Malaysian Journal of Consumer and Family Economics (MAJCAFE) Vol 31 (2023)
https://www.majcafe.com : eISSN : 2948-4189

A Review of Islamic Banks Financing in Malaysia

Mohd Ariff Mohd Daud[1], Mohd Edil Abd Sukor[2], Muhammad Adli Musa[3], Amni Suhailah Abarahan[4], Wan Noor Hazlina Wan Jusoh[1]

[1]*Academy of Contemporary Islamic Studies, Universiti Teknologi MARA Cawangan Terengganu, Malaysia*
[2]*Faculty of Business and Economics, Universiti Malaya, Malaysia*
[3]*Kuliyyah of Islamic Reveal Knowledge, International Islamic University Malaysia*
[4]*Faculty of Islamic Economics and Finance, Universiti Islam Sultan Sharif Ali, Brunei*
DOI: https://doi.org/10.60016/majcafe.v31.18

Abstract

This study aims to investigate the financing behavior of Islamic banks in Malaysia by examining the concepts, types, purposes, and sectors of financing that Islamic banks provide. How Islamic banks behave, whether they are full-fledged Islamic banks or subsidiaries, is also examined. In addition, this study also explores the ethicality of providing non-productive financing. This study utilizes data from Bank Negara Malaysia, along with annual reports of individual Islamic banks in Malaysia. The findings indicate that the financing behavior of Islamic banks is nearly identical to those of their conventional counterparts, in which debt-based financing instruments are widely employed, and that the allocation of financing is predominantly for activities that can be deemed as non-productive. This study contributes to the discourse on financial ethics concerning the financing behavior of Islamic banks, which is currently quite limited. It is anticipated that this research would potentially initiate more discussions on the ethicality of Islamic banks and improve current practices.

Keywords*:* financial ethics, financing concept, financing purpose, financing type, islamic banks

1.0 Introduction

Islamic finance continues to be an emerging force in economic development around the world. The estimated total value of the Islamic Financial Services Industry (IFSI) increased from USD 2.44 trillion to USD 2.70 trillion in 2020 compared to the previous year. IFSI recorded

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

an astounding 10.7% year-on-year growth in 2020 due to exceptional growth mainly in the Islamic banking and Islamic capital market segments. In terms of assets, Islamic finance assets are heavily concentrated in the GCC region (48.9%), Middle East and South Asia (24.9%), Southeast Asia (20.3%), Africa (1.7%), and others (4.3%). With regards to the top jurisdictions, Saudi Arabia is the most dominant in terms of Islamic banking assets, with a 28.5% share, followed by Iran and Malaysia with 22.1% and 11.4% respectively (IFSB, 2021).

There has been an evolution in developing an ecosystem that complies with Shariah requirements in Malaysia. In the 1980s and 1990s, the focus was on the institutionalization of Islamic financial players. This initial stage saw the development of legal and Shariah foundations, and invitations to establish Islamic banks via windows, to increase the number of participants and promote competition. In the period from 1997 to 2006, the focus was on the centralization of Shariah advisory for Islamic finance. During this time, the Central Bank Shariah Advisory Council (SAC) was established as the highest authority in Islamic finance to harmonize interpretations among Islamic financial institutions. In addition to that, a dedicated *Mu'amalat* court was established to manage Islamic finance cases. To complement this, talent and knowledge organizations, for example, the Islamic Banking and Finance Institute Malaysia (IBFIM), International Centre for Education in Islamic Finance (INCEIF), and International Shariah Research Academy for Islamic Finance (ISRA) were set up to cultivate talent and promote knowledge advancements, including 'contemporising' Shariah. Ten years later, Shariah-compliant legal and regulatory frameworks were established to ensure the Shariah compliance of diversified Islamic financial businesses from beginning to end. This includes the enactment of the Central Bank of Malaysia Act 2009, which bound courts and arbitrators to Shariah rulings issued by the Shariah Advisory Council (SAC); the Shariah Governance Framework, which bolstered the roles and accountability of key functionaries in Islamic financial institutions; and the enactment of the Islamic Financial Services Act (IFSA) 2013, which established a legal and regulatory framework for diverse Shariah contracts (Bank Negara Malaysia, 2018).

Despite operating in Malaysia for over four decades, IFIs hold less than a third of the market share in the banking sector. With more than 60% of the population being Muslim, and strong support from the government since the inception of Bank Islam, this situation potentially

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

suggests a difficult situation faced by Islamic Financial Institutions (IFIs) in competing against conventional banks (Isa et al., 2022). The introduction of the Islamic Financial Services Act 2013 (IFSA 2013) has forced all IFIs in Malaysia to establish a Shariah Committee (SC) to ensure their operations comply with Shariah stipulations. In 2019, Bank Negara Malaysia (BNM) issued the Shariah Governance Policy Document (SGPD) to bolster the efficacy of Shariah governance implementation and promote a robust integration of Shariah considerations into the risk strategies and businesses of IFIs (Bank Negara Malaysia, 2019).

As IFIs in Malaysia continue their tremendous growth, they have been criticized for their lack of active involvement in the development of societal well-being, despite such being the raison d'être of the Shariah (*Maqasid al-Shariah*). Asutay & Harningtyas (2015) posit that the contributions of IFIs towards social entities, intellect, posterity, and ecology are minimal. They also argued that the role of Islamic banks in achieving maqasid al-shariah has been fragile as the industry mainly focuses on self, faith, rights, and stake-holding, rather than wealth preservation. Seemingly in response to this, Bank Negara Malaysia (BNM) launched the Value-Based Intermediation (VBI) Strategy Paper in 2018 intending to "strengthen the roles and impact" of IFIs by giving due attention to societal well-being, and not only focusing on economic growth (Bank Negara Malaysia, 2018).

