and standard deviation of nearly (0.88570). Then followed by the statement “time is considered as a barrier for shifting to Islamic banks”, this statement came sixth in the rank with a weighted mean of almost (3.1579) and standard deviation of about (1.13057). Then came the statement “the current computer system in bank can run Islamic banking operations” with a weighted mean of nearly (3.2807) and standard deviation of almost (1.097960).

Furthermore, two statements achieved the same rank and grades in the five-level Likert scale used and those were: “staff have expertise in Islamic banking” with a weighted mean of almost (3.1228) and standard deviation of about (1.11915), and the statement “your bank regulations support shifting into Islamic banking” with a weighted mean of nearly (3.1228) and standard deviation of about (1.03631). Finally, the statement related to “staff has training courses on Islamic banking” came last with a weighted mean of almost (2.8772) and standard deviation of about (1.32382).

With regard to the results of testing the homogeneity of variances, it can be seen from table (1) that the test results were not statistically significant in all the listed statements except the second and the third statements. This shows that the six banks have equally experienced staff of Islamic banking. In addition, departments, staff and public clients support the idea of turning into Islamic banks in these banks, as they believe that the process of shifting into Islamic banking is easy and does not require substantial costs. Therefore, these systems are able to execute Islamic banking operations, and subsequently can provide a specialized way to Islamic banks. On the other hand, as for the second statement, the result of variances test was statistically significant. This shows that the six banks differed in the extent of staff training programs and Islamic banking instruments, as well as in the internal regulations that can give support for the transformation into Islamic banking.

Post Hoc Test:

Research statements' dimensions were tested in order to determine which set of the six groups differs from the other groups. Table (2) shows that there was a slight difference between Sahara and Wahda banks. In contrast, there was a statistically significant difference between commercial

bank and Sahara bank. This indicates that the difference occurred mainly related to staff training on Islamic finance, while other banks were not statistically significant

Table : (2) Multiple Comparisons

(I) Bank	(J) Bank	Mean Difference (I- J)	Std. Error	Sig.	Dependent Variable: q2	
					95% Confidence Interval	
					Lower Bound	Upper Bound
Wahda bank	Commercial bank	.07273	.52482	1.000	-1.5436	1.6891
	Sahara Bank	-1.82727*	.52482	.015	-3.4436	-.2109
	North Africa bank	-.82727	.52482	1.000	-2.4436	.7891
	Wahda university bank	-.72727	.58075	1.000	-2.5159	1.0613
	Commerce & Develop bank	-.39394	.53988	1.000	-2.0566	1.2688
Commercial Bank	Wahda bank	-.07273	.52482	1.000	-1.6891	1.5436
	Sahara Bank	-1.90000*	.53717	.013	-3.5544	-.2456
	North Africa bank	-.90000	.53717	1.000	-2.5544	.7544
	Wahda university bank	-.80000	.59194	1.000	-2.6230	1.0230
	Commerce & Develop bank	-.46667	.55189	1.000	-2.1664	1.2330
Sahara Bank	Wahda bank	1.82727*	.52482	.015	.2109	3.4436
	Commercial bank	1.90000*	.53717	.013	.2456	3.5544
	North Africa bank	1.00000	.53717	1.000	-.6544	2.6544
	Wahda university bank	1.10000	.59194	1.000	-.7230	2.9230
	Commerce & Develop bank	1.43333	.55189	.184	-.2664	3.1330
North Africa Bank	Wahda bank	.82727	.52482	1.000	-.7891	2.4436
	Commercial bank	.90000	.53717	1.000	-.7544	2.5544
	Sahara Bank	-1.00000	.53717	1.000	-2.6544	.6544
	Wahda university bank	.10000	.59194	1.000	-1.7230	1.9230
	Commerce & Develop bank	.43333	.55189	1.000	-1.2664	2.1330
Wahda University Bank	Wahda bank	.72727	.58075	1.000	-1.0613	2.5159
	Commercial bank	.80000	.59194	1.000	-1.0230	2.6230
	Sahara Bank	-1.10000	.59194	1.000	-2.9230	.7230
	North Africa bank	-.10000	.59194	1.000	-1.9230	1.7230
	Commerce & Development Bank	.33333	.60533	1.000	-1.5309	2.1976
Commerce & Development Bank	Wahda bank	.39394	.53988	1.000	-1.2688	2.0566
	Commercial bank	.46667	.55189	1.000	-1.2330	2.1664
	Sahara Bank	-1.43333	.55189	.184	-3.1330	.2664
	North Africa bank	-.43333	.55189	1.000	-2.1330	1.2664
	Wahda university bank	-.33333	.60533	1.000	-2.1976	1.5309

* The mean difference is significant at the 0.05 level.

