The Factors that Influence the Conversion Process from Conventional Banks into Islamic Banking in Libyan Conventional Banks: Proposing Conceptual Framework

Abstract
The process of conversion from conventional banks to Islamic banks involves the conversion from an interest-based system (haram) to a shari’ah-based system (halal). On the basis of prior studies, several factors were proposed to influence the successful conversion of banks from a conventional model to an Islamic one. Such studies reported that human resources, regulations and legislation, shari’ah compliance, conversion resistance, and Islamic banking products are the major factors that affect the process of conversion from the conventional-based banking to Islamic banking. Accordingly, this paper proposed a conceptual framework to examine the above influential factors in light of the conversion process from conventional-based banking to an Islamic one.

Key words: Conversion process, conventional banks, Islamic banking

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Published on: 01-10-2016
1. Introduction

There are many factors that urged the conversion from conventional banking to Islamic banking, through several means notwithstanding their intentions; either to open Islamic windows/branches, or completely convert into a full-fledged Islamic bank. In this regard, several studies revealed that religious ideals urged customers of conventional banks to encourage their banks to convert to Islamic banking or provide Islamic banking products and services. This trend can be noted in majority of the Muslim nations. Several studies in literature also revealed that conventional banks have been motivated to convert by higher profitability, to maintain current customers, to attract potential ones or to go head-to-head with Islamic banks.

Nevertheless, it is a challenge to convert from a conventional bank to an Islamic one owing to its involvement of a complete revamp of the system from one format to another – more specifically from a debt-based system to an equity-based system (Garas, 2006), and from an interest-based system to one that is based on profit-loss sharing. Owing to the significance of the conversion process, the Accounting and Auditing Organization of Islamic Financial Institutions (AAOIFI) addressed the development by launching Shari’ah Standard No. 6 entitled “Converting from Conventional Bank to Islamic Bank”. The primary purpose behind the launching of this standard is to provide an insight into the procedures, mechanisms, and treatments entailed for successful conversion of a conventional bank to an Islamic one. In this regard, an Islamic bank is mandated to follow the Shari’ah rules and principles in terms of its operations and financial interactions, including its objectives and banking services functions (AAOIFI, 2010).

Majority of countries, particularly Muslim nations have been affected by this conversion, and Libya is no exception. Owing to the significant proportion of Muslim population in Libya, the desire for Islamic banking products has notably increased in the country, particularly following the revolution that took place on the 17th of February, 2011. Thus, banks’ regulators and Shari’ah jurists in Libya have immersed in the issue of providing Islamic banking products and promoting conventional banks’ conversion into Islamic banks.

The issue is compounded by the fact that the environment in Libya differs from that of other Middle Eastern and GCC countries, in that Libya does not have ample experienced in dealing with the Islamic banking system. In other words, the Islamic banking system is a new event in Libya as evidenced by only a few government-owned conventional banks offering Murabaha products along with conventional products in the past four years (The World Islamic Banking Conference, 2011-2012). Therefore, the conversion process from a convention bank to an Islamic bank in Libya is a process riddled with obstacles and challenges that are distinct from other Muslim countries that have been pioneers in applying Islamic banking system for the past 3 decades or more. Accordingly, this study examines and explores the barriers to converting from conventional banking system to an Islamic banking system in the context of the Libyan banks.

In this work, the researcher brings forward a framework to examine the influence of human resources, regulations and legislation, Shari’ah compliance, resistance to conversion, and Islamic
products on successful conversion of Libyan conventional banks. The remaining sections of this paper are organized as follows; section two provides a review of literature, section three presents the study’s conceptual framework and hypotheses development and finally section four concludes the paper.

2. Literature Review

Literature dedicated to the Arab nations rarely addresses the conversion process phenomenon despite its importance – as a consequence, only a few conceptual studies exist. For instance, Al-Matran (1999) reported on the conversion of the National Commercial Bank (NCB) Saudi Arabia, a country that follows the dual banking system. The report revealed that the NCB conversion faced many challenges that were divided into internal and external obstacles. The former category included issues related to administration, department relationships, human resource, systems and policies, Islamic products, and banking market. On the other hand, the latter category covered lack of knowledge among accountants and auditors concerning the Islamic banking rules. On the basis of the NCB experience, a step-by-step or incremental jurisprudence conversion may be the best approach to adopt as it involves a flexible plan drawn out for the conversion process with the assistance and participation of the CBs employees.