Considering the above, this study seeks to assess the progress and direction of Islamic banks in Malaysia. This will be achieved by analyzing their financing behavior, i.e., how they provide financing, and for what purposes. To what extent does the financing behavior of Islamic banks reflect VBI? This study also seeks to explore if there are any differences in financing behavior between Islamic banks and conventional banks' Islamic subsidiaries.

The remaining sections of the paper are organized as follows: the second section provides a literature review and a brief discussion of VBI and the ethical dimension of Islamic financing. In Section 3, the data and research methodology used to address the research questions are presented. Section 4 examines the findings and implications of the research. In Section 5, the conclusion of this study is presented.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

2.0 Literature Review

2.1 Comparison Between Islamic and Conventional Banks

Iqbal (1997) posits that Islamic banking principles differ from their conventional counterparts based on four features: (i) risk-sharing, whereby providers of capital and entrepreneurs would share the risk in exchange for shares in the profits; (ii) the concept of money, whereby Islamic banks treat money as "potential", in which it becomes actual capital only when it is used with other resources to carry out a productive activity; (iii) prohibition of transactions that contain elements of extreme uncertainty such as gambling, as well as the prohibition of speculative behaviors such as hoarding; and (iv) participation in business activities that comply with Shariah requirements.

However, many scholars argue that Islamic and conventional banking schemes are similar as the former mimics debt-like instruments used by conventional banks and is not based on real Shariah principles as there is no significant difference between mark-up and rate of interest (Aggarwal & Yousef, 2000; El-Gamal, 2006). The "form over substance" approach in the "Islamization" of traditional finance by IFIs has been critiqued for failing to encourage the real principles of Shariah (Ahmed, 2015; Mansour et al., 2015; Nazar, 2015). In general, the impression is that the Islamic financial sector offers financial services and products that adhere to the legal aspect of Shariah, but not the true intent underlying those rules.

One of the major components of Islamic finance is banking. Like conventional banks, Islamic banks receive deposits but offer only Shariah-compliant products. For liabilities, Islamic banks use *Tawarruq* (commodity *Murabahah*), *Mudarabah* (profit-sharing), or *Wakalah* (agent charging a fixed fee for managing funds) contracts. On the asset side, Islamic banks provide financing through profit and loss sharing (PLS) contracts, cash purchases and credit sales, and other trading, leasing, and manufacturing activities. On the financing side, Islamic banks heavily depend on debt-based instruments, for example, mark-up financing and guaranteed profit margins on deferred obligation contracts (Zulkhibri, 2018). Previously, Islamic banks in Malaysia used conventional interest rates, i.e., the Kuala Lumpur Interbank Offered Rate (KLIBOR), as the benchmark for profit margin. In 2021, BNM introduced the Malaysia Islamic Overnight Rate (MYOR-i) exposure draft to replace KLIBOR as the benchmark for the profit margin of Islamic banks.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Currently, Malaysia has sixteen banks that offer Islamic financial services since the inception of Bank Islam in 1983. This includes five full-fledged Islamic banks and eleven Islamic subsidiaries. Currently, Islamic banks in Malaysia offer financing using various contracts, such as *Bay' Bithaman Ajil* (BBA - deferred payment sale), *Al Ijarah Thumma Al Bay'* (AITAB - hire purchase), *Murabaha* (cost plus), *Ijarah* (leasing), *Istisna'* (contract manufacturing), *Musharakah* (partnership), *Musharakah Mutanaqisah* (diminishing partnership), and *Mudarabah* (profit sharing). Bank Negara Malaysia (2021) highlights that *Murabahah* is the dominant Islamic mode of financing in the Malaysian Islamic banking system, with a 46% share, followed by *Ijarah Thumma Al-Bay'* with an 11% share, *Bay' Bithaman Ajil* and *Musharakah,* both with a 9% share, *Ijarah*, *Istisna'* and *Mudarabah*, 1%, 0.1%, and less than 0.1%, respectively, and 24% of other modes of financing.

Several empirical studies explore the difference between the Islamic rate of return and the conventional bank interest rate. Kasri & Kassim (2009) discovered that the rate of return and interest rate move in tandem, which indicates that Islamic banks in Indonesia are subjected to benchmark and rate of return risks. Cervik & Charap (2011) compared the empirical behavior of the rate of return on retail Islamic PLS investment accounts in Malaysia and Turkey with conventional bank deposit rates. They discovered that both conventional bank deposit rates and Islamic PLS deposit rates exhibit long-run cointegration and are correlated. In a similar vein, Chong & Liu (2009) discovered that the behavior of retail Islamic deposit rates was comparable to that of conventional interest rates. Furthermore, only a small percentage of financing provided by Islamic banks was PLS-based, and Islamic deposits were pegged to conventional deposits. Ito (2013) concurred with this and posited that, within the context of the Malaysian deposit market, both conventional interest rates and Islamic rates of return move in tandem.