As it can be seen from the above table (3), the difference between Wahda bank and Commerce & Development bank was statistically significant, suggesting that these banks vary in the extent of conformance of regulations that support the transformation of Islamic banking and other groups were not statistically significant.

Table: (3) Multiple Comparisons

(I) Bank	(J) Bank	Mean Difference (I- J)	Std. Error	Sig.	Dependent Variable: q3	
					95% Confidence Interval	
					Lower Bound	Upper Bound
Wahda bank	Commercial bank	-.91818	.42012	.502	-2.2121	.3757
	Sahara Bank	-1.21818	.42012	.082	-2.5121	.0757
	North Africa bank	-1.31818*	.42012	.042	-2.6121	-.0243
	Wahda university bank	-1.24675	.46489	.148	-2.6785	.1850
	Commerce & Develop bank	-1.15152	.43217	.154	-2.4825	.1795
Commercial bank	Wahda bank	.91818	.42012	.502	-.3757	2.2121
	Sahara Bank	-.30000	.43001	1.000	-1.6243	1.0243
	North Africa bank	-.40000	.43001	1.000	-1.7243	.9243
	Wahda university bank	-.32857	.47384	1.000	-1.7879	1.1308
	Commerce & Develop bank	-.23333	.44179	1.000	-1.5939	1.1273
Sahara Bank	Wahda bank	1.21818	.42012	.082	-.0757	2.5121
	Commercial bank	.30000	.43001	1.000	-1.0243	1.6243
	North Africa bank	-.10000	.43001	1.000	-1.4243	1.2243
	Wahda university bank	-.02857	.47384	1.000	-1.4879	1.4308
	Commerce & Develop bank	.06667	.44179	1.000	-1.2939	1.4273
North Africa bank	Wahda bank	1.31818*	.42012	.042	.0243	2.6121
	Commercial bank	.40000	.43001	1.000	-.9243	1.7243
	Sahara Bank	.10000	.43001	1.000	-1.2243	1.4243
	Wahda university bank	.07143	.47384	1.000	-1.3879	1.5308
	Commerce & Develop bank	.16667	.44179	1.000	-1.1939	1.5273
Wahda university bank	Wahda bank	1.24675	.46489	.148	-.1850	2.6785
	Commercial bank	.32857	.47384	1.000	-1.1308	1.7879
	Sahara Bank	.02857	.47384	1.000	-1.4308	1.4879
	North Africa bank	-.07143	.47384	1.000	-1.5308	1.3879
	Commerce & Develop bank	.09524	.48456	1.000	-1.3971	1.5876
Commerce & Development bank	Wahda bank	1.15152	.43217	.154	-.1795	2.4825
	Commercial bank	.23333	.44179	1.000	-1.1273	1.5939
	Sahara Bank	-.06667	.44179	1.000	-1.4273	1.2939
	North Africa bank	-.16667	.44179	1.000	-1.5273	1.1939
	Wahda university bank	-.09524	.48456	1.000	-1.5876	1.3971

* The mean difference is significant at the 0.05 level.

Conclusion:

This paper has described the main issues related to measuring the readiness of conventional banks to shift into Islamic banks in Libya. From this study, the following conclusions have been reached:

1. The administrations, staff, and customers of all conventional banks support the idea of shifting their banks into Islamic banks.
2. Wahda Bank is different from Commerce & Development bank in terms of supporting their internal regulations to transform their banks to Islamic banks, while the rest of the banks support Islamic banking.
3. Wahda bank is different from Sahara bank, and commercial bank is different from Sahara bank in terms of training of their staff on Islamic banking instruments.
4. The entire sample agreed that shifting into Islamic banks did not require substantial cost. Therefore, conventional banks computer system was able to operate Islamic banking operations. In addition, all conventional banks can provide Shariah supervisory board for their banks when they transform into Islamic banks.

Recommendations

1. Review the Internal Banking Regulations in a way that allows them to move to the Islamic banking system.
2. Commercial bank staff need training on how to apply Islamic banking tools.

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