In addition, in the context of Libya, Abdalla et al. (2015) and Abo-Homera and Aswaysy (2008) examined the conversion process. More specifically, Abdalla et al. (2015) examined the validity of successful conversion of conventional banks to Islamic banks based on the Libyan model and the factors that affect the conversion. They examined four independent variables namely the availability of qualified human resources in Islamic banks, the availability of Islamic capital market, the employees’ willingness to convert to Islamic banks, and the success of the Islamic banking experience, and a single independent variable namely the success of the experience in converting into Islamic banks. They adopted the quantitative method to collect data and found that all the tested factors positively influenced successful conversion into Islamic banks in Libya.

On the other hand, Abo-Homera and Aswaysy (2008) focused on two banks namely the Jumhouria bank and the Bank of Commerce & Development in terms of the converse of conventional banks into Islamic banks. They made use of descriptive statistics analysis to analyze the data obtained from the questionnaires. Their primary objective was to provide an insight into the attitude of the conventional banks’ customers to the conversion process. The authors revealed that almost 76% of the study sample agreed to the conversion of all Libyan conventional banks into Islamic banks and that 79% of them agreed that the Libyan environment facilitates basic constituents to bring about successful conversion process. Moreover, their findings also showed that majority of the sample (91%) confirmed that religion is the main factor that led to the being advocates of the conversion process.

In Jordan, Al-Atyat (2007) investigated the conversion of conventional banks to Islamic banks following Shari’ah law to determine its application viability. The author attempted to shed light on the related legislation of the conversion process by examining several factors, which are, the
Islamic rules clarity in relation to the CBs acts, the CB leaders’ desire to provide services based on Islamic Shari’ah, the expectations to achieve additional long-term profits, the availability of the conversion laws and regulations, the availability of qualified human resources, the availability of financial instruments that meet Islamic Shari’ah principles, and successful experience of Islamic banks. He focused on the Jordanian private banks in terms of the enactment of Shari’ah laws within them. The sample specifically comprised of leaders and executive managers of Jordanian CBs. The findings showed that the entire factors positively impacted the experience of Jordanian banks conversion to Islamic banks.

In a related study, Ahmad (2008) looked into the opportunities and major challenges noted in the UK Islamic banks. Data was collected through in-depth interviews of different groups (banking authorities, customers and non-customers of Islamic banking). The author found considerable opportunities for the Islamic financial system to grow and develop in the U.K. Added to the above, the study also revealed some barriers to such growth and they include the state of the service network related to Muslims across the U.K., the lack of Islamic banks and institutions that fully satisfies the whole Muslim community, the lack of harmonization of the accounting system, and the lack of qualified employees that are skilled in Islamic financial products, marketing and sales. (Sarker, 1999)

Moreover, in Sarker’s (2014) study, he focused on the Islamic banks achievement and challenges in the context of Bangladesh and highlighted the following barriers; lack of an interest-free mechanism for the short-term replacement of funds, high risks in profit-sharing, and majority (60-70%) of the investments in Islamic banks are made on a mark-up basis through Murabaha and Bai’-Muajjal. This indicates that the concentration of the short-term trade investments of Islamic banks is a crucial issue to be addressed in Islamic banks in Bangladesh. The barriers also include the lack of a full-fledged legal framework for Islamic banking, lack of trained and efficient human resource committed to Islamic banking, and the absence of Shari’ah compliant regulatory and supervisory standards. The author recommended that micro, small and medium enterprises should arrange their priorities of when it comes to investment decisions in Islamic banks – more specifically, the quality of manpower in such banks has to be upgraded to enhance their performance.

Generally speaking, Islamic banking and finance are based on Shari’ah principles and jurisprudence (Fatwa) issued by qualified Muslim jurists. Therefore, it can be stated that the primary challenges facing the process of conversion is the ability of the CBs to adhere to the principles and guidelines. Al-Atyat (2007) extended the explanation by stating that any CB desirous of converting and complying to Shari’ah law should fulfill the following; the bank’s treatment of receivables and liabilities that are received or paid before the conversion, and the way the bank handles prohibited assets that the bank possessed prior to the conversion, and the appropriate disposal methods to be adopted.

The next section provides an explanation of the conversion process in terms of barriers and their influence on the conversion process as discussed in literature. Such barriers include human
resources, regulations and legislation, Shari’ah compliance, resistance to conversion and Islamic banking products.

3. Conceptual Framework and Hypotheses Development

The study’s conceptual framework is developed on the basis of prior studies in literature relevant to the topic. In this paper, five independent variables are examined for their influence on the conversion of the CBs to Islamic banks and they are resistance to conversion, Shari’ah compliance, human resources, regulations and legislation, and Islamic financial products. Meanwhile, the study considers successful conversion process as the dependent variable. The study’s conceptual framework is presented in Figure 1. Following this section is the explanation and presentation of the development of hypotheses.