Zulkhibri (2018) suggested that the similarity between the Islamic bank profit rate and the conventional bank interest rate is due to the variation in perceptions of riskiness at the institutional and systemic levels. This is especially important on the asset side. Ariff (2017) highlighted the tension between the theory and practices of Islamic banking, as Islamic products are deemed analogous to conventional ones, including the prices charged for them. He outlined the Law of One Price, which states that two products with the same risk profile must have comparable prices.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

2.2 Value-Based-Intermediation

VBI is "an intermediation function that aims to deliver the intended outcomes of Shariah through practices, conduct, and offerings that generate positive and sustainable impact on the economy, community, and environment, consistent with the shareholders' sustainable returns and long-term interests". VBI is intended to benefit four target segments: (i) the financial industry via enhancement in innovation, improved efficiency, and an effective ecosystem; (ii) customer or community via standard of living improvement and receiving fair and transparent treatment; (iii) government via alignment of business focus with national agenda; and (iv) regulator via strengthened financial stability. VBI aims to ensure that Islamic banking offerings and practices achieve the intended outcome of Shariah and not mere Shariah compliance. This includes the improvement of human well-being via the protection of wealth, faith, lives, posterity, and intellect. From the business perspective, the protection of wealth comprises inducements to create, amass, and circulate wealth just and fairly (Bank Negara Malaysia, 2018).

In line with BNM's vision on VBI, nine Islamic banks established the VBI Community of Practitioners (CoP) in 2017. To date, the CoP has thirteen member banks, namely Agrobank, Alliance Islamic, AmBank Islamic, Bank Islam, Bank Muamalat, Bank Rakyat, CIMB Islamic, HSBC Amanah, Maybank Islamic, OCBC Al-Amin, Public Islamic, RHB Islamic and Standard Chartered Saddiq Berhad. The CoP has four mandates: (i) to serve as a single reference point to identify possible impediments related to VBI; (ii) to spur industry-wide VBI initiatives; (iii) to promote continuous industry-wide knowledge exchange; and (iv) to expand the pool of expertise and talent in VBI. In doing so, the CoP members are guided by three guiding principles: (i) openness and transparency; (ii) responsibility; and (iii) diligence and resourcefulness. From January 2017 to September 2020, approximately RM94.2 billion worth of financing was intermediated by the Malaysian Islamic banking industry for VBI-related or aligned initiatives. SMEs and MicroSMEs received more than 43% of total VBI-related financing (RM40.6 billion), followed by public infrastructure (25.6% or RM24.1 billion), and affordable homes (20.8% or RM19.6 billion). 9% of financing worth RM8.9 billion was allocated for renewable energy and green projects, and 1% or RM0.9 billion was for education (AIBIM, 2020).

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

2.3 Ethical Dimension of Islamic Financing

Islamic finance claims to be more ethical, with profit and loss sharing (PLS) often mooted as its key differentiation factor (Beck et al., 2013; Dusuki, 2007). According to Dar & Presley (2000), most theoretical models of Islamic banking are based on PLS, either *Mudarabah* (profit-sharing) and/or *Musharakah* (joint venture).

Equity-based financing is also associated with productive financing. This is because the funds are supposed to generate the economy rather than be used to purchase existing assets, which causes asset price inflation and results in a higher cost of living. Philippon (2017) highlighted the evolution of credit markets over the last decades, with most of the growth in credit markets since 1980 happening in household credit. And the majority of this is associated with real estate. This contributes to two major issues. Firstly, as land is a finite resource, higher mortgage credit will lead to higher land prices and only a tiny increase in the number of housing units. This credit-driven house price inflation is non-productive and a waste of real resources; it does not contribute towards improving the welfare of the population but also increases the risk of financial instability. In addition to that, household credit can reduce firms' credit, either by increasing the real interest rate or the cost of intermediation.

Bezemer & Hudson (2016) suggest that we currently exist in two types of economies. First, there is the "real" economy, in which goods and services are produced and exchanged, tangible capital formation occurs, workers are hired, and productivity increases. This is the "productive" portion that creates income and surplus. On the other hand, there are second-type economies, in which interest and economic rent are extracted. This "extractive" rentier portion siphons off the surplus as rents, which are the costs for property rights, credit, or related advantages. In addition, they stressed that almost all asset-price inflation was debt-leveraged, meaning that money and credit were not used for tangible capital investment to produce goods and non-financial services. This in turn does not lead to an increase in wage levels. The traditional assumption is that banks, including Islamic banks, provide credit to finance real capital investments in new production methods. However, they finance the acquisition and transfer of existing property and financial assets most of the time.

In the same way that financing for non-financial businesses helps the Gross Domestic Product (GDP) grow, household financing

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

increases demand and buying power. However, unlike business financing, household financing leads to more financial instability and promotes less growth vis-à-vis business financing. Consumer credit does not generate income that will be used to pay off the loan, unlike business financing. Moreover, consumer credit is an inefficient method of financing production because of the higher interest/profit rates imposed. Compared to business credit, household credit has been demonstrated as having a small impact on growth (Beck et al., 2013; Jappelli & Pagano, 1994). Household financing increases debt, but not the income of households, which in turn increases financial instability. However, in contrast to consumer credit, mortgage credit for existing properties does not create value, as it is extended to buy existing assets. Capital gains on real estate are generated, but this is not a result of producing goods and services (Bezemer & Hudson, 2016). There have been numerous studies linking the expansion of household credit with higher crisis probabilities (Barba & Pivetti, 2009; Berrak & Neven, 2010; Frankel & Saravelos, 2012; Mian et al., 2013; Rose et al., 2011).

Al-Zuhaily (1991) argued that debts /loans are only permissible for those seeking necessities, as in the saying: “A person should not undertake debt unless he is facing a crucial requirement for such and is in dire need”. Classical and contemporary scholars unanimously consider the excessive use of debts, credits, and loans as not being in line with the purposes and principles of Shariah, which champion socio-economic prosperity and sustainability (F. M. Khan, 1995). According to Usmani (2005), if the whole scheme were founded on ideal Islamic principles, debt-based products would not have been a mode of financing. Choudhury (1986) on the other hand, viewed that the use of Islamic financial products, regardless of whether for the sake of consumption or investment, or to fulfill necessities, needs, and luxuries, is permissible and encouraged, as long as no wastage takes place. However, Islam accepts the use and provision of debt financing only when a person is in desperate need, with no other alternative. Al-Qurtubi (2002) stressed that dealing with debt is prohibited if the person is not in dire need. However, to satisfy one’s needs, it is a duty to take on debts. This comes from the wisdom of the Prophet's (peace be upon him) indebtedness, which should guide those in desperate need.

Ariff (2017) addressed these issues and argued that real-sector connectivity and risk-sharing practices distinguish Islamic banking from its conventional counterpart. He further stressed that all financial

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

transactions within the Islamic banking system must be linked to the real economy, leaving no room for financialization. He concluded that, from an Islamic perspective, the primary function of the financial sector is to facilitate the real sector, as the financial sector cannot exist on its own.

Considering the arguments that Islamic banks mimic their conventional counterparts, the introduction of VBI and the emphasis on the ethical dimension of Islamic financing in Malaysia are expected to change the financing landscape of the Malaysian Islamic banking industry. Limited studies have explored the financing behavior of Islamic banks in Malaysia by exploring the concept, type, purpose, and sector of financing that Islamic banks provide. The discrepancies in the financing behavior of full-fledged Islamic banks and Islamic subsidiaries have also received less attention. This research seeks to fill this gap.

3.0 Methodology

This research uses data from the Monthly Highlights and Statistics issued by BNM from 2007 to 2021 for an analysis of all Islamic banks. This study also uses a panel of annual bank-level data of all Islamic banks operating in Malaysia from 2016 to 2020 to analyze the financing behavior of individual banks. The two datasets were analyzed, with the former being used to see the long-term trend of all Islamic banks in Malaysia and the latter being applied to investigate the present behavior of individual Islamic banks in Malaysia. Since the shift towards Islamic bank subsidiaries (from previously Islamic bank windows) is quite recent, we find it appropriate to use the last five years period.

We analyze the annual aggregate of Islamic financing by concept, type, purpose, and sector. For individual banks, our analysis is based on the concept and nature of the bank (full-fledged or subsidiary). We then look at the time series and cross-sectional ratios of financing to explore whether the trend is in line with VBI and Islamic financial ethics.

4.0 Findings

4.1 Aggregate Analysis

Figure 1 shows an increasing trend of Islamic financing from 2007 to 2021. Despite multiple challenges, including the Global

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Financial Crisis in 2008 and the COVID-19 pandemic in 2020 and 2021, Islamic financing continues to grow steadily.

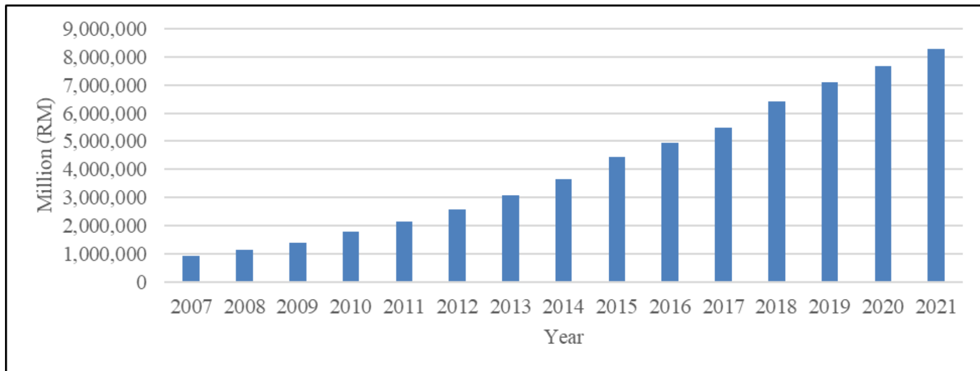

Figure 1 : Total Islamic Financing Offered by Islamic Banks in Malaysia from Year 2007 to 2021. Source: BNM

Although equity-based financing (*Mudarabah* and *Musharakah*) remains a small portion of financing, the trend is positive and encouraging, especially when it comes to *Musharakah*. As highlighted in Table 1, in 2007, only 0.3% of the financing provided by Islamic banks utilized *Musharakah* contracts, but in 2021 this percentage increased tremendously to 9.3%. Interestingly, BBA and AITAB contracts exhibited a declining trend, from more than 30% each in 2007, to close to 10% each in 2021. In the same period, *Murabahah* financing recorded the biggest growth percentage, from 8.6% in 2007 to 45% in 2021. Zulkhibri (2018) in his study on the impact of monetary policy on Islamic banking highlighted that BBA (32%) and AITAB (23%), are the dominant modes of financing from the period of 2006-2012, and subsequently argued that this supports the view that Islamic banking is mimicking conventional banking in practice as both contracts are debt-based instruments. Nonetheless, we found that Islamic banks have started to move away from BBA and AITAB financing and appear to prefer *Murabahah* financing over the years (mostly using *Tawarruq* contracts as highlighted in Table 4 and Table 5.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA https://creativecommons.org/licenses/by-sa/4.0/

Table 1 : Islamic Financing Ratio by Concept

Concept	*BBA*	*Ijarah*	*AITAB*	*Murabahah*	*Musharakah*	*Mudharabah*	*Istisna'*	Others
2007	39.3%	1.3%	30.0%	8.6%	0.3%	0.2%	0.8%	19.5%
2008	33.9%	2.1%	30.4%	14.9%	0.8%	0.2%	1.4%	16.3%
2009	32.6%	2.8%	30.7%	17.1%	1.5%	0.3%	1.3%	13.7%
2010	33.2%	2.7%	28.0%	15.6%	2.3%	0.2%	1.0%	16.9%
2011	33.4%	2.2%	26.3%	15.0%	3.0%	0.1%	0.8%	19.1%
2012	32.1%	2.0%	24.1%	16.3%	4.7%	0.1%	0.8%	19.9%
2013	31.4%	2.2%	23.0%	18.4%	5.5%	0.1%	0.6%	18.9%
2014	26.9%	2.4%	21.7%	22.0%	6.4%	0.0%	0.6%	20.1%
2015	21.0%	2.5%	19.4%	29.2%	7.0%	0.0%	0.6%	20.4%
2016	17.3%	2.4%	16.9%	34.9%	8.5%	0.0%	0.4%	19.6%
2017	14.6%	2.3%	15.4%	38.5%	9.8%	0.0%	0.4%	19.0%
2018	12.1%	1.9%	13.6%	39.1%	9.5%	0.0%	0.4%	23.3%
2019	10.8%	1.5%	12.5%	40.9%	9.4%	0.0%	0.3%	24.5%
2020	9.7%	1.4%	11.5%	43.5%	9.3%	0.0%	0.2%	24.5%
2021	9.0%	1.2%	11.3%	45.0%	9.3%	0.0%	0.2%	24.1%
Mean	23.8%	2.1%	21.0%	26.6%	5.8%	0.1%	0.7%	20.0%

However, a huge allocation of financing is term financing, which includes home financing, syndicated financing, hire purchase receivables (car financing), personal financing, bridging financing, and other term financing. This indicates that a substantial portion of financing is allocated to consumption rather than production. As illustrated in Table 2, financing for residential property and working capital dominate financing allocation with an average of 23.6%, followed closely by financing for transport at an average of 22.1%, and 9.5% financing for personal use.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Table 2 : Islamic Financing Ratio by Purpose

Purpose	Securities	Transports	Residential property	Non-residential property	Fixed assets	Personal use	Credit card	Consumer durables	Construction	Working capital	Other purpose
2007	1.0%	33.9%	21.1%	4.0%	1.1%	7.4%	0.7%	0.0%	2.6%	23.5%	4.6%
2008	2.3%	32.3%	18.8%	4.0%	1.6%	8.5%	0.6%	0.0%	2.5%	25.6%	3.7%
2009	3.8%	31.0%	18.1%	4.4%	2.1%	10.1%	0.8%	0.0%	2.2%	24.9%	2.5%
2010	4.9%	28.9%	18.0%	4.4%	1.9%	11.1%	0.8%	0.0%	2.1%	24.8%	2.9%
2011	5.3%	27.5%	18.6%	4.4%	1.7%	11.6%	0.8%	0.0%	2.6%	23.6%	3.9%
2012	5.1%	25.5%	19.8%	5.3%	1.2%	11.6%	0.8%	0.0%	3.0%	22.2%	5.6%
2013	6.2%	24.3%	21.4%	6.6%	1.0%	10.8%	0.7%	0.0%	3.0%	21.4%	4.6%
2014	6.2%	22.4%	22.8%	7.7%	0.9%	9.5%	0.6%	0.0%	2.9%	22.6%	4.3%
2015	5.9%	19.9%	23.7%	8.3%	0.9%	8.2%	0.6%	0.0%	2.5%	25.3%	4.8%
2016	6.2%	17.5%	25.4%	8.7%	0.7%	7.8%	0.6%	0.0%	2.3%	25.8%	5.0%
2017	6.7%	16.0%	26.8%	8.7%	0.5%	7.4%	0.6%	0.0%	2.4%	25.8%	5.1%
2018	7.0%	13.9%	27.6%	8.3%	0.5%	9.8%	0.6%	0.0%	3.2%	23.5%	5.7%
2019	7.7%	12.8%	29.1%	8.3%	0.5%	10.0%	0.6%	0.0%	3.2%	22.3%	5.4%
2020	7.5%	12.5%	30.6%	8.6%	0.6%	9.6%	0.6%	0.0%	3.0%	21.6%	5.3%
2021	7.5%	12.8%	32.3%	8.5%	0.6%	9.4%	0.5%	0.0%	2.8%	20.9%	4.6%
Mean	5.6%	22.1%	23.6%	6.7%	1.1%	9.5%	0.7%	0.0%	2.7%	23.6%	4.5%

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Table 3 : Islamic Financing Ratio by Sector

Sect	Agri	Mine	Manu	Elec, gas & water	Wholesale, Hotels & Rest	Const	Real Estate	Transport, storage & comms	Finance & Business	Education, health & others	Household	Others
2007	3.5%	0.1%	11.0%	0.3%	5.1%	4.6%	1.5%	2.3%	4.2%	1.1%	63.3%	3.2%
2008	2.6%	0.2%	10.5%	0.4%	5.6%	4.9%	1.6%	3.7%	4.7%	1.1%	59.7%	4.9%
2009	2.5%	0.3%	8.3%	0.6%	5.1%	4.4%	2.7%	4.5%	5.5%	1.8%	60.0%	4.2%
2010	2.3%	0.5%	7.4%	1.1%	4.3%	3.8%	2.8%	5.3%	5.1%	4.2%	61.0%	2.3%
2011	2.0%	0.6%	7.5%	0.8%	4.0%	3.6%	3.2%	3.7%	5.5%	5.4%	62.2%	1.6%
2012	2.2%	0.6%	6.5%	0.7%	4.1%	3.9%	3.7%	3.1%	6.2%	6.3%	61.5%	1.2%
2013	2.0%	0.5%	5.7%	1.1%	3.9%	4.2%	3.9%	2.6%	6.0%	5.8%	63.0%	1.1%
2014	2.1%	0.5%	5.3%	1.0%	4.0%	4.4%	3.9%	3.0%	7.0%	5.2%	61.9%	1.5%
2015	2.7%	1.4%	5.1%	0.8%	4.2%	4.3%	4.5%	3.6%	8.0%	4.8%	59.0%	1.6%
2016	3.1%	1.4%	4.9%	0.6%	4.3%	4.2%	5.1%	3.4%	8.5%	5.2%	58.5%	0.9%
2017	3.1%	1.2%	4.8%	0.5%	4.4%	4.5%	5.1%	3.9%	8.0%	4.6%	58.3%	1.5%
2018	2.9%	1.1%	4.3%	0.5%	4.5%	6.0%	5.1%	3.1%	6.1%	5.2%	59.9%	1.3%
2019	2.8%	0.6%	4.5%	0.6%	4.7%	6.0%	4.8%	3.0%	5.4%	4.9%	61.4%	1.1%
2020	2.8%	0.6%	4.6%	0.8%	5.0%	5.4%	4.8%	2.9%	5.3%	4.8%	62.0%	0.9%
2021	2.4%	0.6%	4.9%	0.9%	5.3%	4.7%	4.6%	2.7%	5.4%	4.2%	63.5%	0.8%
Mean	2.6%	0.7%	6.3%	0.7%	4.6%	4.6%	3.8%	3.4%	6.1%	4.3%	61.0%	1.9%

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Diving deeper into financing by sector as highlighted in Table 3, we discover that the household sector is the biggest segment that receives financing from Islamic banks. Bezemer & Hudson (2016) opined that financing for the household sector is considered non-productive financing. Nonetheless, household financing, especially for those in need, fulfills *Maqasid al-Shariah*. However, excessive credit provided for this category is not commendable and, as discussed earlier, can increase financial instability and cause problems for households (Barba & Pivetti, 2009; Berrak & Neven, 2010; Frankel & Saravelos, 2012; Mian et al., 2013; Rose et al., 2011).

4.2 Housing Loans Approved for First-Time Home Buyers

Banks in Malaysia (both conventional and Islamic) received housing loan applications totaling RM194.4 billion, of which RM137.7 billion were approved in 2020. However, as we can see in Figure 2, only 43% of these newly approved mortgages were for first-time home buyers (an average of 41% between 2013 and 2019). Since Islamic and conventional banks behave almost alike, we estimate that Islamic banks also allocate financing for first-time home buyers at a similar rate.[3] This indicates that more than 50% of home financing was given to non-first-time home buyers. In other words, Islamic banks approved more than 50% of home financing for acquisitions that could be deemed unnecessary. Philippon (2017) argued that this act of financing non-productive assets, in particular real estate other than for own use, may contribute to asset price inflation. As such, we can assume that Islamic banks also contribute to higher costs of living.

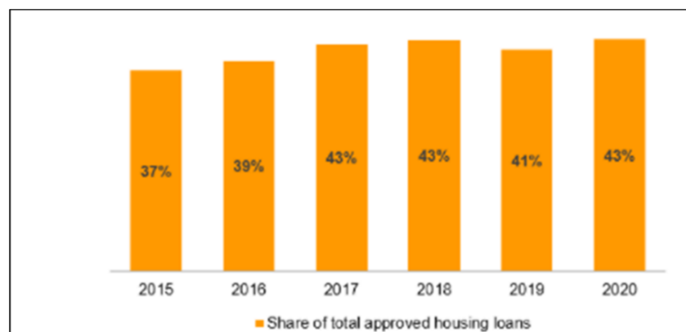

Figure 2 : Housing Loans Approved to First-Time Home Buyers (Share of Total Housing Loan Accounts Approved). Source: BNM

[3] We have requested information from BNM, but our request was denied due to privacy issues.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

4.3 Individual Bank Analysis (Source from Annual Report)

It is interesting to note that Islamic subsidiaries provide more financing based on equity-based contracts, as portrayed in Table 4 and Table 5. For example, 22.2% of the financing provided by RHB Islamic is based on *Musharakah*, followed by Affin Islamic at 33.3%, HSBC Amanah at 39%, Public Islamic at 49.1%, and Standard Chartered Saddiq at 51.2%. This is in contrast with full-fledged Islamic banks, which recorded only around 1% of financing based on *Musharakah*. Ariff (2017) argued that Islamic subsidiaries have strong backing from their parent banks. Whilst foreign Islamic banks also have the support of their Islamic parent banks abroad, they lack the logistics and institutional infrastructure enjoyed by the Islamic subsidiaries of conventional parent banks. He pointed out that local Islamic subsidiaries received implicit subsidies from their conventional parent banks. However, debt-based financings such as *Murabahah*, *Tawarruq*, BBA, *'Inah,* and AITAB remain dominant in both full-fledged Islamic banks and Islamic subsidiaries.

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Table 4 : Total Financing for Individual Islamic Banks in RM (‘000) (2016-2020)

Bank	BBA & *‘Inah*	*Ijarah*	AITAB & IMBT	*Murabahah & Tawarruq*	*Musharakah*	*Mudarabah*	*Istisna'*	Others	Total
Panel A: Full-fledge Islamic Bank									
ArRajhi	16,940,571	N/A	N/A	10,539,409	N/A	N/A	N/A	4,969	27,484,949
Bank Islam	25,288,390	N/A	833,563	206,654,408	N/A	N/A	640,767	1,441,635	234,858,763
KFH	N/A	N/A	10,687,370	16,891,000	363,467	263,517	5,528	6,541	28,217,423
MBSB	9,129,680	N/A	4,914,497	89,663,297	N/A	N/A	165,147	353	103,872,974
Muamalat	28,323,612	65,834	3,264,305	90,389,925	344,921	N/A	855,050	3,263,084	126,506,731
Panel B: Subsidiaries Islamic Bank									
Affin	4,819,244	5,349,188	19,132,408	23,174,105	28,158,905	N/A	3,421,490	437,835	84,493,175
Alliance	26,790,844	N/A	2,095,642	13,286,420	N/A	N/A	N/A	437,418	42,610,324
Ambank	51,324,570	N/A	31,491,395	57,050,388	1,668,881	N/A	N/A	3,395,215	144,930,449
CIMB	74,179,543	N/A	44,766,064	220,313,478	N/A	N/A	N/A	1,340,514	340,599,599
Hong Leong	29,865,533	375,170	17,883,309	70,206,546	N/A	N/A	N/A	115,940	118,446,498
HSBC	10,842	4,656	975,006	34,942,179	26,262,294	N/A	N/A	5,137,648	67,332,625
Maybank	175,117,673	856,106	184,136,712	971,189,326	15,385,675	N/A	407,836	5,837,387	1,352,930,715
OCBC	3,120,242	1,654,200	21,354,151	26,351,237	981,172	N/A	N/A	603,498	54,064,500
Public	66,393,842	N/A	49,418,312	800,236	112,925,761	N/A	N/A	636,392	230,174,543
RHB	8,408,385	N/A	36,813,949	152,846,031	57,150,136	N/A	N/A	1,878,882	257,097,383
SC	3,050,551	401,875	193,356	9,896,375	14,735,973	N/A	N/A	486,651	28,764,781

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Table 5 : Islamic Financing Ratio for Individual Islamic Banks (2016-2020)

Bank	**BBA & *'Inah***	***Ijarah***	**AITAB & IMBT**	***Murabahah & Tawarruq***	***Musharakah***	***Mudarabah***	***Istisna'***	**Others**	**Total**
Panel A: Full-fledge Islamic Bank									
ArRajhi	61.6%	0.0%	0.0%	38.3%	0.0%	0.0%	0.0%	0.0%	100%
Bank Islam	10.8%	0.0%	0.4%	88.0%	0.0%	0.0%	0.3%	0.6%	100%
KFH	0.0%	0.0%	37.9%	59.9%	1.3%	0.9%	0.0%	0.0%	100%
MBSB	8.8%	0.0%	4.7%	86.3%	0.0%	0.0%	0.2%	0.0%	100%
Muamalat	22.4%	0.1%	2.6%	71.5%	0.3%	0.0%	0.7%	2.6%	100%
Panel B: Islamic Bank Subsidiaries									
Affin	5.7%	6.3%	22.6%	27.4%	33.3%	0.0%	4.0%	0.5%	100%
Alliance	62.9%	0.0%	4.9%	31.2%	0.0%	0.0%	0.0%	1.0%	100%
Ambank	35.4%	0.0%	21.7%	39.4%	1.2%	0.0%	0.0%	2.3%	100%
CIMB	21.8%	0.0%	13.1%	64.7%	0.0%	0.0%	0.0%	0.4%	100%
Hong Leong	25.2%	0.3%	15.1%	59.3%	0.0%	0.0%	0.0%	0.1%	100%
HSBC	0.0%	0.0%	1.4%	51.9%	39.0%	0.0%	0.0%	7.6%	100%
Maybank	12.9%	0.1%	13.6%	71.8%	1.1%	0.0%	0.0%	0.4%	100%
OCBC	5.8%	3.1%	39.5%	48.7%	1.8%	0.0%	0.0%	1.1%	100%
Public	28.8%	0.0%	21.5%	0.3%	49.1%	0.0%	0.0%	0.3%	100%
RHB	3.3%	0.0%	14.3%	59.5%	22.2%	0.0%	0.0%	0.7%	100%
StanChart	10.6%	1.4%	0.7%	34.4%	51.2%	0.0%	0.0%	1.7%	100%

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

5.0 Conclusion and Recommendations

With VBI now at the forefront of the agenda, Islamic banks should be at the forefront of funding productive ventures, creating real wealth, and raising living standards. Increasing equity-based financing might be one of the means to make this possible. Although equity-based financing has shown a positive and encouraging trend, this research indicates that Islamic banks in Malaysia have adopted almost similar approaches as their conventional counterparts. They act almost similarly to conventional banks and prefer to offer and provide debt-based financing. Islamic banks also allocate a significant portion of financing for households, which is considered not only unproductive but also contributes to asset price inflation that subsequently leads to a higher cost of living. This raises the question of the ethicality of the Islamic banks. Are they complicit in 'instigating' financial insecurity and partly to blame for lower living standards?

Islamic banks are therefore expected to revive the original idea behind their establishment. In the whole scheme of Islamic finance, Islamic banks should serve to fulfill *Maqasid al-Shariah* and not merely offer products and services that comply with the legal dimensions of the Shariah. Islamic banks need to reduce financing for non-productive activities that are not aligned with the objectives of Shariah of fulfilling *daruriyyat* or *hajiyyat* (essentials and complementaries). Islamic banks should refrain from financing *tahsiniyyat* (luxuries), as people should seek to acquire them without engaging in debt via financing. After all, easy financing, especially for non-essential items is non-productive and a waste of real resources; it does not contribute towards improving the welfare of the population but also increases the risk of financial instability. In addition to that, it would potentially cause higher prices due to inflationary pressure. However, this would of course put Islamic banks at a disadvantage, as conventional banks would continue to provide financing (i.e., loans) for such purposes. Moving forward, a shift towards more productive financing by Islamic banks is expected, as they need to align themselves with the VBI agenda. The pertinent question then is: do Islamic banks' financing practices resemble those of conventional banks?

This study contributes to the limited literature on financial ethics concerning the financing practices of Islamic banks. It is anticipated that this research would potentially initiate more discussions on the ethicality of Islamic banks and improve current practices. We argue that there should be distinguishing features of Islamic banks that would

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

differentiate them from conventional banks, transcending the prohibitions of *riba', gharar*, and *maysir.*

Acknowledgments

This research received a Research Collaborative Fund (RCF) grant from Universiti Teknologi Mara Cawangan Terengganu, Malaysia.

References

Aggarwal, R. K., & Yousef, T. (2000). Islamic Banks and Investment Financing. *Journal of Money, Credit and Banking*, *32*(1), 93. https://doi.org/10.2307/2601094

Ahmed, T. (2015). Islamic finance ijtihad in the information age: Quo vadis? In H. A. El-Karanshawy, A. Omar, T. Khan, S. Syed Ali, H. Izhar, W. Tariq, K. Ginena, & B. A. Quradaghi (Eds.), *Ethics, Governance and Regulation in Islamic Finance* (4th ed., pp. 1–8). Bloomsbury Qatar Foundation Journals.

Ariff, M. (2017). Islamic banking in Malaysia: The changing landscape. *Institutions and Economies*, *9*(2), 1–13.

Bank Negara Malaysia. (2021). *Monthly Highlights and Statistics*.

Barba, A., & Pivetti, M. (2009). Rising household debt: Its causes and macroeconomic implications - A long-period analysis. *Cambridge Journal of Economics*, *33*(1), 113–137. https://doi.org/10.1093/cje/ben030

Berrak, B., & Neven, T. V. (2010). The role of household and business credit in banking crises. *Journal of Banking & Finance*, *34*(6), 1247–1256.

Cervik, S., & Charap, J. (2011). *The behavior of conventional and Islamic bank deposit returns in Malaysia and Turkey* (WP//11/156; IMF Working Paper).

Chong, B. S., & Liu, M. H. (2009). Islamic banking: Interest-free or interest-based? *Pacific Basin Finance Journal*, *17*(1), 125–144. https://doi.org/10.1016/j.pacfin.2007.12.003

El-Gamal, M. A. (2006). Islamic finance: Law, economics, and practice. In *Islamic Finance: Law, Economics, and Practice*. Cambridge University Press. https://doi.org/10.1017/CBO9780511753756

Frankel, J., & Saravelos, G. (2012). Can leading indicators assess country vulnerability? Evidence from the 2008-09 global financial crisis. *Journal of International Economics*, *87*(2), 216–231. https://doi.org/10.1016/j.jinteco.2011.12.009

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/

Iqbal, Z. (1997). Islamic Financial Systems. In *Finance & Development* (Issue June, pp. 42–45). International Monetary Fund. https://doi.org/10.4337/9781843762959.00012

Ito, T. (2013). Islamic rates of return and conventional interest rates in the Malaysian deposit market. *International Journal of Islamic and Middle Eastern Finance and Management*, *6*(4), 290–303.

Kasri, R. A., & Kassim, S. H. (2009). Empirical determinants of saving in the Islamic banks: Evidence from Indonesia. *Journal of King Abdulaziz University, Islamic Economics*, *22*(2), 181–201. https://doi.org/10.4197/islec.22-2.7

Mansour, W., Ben Jedidia, K., & Majdoub, J. (2015). How ethical is islamic banking in the light of the objectives of islamic law? *Journal of Religious Ethics*, *43*(1), 51–77. https://doi.org/10.1111/jore.12086

Mian, A., Rao, K., & Sufi, A. (2013). Household Balance Sheets, Consumption, and the Economic Slump. *The Quarterly Journal of Economics*, *128*(4), 1687–1726.

Nazar, J. K. (2015). Regulatory and financial implications of Sukuk's legal challenges for sustainable Sukuk development in Islamic capital market. In H. A. El-Karanshawy, A. Omar, T. Khan, S. Syed Ali, H. Izhar, W. Tariq, K. Ginena, & B. A. Quradaghi (Eds.), *Ethics, Governance and Regulation in Islamic Finance* (4th ed., pp. 135–134). Bloomsbury Qatar Foundation Journals.

Philippon, T. (2017). Finance, Productivity, and Distribution. *National Bureau of Economic Research*, *October*, 1–11.

Rose, A. K., Spiegel, M. M., Rose, A. K., Spiegel, M. M., Rose, A. K., & Spiegel, M. M. (2011). *FEDERAL RESERVE BANK OF SAN FRANCISCO Cross-Country Causes and Consequences of the Crisis : An Update An Update*.

Zulkhibri, M. (2018). The impact of monetary policy on Islamic bank financing: bank-level evidence from Malaysia. *Journal of Economics, Finance and Administrative Science*, *23*(46), 306–322. https://doi.org/10.1108/JEFAS-01-2018-0011

Copyright © 2018 Malaysian Consumer and Family Economics Association (MACFEA).
This is an open access article under the CC BY-SA
https://creativecommons.org/licenses/by-sa/4.0/