Figure 1. Conceptual Framework Of This Study

3.1 Dependent Variable

3.1.1 Success of Conversion Process

The conversion of CBs to Islamic banks involves a system conversion from interest-based system to Shari’ah-based system. The major challenge in the conversion is related to the complexity of the implementation of a strategic plan for conversion, and the addressing of barriers that may be faced before, during and after the process by the conventional banking authorities, regulators and leaders.

Moreover, studies in literature highlighted many challenges and barriers to a successful CB conversion into an Islamic bank model. Majority of studies (e.g., Alani & Yaacob, 2012; Al-Oqool, 2011; Al-Atyat, 2007; Mustafa, 2006; Al-Martan, 1999) evidenced that human resources, regulations and legislation, Shari’ah compliance and Islamic banking products are the major
barriers that affect the CBs conversion to Islamic banks. Added to this, factors that determine successful conversion include resistance to conversion and leadership rule. The significance of the above factors necessitated their inclusion in this study to test their influence on the conversion process.

3.1.2 Independent Variables

3.1.2.1 Resistance to Conversion

According to Dent and Goldberg (1999) and Zander (1950), resistance refers to behavior that protects an individual from the influence of real or actual change. Previous studies including Ramnarayan and Rao (2011), Ford and Ford (2010), Yukl (2001), Conger and Kannungo (1987), and Bass stated that one of the major barriers to successful organizational change may be the lack of the employees’ inclination towards the change process or their resistance towards it. This is reinforced by other evidence provided by Waddell and Sohal (1998), Maurer (1996), Strebel (1994) and Lawrence (1954) who highlighted resistance to change as the failure of change initiatives. Resistance to change has also been evidenced to facilitate costs and delays to the change process (Val & Clara, 2009).

Generally speaking, the conversion of CBs to Islamic banks can be brought about by management or by an imposition of a specific policy change and procedure, or through external pressure. However, this conversion urges organizational employees to think, behave and perform in a different way. Also, individuals view changes in different ways, with some addressing change with little to no tolerance, while others embracing change initiatives readily (Kilicoglu & Yilmaz, 2013). However, the awareness of the leaders of such resistance will assist in their mitigation of time and cost of the process of change. It was also argued that resistance to the conversion is among the major determinants of successful conversion process from CB to Islamic bank. Based on the above discussion, the following hypothesis is developed;

\[ H_1: \text{Resistance has a significant effect on the conversion process among the respondents.} \]

3.1.2.2 Shari’ah Compliance

As mentioned earlier, Islamic finance and banking have their basis on Shari’ah principles and jurisprudence (Fatwa) issued by qualified Muslim jurists. The rules and principles of Shari’ah are what distinguishes Islamic banks from convention banks, and promotes the confidence of customers who deal with Islamic banks. Owing to the basis of Islamic banks, it is logical to state that the establishment and activities of Islamic banking and finance is controlled by the principles and jurisprudence of Shari’ah (Mohd Zamil, 2014) and such principles are considered as one challenge/obstacle that arises during the conversion process from CB to Islamic bank (Al-Martan, 1999; Al-Atyat, 2007; Mohd. Zamil, 2014). This is supported by Kahf (2004) who claimed that the major distinguishing factor between Islamic banks and conventional banks is the former’s compliance to the Islamic principles. Added to this, prior studies evidenced that Islamic banks that operate a dual-banking system are faced with challenges in their operations as they have to adhere
to Shari’ah principles in terms of regulatory and financial infrastructure that are often based on conventional banking. Consequently, this may prevent the development and innovation of products/services on the basis of Shari’ah principles (Al-Oqool, 2011; Al-Sarhi, 2010; Al-Atyat, 2007; Al-Martan, 2005; Al-Omar & Iqbal, 1999; Al-Rbaia, 1989).

However, studies dedicated to examining the influence of Shari’ah compliance on the conversion process are still few and far between, and the little number of studies in the area concentrated on Islamic banking in general. Hence, based on the above discussion, the ability of the Libyan CBs to convert and comply to Shari’ah rules is a major issue in the process of conversion, and as such the following hypothesis is proposed;

\[ H_4: \text{Shari’ah compliance has a significant effect on the conversion process among the respondents.} \]

3.1.2.3 Human Resource

Another major obstacle to the conversion process of CBs to Islamic banks is human resources. It is considered to be a crucial element for successful conversion in that qualified human resources are required in any Islamic bank. In particular, Islamic banks require qualified and trained staff in Islamic banking system to be able to achieve developmental objectives and evaluate investments, and to determine the appropriateness of investments to Islamic banking. In relation to this, the nature of the Islamic bank’s work cadres is distinct from the conventional banks in light of the legitimate factors that govern the banking business and special controls implemented in Islamic banks, and as such, qualified employees have to be employed (Noor Khan, 2015; El-Seoudi et al., 2012; Zainol et al., 2008).

Furthermore, conventional banks operations are based only on the business legal aspects rather than considering what is legal (halal) or illegal (haram) in the Islamic sense. In this background, Islamic banking employees are required to hold specialized qualifications in the field of accounting, management, economics and other banking fields. Meanwhile, employees in CBs lack the knowledge concerning Shari’ah principles when it comes to the above fields and thus, CBs face barriers in terms of their conversion planning to the Islamic banking model. This necessitates the carrying out of a series of specialized training programs regarding Islamic banking in conventional banks prior to the conversion. This contention is supported by Al-Oqool (2011) who stated that the only way a CB can succeed in converting to an Islamic bank is when it employs suitable employees who hold the appropriate qualifications and experience in the Islamic banking sector. Considering the above discussion, the following hypothesis is proposed to be tested;

\[ H_2: \text{Human resource has a significant effect on the success of the conversion process among the respondents.} \]

3.1.2.4 Regulations and Legislations

Prior studies noted that the conversion of CBs to Islamic banks is challenged by the regulations and legislation in place (e.g., Alani & Yaacob, 2012; Al-Atyat, 2007; Mustafa, 2006; Karbhari et
al., 2004; Al-Martan, 1999). In this regard, Islamic banking and finance, like the conventional finance industry, has its regulations and relevant legislation in place that is regulated by national law and Shari‘ah law. This sets Islamic banks apart from their conventional counterparts. According to Karbhari et al. (2004), one of the major issues that Islamic banking development is facing is the present legal structure coupled with the lack of understanding and lack of regulation that bring about tension between the Islamic banks and regulators. Moreover, in CBs, the accounting system is based on the interest method and this necessitates their adoption of a different technical systems, procedures and regulations if they are desirous of converting to Islamic banks. This is exemplified by the fact that most of the tax systems that are suitable for CBs enable interest to be tax-deductible; contrastingly, the profit (an alternative to interest in Islamic banks) is non-tax-deductible (Karbhari et al., 2004). This change calls for CBs to modify their documents and sheets of balance and entry.

The regulations and legislation challenge is compounded by the fact that significant regulatory challenges are faced by the Islamic banking industry in terms of a suitable environment for the Islamic banking system as reported by the supervisory authorities (Rafay & Sadiq, 2015). Aside from the above information, little knowledge is present in literature concerning the influence of regulations and legislation on the conversion process. Therefore, owing to the importance of this factor in such a process, the study develops the following hypothesis;

\[ H_3: \text{Regulations and legislation have a significant effect on the success of the conversion process among the respondents.} \]

3.1.2.5 Islamic Financial Products

The development of novel financial products in the Islamic banking industry is quite slow (Al-Omer & Iqbal, 1999) and in the same context, the limitation of Islamic banking products may be deemed to be one of the major challenges faced by Islamic banks, and the CBs desirous of converting or offering Islamic financial products. This is evidenced by the treasury products that indicate that almost all the Islamic finance products were adopted and reengineered from their conventional counterparts. It is therefore a huge challenge for the CBs who are looking to convert to develop innovative products that are suitable and competitive in the market. As a consequence, majority of the Islamic products customers are convinced that Islamic products are identical to any other bank produce and therefore, the separation of Islamic from non-Islamic operations and products is impossible (Al-Salem, 2009). This highlights the importance of Islamic banks innovation and creation of new products to remain competitive in the market – products that are attractive and appealing to both individual and corporate sets of clients.

Nevertheless, despite the innovations and developments noted in financial Islamic instruments and the increasing demand for them, problems and challenges are still faced by Islamic financial institutions in this regard (Abdul Aris et al., 2013; Ashraf & Giashi, 2011; Al-Salem, 2009). It is therefore argued in this study that Islamic financial products are related with successful conversion...
process from CB to Islamic bank. The above discussion leads to the following proposed hypothesis;

$H_5$: Islamic financial products have a significant effect on the success of the conversion process among the respondents.

4. Summary and Conclusion

Prior studies’ findings on the conversion process showed various factors influence on the CB conversion to Islamic bank. These factors include human resources, regulations and legislation, Shari’ah compliance, resistance to conversion, and Islamic banking products. The mentioned factors differ from one bank to the next on the basis of specific situations, economic and social factors in the environment of the banks, and the employees and management’s perceptions and aspirations.

This paper is an attempt to examine the factors influencing successful conversion from CB to Islamic bank in the context of Libya. Five challenges were proposed to influence such a conversion namely, human resources, regulations and legislation, Shari’ah compliance, resistance to conversion, and Islamic banking products, upon which five hypotheses were developed. The hypotheses are validated by conducting a survey.

Bibliography:


