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COMMERCIAL BANKING IN LIBYA AND THE POTENTIAL FOR ISLAMIC BANKING

By
Amal Kumati

Thesis presented in fulfilment of the requirements for the award of the Doctor of Philosophy Degree at the School of Government and International Affairs, University of Durham

2008

2 6 JAN 2009

ABSTRACT

Islamic banking and finance is considered a novel way of conducting financial matters for growth and social inclusion. It has expanded in an unprecendented manner since its initial appearance in the mid-1970s. Since then, Islamic banking has earned recognition worldwide which has paved the way for a rapid growth in the Islamic banking services industry. With this background, this study focuses on the potential for Islamic banking in Libya.

Since the 1970s the Libyan banking sector has witnessed remarkable changes especially after the state introduced the nationalisation programmes and socialist system. Under public ownership, the banking industry, however, has underperformed due to various problems such as the high level of non-performing loans. Therefore, the state has recently initiated a reform and deregulation policy to enhance the performance of the sector. This study aims to analyse the developments which have taken place in the Libyan banking sector not only to evaluate performance but also to discuss the reasons for underperformance. However, importantly, this research explores the potential demand for Islamic financial services in Libya by also questioning relevant issues. The methodology of the study includes a literature review, data collection, analysis of available banking system statistics and semi-structured interviews with experienced bankers. The empirical research in this study is based on a survey conducted in the city of Benghazi, one of the largest financial centres in the country.

The empirical findings on Libyan banking demonstrate that the sector is plagued by problems which weaken its contribution to the economy. The second part of the empirical results has proved that there is a significant demand for Islamic banking in Libya. Although the respondents and interviewees were less familiar with Islamic banking products, services and principles, the study has proved that Islamic banking in Libya is developing tangible roots and has a growing level of support and demand.

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DECLARATION

I hereby declare that this thesis results entirely from my own efforts and confirm that none of the material in this study has previously been submitted by me for a degree in this or in any other University.

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Dedicated to

My Beloved Parents,

Professor Rodney Wilson,

Dr Mehmet Asutay,

and Mr AbdElslam Mokhtar

With love

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LIST OF ABBREVIATION

ABBREVIATION	FULL NAME
AAOIFI	: The Accounting and Auditing Organisation for Islamic Financial Institution
ATM	: Automated Teller Machine
BCD	: The Bank of Commerce and Development
CBL	: The Central Bank of Libya
CSF	: Critical Success Factors
CSR	: Banks' Social Responsibility
EPS	: Earnings per share of stock
GBOT	: General Board of Privatisation
GDDS	: General Data Dissemination System
GMMR	: The Great Man Made River
IMF	: International Monetary Fund
LC	: Letters of Credit
LD	: Libyan Dinar
LFIB	: Libyan Foreign Investment Board
NCB	: National Commercial Bank
NIC	: National Investment Company
OIC	: Organisation of Islamic Conference
PLS	: Profit and Loss Sharing
SRS	: Simple Random Technique
ROA	: Return on assets
ROE	: Return on equity
UEA	: United Arab Emirates
UN	: United Nations
US	: United States
WTO	: World Trade Organisation

Glossary of Islamic/Arabic Terms Frequently Used in the Study

Word	Meaning
Arrahnu	Collateral.
Bai al Inah	Sell and Buy back.
Fatwa	A scholarly opinion on a matter of sharia.
Fiqh	The science of sharia.
Fiqh almua'mat	Islamic commercial jurisprudence.
Gharar	Uncertainty.
Halal	Lawful.
Haram	Forbidden.
Kafalah	Guarantee.
Ijara	Leasing or contract hire.
Ijara wa Iktina	Leasing to purchase or hire purchase.
Istisna	Manufacturing.
Madahab	Islamic School.
Mudaraba	Trust financing.
Mudaraba-bi-muajjal	Deferred payment basis.
Mudarib	Entrepreneur in trust financing.
Mufawoda	Equal partnership.
Musharaka	Equity participation or joint venture.
Murabaha	Cost-plus or mark-up.
Nasiah	Delay.
Rabb al-mal	Owner of capital.
Riba	Interest.
Qard al-hasn	Interest free loans or Nobel loan.
Sharia	Islamic law.
Shirkah al-ian	Two or more parties contributing to a capital fund either by money or labour.

Sukuk	Certificate or Islamic bond.
Takaful	Islamic insurance
Urf	Social custom
Wadiah	Safe keeping
Zakah	The amount payable by a Muslim on his net worth to poor people.

Chapter One

Introduction

1.1 Introduction

Islamic banks have grown recently in the Muslim world and Islamic banking products have became available outside the borders of the 56 members of the Organization of the Islamic Conference (OIC)[1]. However, almost all the major players in the world have begun to offer Islamic banking products. Muslims and non-Muslims have the possibility of opening current accounts and obtaining mortgages for their houses in compliance with religious and moral principles.

As a matter of fact the recent unprecedented achievements of Islamic banking have led the International Monetary Fund (IMF) and the World Bank to recognize Islamic financial products as valid means of financial mediation and have published studies and papers to this effect.

It should, however, be noted that the attitudes of the OIC members towards Islamic banking differ. In Qatar, Bahrain, Kuwait, the United Arab Emirates, Pakistan, Iran and Sudan, Islamic banking has gained a considerable impressive share in the financial markets and receives government support[2]. In the other member countries, such as Turkey, Tunisia, Syria and Algeria, Islamic banking remains marginal and works in mixed environments. Saudi Arabia did not permit Islamic banking until March 1987 when the first Islamic bank was licensed under the umbrella of a commercial bank[3]. Although Morocco and Libya are countries that place emphasis on Islamic bases of legitimacy, they view autonomous Islamic financial institutions with suspicion and at present do not permit Islamic banking.

---

[1] Organisation of the Islamic Conference. [On line]. Available from: http://www.oic-oci.org/home.asp. [Accessed on 10th October 2006].

[2] Clement M, H. Islamic Banks and Competitive Politics in the Arab World and Turkey. *Middle East Journal.* Spring 1990, 44(2), pp. 234-255.

[3] Ibid.

In the case of Libya, for hundreds of years Islam has been the official religion. Soon after taking office, the revolutionary government expressed a clear desire to exalt Islam and restore it to its proper central place. Several steps have been taken by the government to show itself as a devout Islamic government. During the 1970s, Islam in Libya played a major role in legitimizing spheres of political and social reform, but not in the realm of economics and finance. Moreover, during this time the Libyan banking sector witnessed a significant transformation, characterized for more than three decades by massive state intervention in the commercial banking sector. This has led the sector to unacceptable performance and to be less diverse in term of its banking services and products compared to other developing countries. This study, hence, attempts to explore the possibility of Islamic banking and finance in Libya by contextualizing it within the larger body of Libyan commercial banking and the transformation it has taken.

This chapter aims to introduce the main issues of the study. These include its main purpose; the research questions; its aims and objectives; its significance; the sources of data and the structure.

It should be noted that in this study Islamic banking refers to a banking system that accords with Islamic and ethical principles and has the same functional purposes as conventional banking.

1.2 Statement of the Problem

The banking sector always plays an important role in any emerging nation's economy through its intermediation between depositors and investors. As a developing sector of the economy, the Libyan banking industry has undergone fundamental change. Due to governmental interventions, profitability and efficiency were not among the top priorities, the primary role of the banking sector was to channel funds to the public sectors. The results of this change

were the lack of a prudent regulatory and supervisory framework; the lack of an internal control system; mismanagement; the growth of non-performing loans and over-employment. All of these malpractices have led to a decline in the performance as well as inefficiency of the sector. Therefore, the state has adopted policies to liberalize the banking sector in order to improve the sector's performance. As a consequence private banks have been opened and many laws enacted to encourage foreign investors to take part in the development of the banking sector.

After over a decade of implementing policies to liberalize the banking sector, services and products are still very limited. It seems that not opening up some aspects of the banking industry such as Islamic banking has fragmented a considerable section of Libyans who have led an Islamic life, which has resulted in financial exclusion. They have become dissatisfied by conventional banking services and are looking for a banking system in accordance with Islamic doctrines and moral principles as part of their search for a new Islamic identity. As part of this identity, their saving habits are influenced by what they believe is prohibited interest. Therefore, as a consequence of financial exclusion, they are losing opportunities to use their savings in productive and profitable ways. They insist keeping their savings in gold or under their mattresses and so lose the opportunity to stay in close contact with the banking system and support the national economy by contributing to the expansion of financial base of the country. Moreover, as the country has adopted an open-economy policy, many new immigrants are losing the chance to use ethical banking.

It is easy to argue that Libya has a dual view in dealing with Islamic banking. First, in the international sphere, Libya considers it as a profitable investment sector which is always ready to invest in projects in the sector. Second, in the national sphere it is considered as having unwelcome connections with terrorist groups. It is easy to claim that Libya's case

provides evidence for the argument that "Muslim governments tend to be a lot more Islamic outside their own borders than within"[4].

1.3 Aims of the Study

From the previous considerations, the main aims of this research can be stated as: first, it aims to examine the structure, services, performance, reform and perceived obstacles and development of the Libyan commercial banking. Second, because previous studies have concentrated on the Libyan banking sector's regulatory, performance and operational side and disregarded the possibility of introducing new services, one of the basic aims of this study is to explore the possibility of introducing Islamic banking to Libya as a new service. In other words, the study has a particular value in providing a better understanding of the principles, services and fundamental characteristics of Islamic banking and what it could offer the banking industry and the country.

1.4 Objectives of the Study

There are many issues that need to be addressed, before looking at the contents of the study in detail. The general objectives of the study can be summarized as follow:

1) a review of the literature on the Islamic banking industry concerning its principles, regulation and methods of finance;

2) an investigation of the role of Islamic banks as intermediates between savers and investors;

3) an empirical examination of the ability of Libyan society to accept and utilize Islamic banking services and products;

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[4] Kahf, Monzer. Islamic Banks: The Rise of a New Power Alliance of Wealth and Shari'a Scholarship. Chapter 1. In: Henry, Clement, M, and Wilson, Rodney. (eds). *The Politics of Islamic Finance.* Edinburgh: Edinburgh University Press. 2004, p. 21.

4) an investigation of the reasons that have hindered the development of Islamic banking in Libya;

5) based on previous considerations, a predication of the future of Islamic banking, of its providers and regulation;

6) a survey of the main features of the Libyan commercial banking sector such as services, bank types and regulation;

7) determination of the main factors which influence the performance of the Libyan commercial banking sector;

8) provision of a practical approach to improve the commercial banking sector's future performance and provision of a descriptive analysis of the Libyan commercial banking sector which may help future researchers in the area.

1.5 Research Questions

Since Libyan banking statistics and publications give few details about the sector's performances, or help in predicating the future financial attitudes of the sector, it makes it very difficult to estimate performance accurately. Thus, the study attempts to focus on two areas:

First, the Libyan Commercial Banking Sector: in consideration of the performance and reforms of the Libyan banking sector in the last thirty-five years the study will attempt to answer: a) whether the current performance of the Libyan banking sector is acceptable; b) what obstacles are hindering the reform of the sector; c) what the country needs to attract foreign banks to operate in Libya.

Second, Islamic banking: contrary to the situation in Libya, most other countries worldwide have given early recognition to an Islamic banking sector. Therefore, this study attempts to answer: a) what reasons have hindered the build up of an Islamic banking sector in Libya; b)

should Islamic banks open up in Libya, what would be the level of services utilisation and the acceptances of the industry within Libyan society?; c) building on the previous questions, should an Islamic banking system be implemented, what forms of regulation, supervision, provider and channels of products and services would there be; d) what would the industry provide for benefit of the country's economy and banking system?

1.6 The Significance of the Study

In general, the significance of the study stems from its originality and purpose: a) it is the first piece of research at this academic level in Libya concerned with Islamic banking, both at a theoretical and a practical level; b) it sheds light on the nature, structures and principles of Islamic banking to help in explaining and introducing the industry in Libya; c) it enables both policy-makers and academic researchers to benefit from this study since many aspects of the present Libyan banking sector have not been previously analysed and discussed; f) the study may also contribute to the development and reform of the Libyan banking system as well as being used for comparative purposes and future studies; g) the study is intended, as a guide for any further attempt to introduce new banking services to Libya.

However, it is worth mentioning that the research analysis is purely academic and does not suggest or imply a certain path for the state and monetary authorities to follow. The research simply describes situations as they are and explains how they could appear in the event of Islamic banking establishing a presence. Moreover, there is no current indication that Islamic banking is about to become a major presence within Libyan banking.

1.7 Source of Data

Despite the data collection problems associated with the absence of a suitably comprehensive and accurate data base and an information banking centre, the researcher has depended on the

following sources to meet the aims and main objectives of the research,: first, visits: during the preparation of the research, the researcher visited many of bank branches, agencies and headquarters. The value of these visits was the opportunity to observe the banking sector in its physical environment in addition to observing the procedures in managing day-to-day work and noting the difficulties that obstruct its efficiency and development. In addition, secondary data from the official publications of the Central Bank of Libya (CBL) were collected. These included statistical information on both the sector in general and on individual banks. These publications include details of CBL Annual Reports, Economic Bulletins, Special Reports and Studies, the Official Gazette, and government decrees and acts. In addition there were the annual reports of individual commercial banks, international financial statistics, International Monetary Fund papers, regional country reports and World Bank publications. At a third level there was the theoretical literature which included reviews of other empirical studies regarding the banking industry in general and commercial and Islamic banking in particular. In addition, information was gathered from books, articles and newspapers by utilizing university libraries and other relevant specialist libraries. At a fourth level was empirical fieldwork, which to a large extent constitutes the main source of primary data. This was necessary, as mentioned earlier because of the lack of publicly available information regarding the Libyan banking sector in general.

The main research instruments were semi-structured interviews and a questionnaire. The interviewed groups included thirty interviewees closely attached to the banking sector and with considerable knowledge regarding Islamic finance. These groups consisted of bankers, scholars and jurisprudents. Moreover, the questionnaire was designed and distributed to explore the extent of the participants' knowledge of Islamic banking as well as their opinions. Therefore, the questions included open-ended questions to stimulate ideas alongside closed questions to obtain more specific information.

1.8 Limitation of the Study

This study has essentially explored certain aspects of the Libyan banking sector and the possibility of implementing Islamic system banking in Libya. The study, however, is not intended to present a final solution to all difficulties and a defect in Libya's banking system. It is hoped that the points made will be taken into consideration in any future plans for developing and reforming the Libyan banking sector.

It must be stressed that, due to the wide scope of the subject and the limited time allotted to carry out this study, it was not possible to cover in depth every aspect. Moreover, taking into account the constraints of time in relation to the limitations on information, data and costs, the study was carried out within the city of Benghazi.

1.9 The Structure and Overview of the Study

This study is organised into ten chapters. The present chapter is an introductory one, in which the objectives and aims of the study are explained, the notion of implementating Islamic banking in Libya is introduced, and the contents of the thesis are outlined.

Chapter two is concerned with the research methodology, describing the research process and methods used in this study. It presents, in detail, the rationale for adopting a combination of methods and issues related to data collection, regarding the questionnaire survey, the methods used to collect data, the data presented, including the questionnaire design, the pilot study and the distribution procedure. In addition semi-structured interviews, access and interview strategies are discussed as well as the statistical analysis that was employed.

In chapters three and four, the theoretical background is presented by means of a review of literature relevant to Islamic banking. Therefore, chapter three a gives brief idea about the principles and methods of finance of Islamic banking. Chapter four outlines the role of the Islamic banks as financial intermediaries.

Chapter five provides a more detailed description of the Libyan Commercial Banking Sector and the role of the Central Bank of Libya (CBL). Chapter six contains a discussion of banking reform in Libya, which also analyses the problems behind the Libyan commercial banking. Chapter seven in turn provides financial analysis of the Libyan commercial banking sector performance by highlighting important historical indicators of the sector over the period 2000-2005.

Chapter eight focuses on the results of the analysis of the questionnaire survey presenting the descriptive empirical findings from bank customers and non bank customers. Chapter nine presents the analysis of the interview survey, which was conducted with interviewees such as Libyan bankers, *sharia* scholars and jurists.

Chapter ten presents the general findings and highlights the main conclusions. It also contains a number of recommendations and suggestions for areas of further research.

Chapter Two

Research Methodology

2.1 Introduction

The study aims to examine and discover the compatibility of the Libyan banking sector and social culture with the Islamic banking sector. In addition, it also aims to examine the structure, services, performance, reform and the perceived obstacles to the development of the Libyan commercial banking sector. Consequently, the study attempts to provide a clear potentiality and compatibility for Islamic banking in Libya, from the customers' and bankers' points of view and to suggest possible ways to improve the banks' quality of service and to implement Islamic banking.

In fulfilling these aims, formulating the research problem is the first important step in the research process. The second important step is to decide on a system of methods to follow in conducting the research, which is called methodology.

A research method is a particular procedure or approach for accomplishing or tackling a research question. The research approach is a way of dealing with the research's problems. Therefore, the term methodology means "a set of methods and principles used to perform a particular activity"[5]. Some authors believe that in a methodology there is an overall philosophical approach to the research problem. For example, Miller and Brewer see methodology as "a set of rules and procedures to guide a researcher and against which his/her claims can be evaluated. It is therefore fundamental to the construction of all forms of knowledge"[6]. Kumar has extended the role of methodology by stating that "research methodology is taught as a supporting subject in several ways and in many academic

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[5] Wehmeier, Sally, and Ashby, Michael *Oxford Advanced Learner's Dictionary.* Oxford: Oxford University Press. 2000, p. 803.

[6] Miller, Robert, and Brewer, John. *The A-Z of Social Research.* London: SAGE Publications Ltd. 2003, p. 192.

disciplines such as health, education, psychology, social work, nursing, public health, library studies and marketing research"[7].

Broadly speaking, there are two approaches to collecting information for research purposes: the quantitative and the qualitative methodologies. However, between the 1970s and 1990s the qualitative approach started to gain greater recognition[8]. During this period the phrase 'Qualitative research' began to be used in many fields. It became the dominant type of research in the social sciences. However, by using this approach the researcher is required to look for clues, motivations and key words beneath the surface of a subject to challenge and tease out the contradictions[9].

As qualitative research is concerned with the quality of the information not the quantity, it is designed to talk to relatively few people in the target audience. Hancock argues that "qualitative research is concerned with finding the answer to questions which begin with: why, how, and in what way"[10]. In other words qualitative research attempts to increase researchers' understanding of why things are the way they are in their field of studies, and why people act the way they do. Therefore, qualitative research can be considered to a large extent as a basic methodological framework which may have different adopted approaches (ways of considering) in the social sciences.

The aim of this chapter is to draw attention to the research's methodology and the methods used. The first section defines the research triangulation or the use of multi research methods. The second section explains the research design. The third section deals with the rationale for choosing qualitative research. The fourth section reveals the duration and the scope of the research methodology. The fifth section outlines the interview preparations such as the list of

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[7] Kumar, Ranjit. *Research Methodology: A Step by Step Guide for Beginners*. London: SAGE Publications Ltd. 2005, p. xvii.
[8] Hancock, Beverly. *Trent Focus for Research and Development in Primary Health Care: An Introduction to Qualitative Research.* Division of General Practice. University of Nottingham .2002, p. 2.
[9] Ibid, p. 3.
[10] Ibid, p. 2.

questions, the issues that need to be considered during the interviews, the interview samples and the conduct of the interviews. The subsequent section reviews the questionnaire processes such as preparation, sampling, the carrying out of the pilot study, and the main questionnaire, data analysis and the statistical techniques used. Finally, the chapter summarises the study's methodology.

2.2 Triangulation: Use of Multi-Research Methods

Due to the complexity and sensitivity of the research topic, the researcher believed that it was necessary to use more than one research method to complete the study. Therefore, triangulation was used in this research for improving the validity, reliability, and evaluating the research findings. In other words, the benefits of triangulation in the case of this research is increased confidence in research data, the creation of innovative ways of understanding the implementation of Islamic banking in Libya, and the provision of a clearer understanding of the research problem.

Grewawell and Miller define triangulation as "a validity procedure where researchers seek convergence among multiple and different sources of information to form themes or categories in a study"[11]. Patton advocated the use of triangulation by stating "triangulation strengthens a study by combining methods. This means using several kinds of methods or data, including both quantitative and qualitative approaches"[12]. In terms of triangulation types, Thurmond states that triangulation can be of two types: first, inter-method triangulation, which includes two or more methods of different nature and origin; and second intra-method triangulation, which employs two or more techniques of the same method[13].

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[11] Grewawell, J.W, and Miller, D.L. Determining Validity in Qualitative Inquiry. *Theory Into Practice*, 39(3). 2000, pp. 124-131.
[12] Potton, M.Q. *Qualitative Evaluation and Research Methods*. 3rd ed. Thousand Oaks, CA: Sage Publication, p. 247.
[13] Thurmond, Veronica. A. The Point of Triangulation, *Journal of Nursing Scholarship*. (33) 3. 2001, p. 256.

For this study, the researcher believes that qualitative and quantitative methods can be used together as a valuable option to obtain complementary findings and to strengthen the results. For these reasons, and to achieve the aims and objectives of this study, both quantitative methods, in the form of a questionnaire survey, and a qualitative method, in the form of interviews, were employed in order to obtain all the information. In addition, a third data collection method with descriptive data and descriptive analysis was also employed to build the literature chapters which relied on textual analysis and also secondary data both in the form of qualitative and quantitative data. All three of these three methods were employed to enhance, strengthen, and reduce weaknesses in each method.

2.3 Rationale for Choosing Qualitative Research

Islamic banking is new territory in Libya. It has not yet been officially introduced in the country. Moreover, little has been written about the banking system in Libya. The researcher has assumed that qualitative research can be a powerful tool that can play an important role in the study. There are several reasons for this. First, qualitative research will allow the researcher to use a variety of research tools such as interviews and a questionnaire together. This permits the build-up of an overall picture about the subject. It should enable an in-depth view of the Libyan banking phenomenon and in its various guises. Second, qualitative research is a very useful tool to investigate why and how the decisions in the Libyan banking system are made in addition to pursuing the reasons behind several other aspects of behaviour in the sector. Third, to a large extent, the approach can help to build up the reliability and credibility of the information gathered from the interviews. This information, however, cannot be graphed or displayed in mathematical terms. Fourth, as the financial and banking field in Libya suffers from a paucity of published information and a deluge of banking regulations the approach can help explain some contemporary Libyan banking attitudes and financial

situations. It is the researcher's intention to achieve this by interviewing responsible, skilled, experienced and informed people involved in the industry.

Most importantly, the researcher believes that qualitative research, as exploratory research, can help get behind the obscurity of certain banking services. In addition, qualitative research can be a suitable tool to highlight the most important obstacles that are hindering the Libyan banking sector from achieving its rehabilitation goals and to explore the possibility of providing Islamic banking in Libya.

2.4 Research Design

There is a variety of qualitative research designs[14]. The five types of qualitative inquiry most frequently appearing in the literature are biographies, phenomenological studies, grounded theory studies, ethnographies, and case studies[15].

A research design is used to structure the research to show how all the major parts of the research project work together to address the central research questions. Kumar defines research design as "a procedural plan that is adopted by the researcher to answer questions validly, objectively, accurately and economically"[16]. Bryman, mentions that research design has two functions[17]: the first relates to the identification and development of procedures and the logistical arrangement required to undertake the study, and the second to ensuring that these procedures are adequate, objective and accurate to answer the research questions[18].

The case study is one among other strategies used in qualitative research. According to Simon the case study is almost synonymous with the descriptive type of research[19]. One of the basic reasons to choose case study is when the study represents a unique or extreme case, or a

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[14] Coper, Cecily D. *Not Just A Numbers Thing: Tactics for Improving Reliability and Validity in Qualitative Research.* University of Southern California, p. 6.
[15] Ibid.
[16] Kumar, Ranjit. *Research Methodology; A Step by Step Guide for Beginners*, p. 84.
[17] Bryman, Alan. *Social Research Methods*. Oxford: Oxford University Press. 2001, p. 32.
[18] Ibid.
[19] Simon, Julian L. *Basic Research Methods in Social Science.* New York: Random House. 1996, p. 276.

revelatory case, where a researcher is investigating sensitive areas to carry out his research[20]. Therefore, Bryman sees a case study as "a social survey research on a single case with a view to revealing important features about its nature"[21].

It is essential that the case study takes the reader into the case situation. Thus, the case study method is used when a 'how' or 'why' question is asked about a contemporary phenomenon[22]. In terms of data collection, the case study method requires the use of multiple sources of evidence. According to Gary, this might include the use of structured, semi-structured interviews, field observations or document analysis[23].

As the study is based on a national, random sample of the population of Libya, and based exclusively upon qualitative research, it is considered as a case study for the potential introduction of Islamic banking in Libya. However, few Libyans know much about Islamic banking either in practice or principle. Nor is there much information available to assist them.

2.5 Research Methods

Researchers have an obligation to use appropriate research instruments in conducting their studies. Sometimes researchers need to identify their research instruments to put their findings into context. However, to ensure depth, the researcher will use two kinds of technique for data investigation and collection. The first technique is the interview in which the basis of the Libyan banking system, information on its background and the possibility of establishing Islamic banking in the country will be considered. The second technique is the use of the questionnaire as an investigative tool to learn about the Libyan banking sector's clients. It needs to be mentioned here that the researcher believes that both tools are essential for conducting a qualitative research on the subject under study.

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[20]Gary, David. *Doing Research in the Real World*. London: SAGE Publications.2006, p. 132.
[21] Bryman, Alan. *Social Research Methods*, p. 36.
[22] Gary, David. *Doing Research in the Real World*, p. 129.
[23] Ibid, p. 131.

2.6 Conducting the Research: Field Work

In order to achieve the research aims and objectives, field work was undertaken in Libya for a period of seven months in 2005 and 2006. The aim of the field work was to collect primary data related to the Libyan banking sector and explore the possibility of establishing an Islamic banking system in the country.

2.7 Interviews[24]

Interviews are ways of gathering broad qualitative data from a small number of people about a particular research issue. Thus, interviews can be described as qualitative research and accepted as powerful tools for acquiring valuable information and examining people's standpoints and the meanings that underpin their lives and behaviours[25]. Saunders and others mention that where the topic is seen by interviewees as relevant to their current jobs, people cooperate and mostly prefer to be interviewed rather than having to complete questionnaires[26]. There are different types of interviews which can be used to produce a transcript. Depending on the aims and objectives of the study, the researcher may decide to use more than one interview technique[27]. Walliman emphasizes that the most important issue when a researcher decides to conduct an interview is to know exactly what he wants to achieve from it and what he intends to do with the information[28]. It seems that another important factor in conducting interview is to built rapport and trust. This gives the interviewees the confidence to express their opinions and views and to illustrate and expand on their initial response.

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[24] Appendix 2.
[25] No Author. *Using Interviews in Research: A Handout for Students Doing Research Projects.* [On line]. Available from: http://www.rider.edu/suler/interviewes.html. [Accessed on 14th July 2007].
[26] Saunders, Mark. Lewis, Philip, and Thornhill, Adrian. *Research Method for Business Students.* 3rd Ed. Essex: Prentice Hall (Financial Times). 2003, p. 123.
[27] Walliman, Nichols. *Your Research Project: Step by Step Guide for the First Time Researcher.* London: Sage Publications. 2000, pp. 39-40.
[28] Ibid, p. 40.

The semi-structured interview is an interview tool, which is similar to the practice used by journalists[29]. It is a guided conversation where general as well as specific questions are asked[30]. However, the questions should not constrain the conversation and new supplementary questions are allowed to surface as a result of the discussion[31]. It can be argued that the semi-structured interview is non-standardized and also relatively informal. It is a kind of simple discussion, based on predetermined topics. Semi-structured interviews can be used in combination with other techniques such as a questionnaire[32]. It is widely accepted that the flexibility of the semi-structured interviews has led it to becoming one of the most commonly used tools in the research field.

The informal conversational interview is another type of interview, where most of the questions will rely on the spontaneous generation of questions and responses as the interview progresses. Gray sees it as the most open-ended form of interview technique. According to him the basic advantage of this approach is the flexibility it offers in terms of what path the interview can take[33]. The interviewees may not even know an interview is taking place[34]. However, in a society which has special features and circumstances such as Libyan society, the informal conversational interview can be a useful tool for obtaining data; and therefore this study uses informal, conversational-type interviews in collecting some of the primary data.

2.7.1 Preparation of the Interviews

In October 2005 preparation of the interviews was started. A list of topics and questions was designed for use in a particular order. The semi-structured interview was selected initially as

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[29] No Author. *Semi-Structured Interviewing*. [On line]. Available from: http://potals.win.wur.nl/msp/?semi-structuredinterviewing. [Accesses on 20th June 2006].
[30] Ibid.
[31] Ibid.
[32] Ibid.
[33] Gary, David. *Doing Research in the Real World*, p. 217.
[34] Ibid.

the main technique for conducting interviews. The researcher tried to achieve a balance and use open-ended questions to explore issues and obtain responses. These responses can be subsequently examined and compared. However, interview questions were tested on commercial banking experts who were excluded from the sample.

Two weeks before each interview the list of topics and questions was handed to each interviewee. A full introduction was made concerning the aims and objectives of the research and how this information would be used. For those who were less fluent in English, the transcription was translated into Arabic. Once an agreement was obtained, the following points were stressed: first, the interviewees would be strictly anonymous and no one apart from the researcher would know who took part. Second, there were no right or wrong answers to the questions. Third, the interviewees should indicate any questions they were not happy to answer. Fourth, the interviewees should feel free to discontinue their participation in the interview or halt it at any stage. However, the interviewees requested one-to-one interviews and not in a group or with two interviewers. This gave the researcher a good chance to discuss various sensitive issues.

2.7.2 Sample

According to Kumar, in qualitative research, "the issue of sampling has little significance as the main aim of most qualitative enquiry is either to explore or describe the diversity in a situation, phenomenon or issue"[35]. However, at the preparation stage, the researcher decided to use a fully random sample. Nevertheless, some possible interviewees refused to participate as, in addition to the sensitive nature of the research topic, they had never met the researcher before. They were reluctant, unhelpful and doubted the purpose behind the interviews. This lack of a simple understanding of the purpose of scientific research in general has led many

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[35]Kumar, Ranjit. *Research Methodology; A Step by Step Guide for Beginners*, p. 165.

researchers, including this researcher, to be unable to share in the opinions and attitudes of these people. Therefore, their opinions and attitudes, which may not correspond with those of the others, will not be reflected in any findings. It should, however, be stated that such a situation is not particular to this study, but rather a problem in all closed societies and communities where civil society has been slow to develop.

As the population was homogeneous, beside the significant role that personal relationships and contacts play in the sector, the researcher decided to select the sample according to the networking or snow-ball technique[36]. This technique of sampling is considered as very flexible with a wide range of opportunities to gain valuable information, especially when the population is homogeneous[37]. Moreover, Bryman mentions that the technique has attracted considerable attention among researchers over the years[38]. According to Lee, "in network sampling (snowball) the researcher starts from an initial set of contacts and is then passed on by them to others, who in turn refer others and so on"[39]. Thus, at the end of each interview, the researcher asked the interviewees to introduce her to others implying a snow-ball technique. This helped the researcher to meet sophisticated, cultured, supportive and enthusiastic interviewees who could understand the objectives of the research. This has also allowed the researcher to increase the sample size until no new view points emerged. Moreover, at this stage the researcher also decided to use informal interview techniques, beside semi-structured interviews and observation. Lee has pointed out that when the research is sensitive in nature the researcher can and should utilize whenever possible a variety of indirect data sources[40].

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[36] Walliman, Nichols. *Your Research Project: Step by Step Guide for the First Time Researcher*, p. 234.
[37] Ibid.
[38] Bryman, Alan. *Social Research Methods*, p. 98.
[39] Lee, Raymond. *Doing Research on Sensitive Topics*. London: SAGE Publications. 1993, p. 65.
[40] Ibid, p. 73.

2.7.2.1 Interview Sample Characteristics

As mentioned earlier, the sample was chosen using the snow ball technique. The target interviewees were *sharia* scholars, jurists and bankers in Libyan commercial banks, either private or state owned, which in terms of hierarchical line included department managers, branch managers, general mangers and chairmen of boards. It is worth mentioning here that the Libyan banking system, to a large extent, lacks standardization in its nomenclature. Consequently, the previous style of rank names will be used to refer to the interviewees' occupations. Most importantly, the specialist banks were excluded because of their special characteristics.

Experience was the second main feature in determining the participants. The interviewees' length of experience in their field varied from 15 years to 45 years. Moreover, many of them are over than 50 years old and none of them is under 36. As for gender distribution, all of the interviewees were men. However, as some of the highly experienced interviewees had considerably less academic education compared with others, the researcher decided not to consider education levels.

The final size of the sample was 30 interviewees: a small sample can provide a fair representation of the total population, especially where people work in the same environment and are subject to the same legislation[41].

2.7.2.2 Interview Stages

During the interviews it appeared that some interviewees, such as the jurists and bankers, had confused ideas about the Islamic banking system. One clear misunderstanding concerned the difference between the concepts of interest and mark-up. This was in addition to the existence and the functions of *sharia* supervision. However, some participants considered Islamic

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[41] Sekraran, Uma. *Research Methods for Business: A skill Building Approach*. 4th ed. USA: John Wiley& Sons. 2003, p. 260.

banking as religious business and accused it of funding terrorists. They view it as a sensitive area to deal with. Moreover, they claimed that the country may not be ready for it.

On the other hand, the participants do not see Islamic banking as another form of modern banking to be identified with politics. This situation led the researcher to conduct the interviews in two stages. In the first stage, the entire sample was interviewed regarding the Libyan commercial banking sector and its reform process. However, once their views on Islamic banking were known, the researcher decided to conduct 10 interviews with informed selected people about Islamic-banking related questions.

2.7.2.3 Conducting the Interviews

In accordance with the interviewees' wishes, all interviews were conducted at their workplaces and they determined the time of the interviews. This eased the way for the researcher to combine interviews and observation of the daily work in the banks.

In terms of recording interviews, the interviewees were worried about the use of a tape recorder and note-taking. Therefore note-taking after interviews was used as the main tool for recording. To avoid misinterpretation throughout the interviews, the researcher tried to clarify and extend the meaning of the questions and statements. Furthermore, the initial use of general topics gradually divided into a number of sub-topics. Interview questions were asked one at a time. Because of the variation in interview techniques and the interviewees' ability to express their ideas and thoughts, each interview was different.

In order to produce a clear picture of each interview the researcher went through her interview notes straight afterwards and grouped the comments according to the topics. To examine and compare the reliability of the information already gathered during the interviews, the interviewees were allowed to speak at great length about any issue they liked.

2.7.2.4 Analysing the Interviews: Interpretive Analysis

Semi-structured and informal interview techniques can be considered as appropriate ways to obtain qualitative information. Unforeseen topics may also emerge in this manner. In addition, open-ended questions may prove difficult to synthesise well enough to obtain clear results; such data may not be sufficiently precise to allow statistical analysis or the use of any software on it to build matrices. Therefore, the researcher utilised the interpretative method in analysing responses during the interviews.

2.8 Questionnaire[42]

The second method used to collect primary data for this research was the questionnaire. It should, however, be stated that questionnaires as tools of collection for primary data and their use in academic research are a controversial issue. Thus volumes have been written on questionnaires as research instruments for gathering information from people. The foundations of all questionnaires are the questions, and their wording is crucial. A good questionnaire must be free of ambiguity; it must be precise, clear, adequate, and every single question should express a single idea in order to fulfil the questionnaire's purposes[43].

Gary argues that when using a questionnaire the researcher should attempt to capture the values, perceptions and interests of the respondents[44]. He defines questionnaires as "research tools through which people are asked to respond to the same set of questions in a predetermined order"[45]. Kumar goes on to say that "in questionnaires, respondents read the questions, interpret what is expected and then write down the answers"[46]. He consequently argues that "in the case of a questionnaire, as there is no one to explain the meaning of

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[42] Appendix 2.
[43] Sekraran, Uma. *Research Methods for Business: A Skill Building Approach*, p. 239.
[44] Gary, David. *Doing Research in the Real World*, p. 189.
[45] Ibid.
[46] Kumar, Ranjit. *Research Methodology; A Step by Step Guide for Beginners*, p. 126.

questions to respondents, it is important that questions be clear and easy to understand"[47]. According to him, this is in contrast with the position in interviews where the interviewer can ask, explain the questions and then recode the participants' replies[48]. He sees this as the only different between interviews and questionnaires[49].

As questionnaires are fundamental elements that can address the needs of researchers, and not a mechanism for assessing respondents, Burgess insists that researchers need to review the literature and, in some cases, do preliminary research on their target population[50]. Accordingly, he believes this then drives researchers to design their questionnaires and select questions which are relevant, concise and efficient[51]. In other words, one can conclude that the content, structure, format and sequence of questionnaires must be clear and understandable in order to motivate the respondents to provide the information required.

2.8.1 The Main Goals of the Questionnaire

Goals in the academic research sphere are the aims of researchers. Goal setting can be an invaluable tool as it enhances and focuses attention on developing strategies for achieving goals. In this context, the main goals of the questionnaire were: first, collect the required primary data to answer the research questions; second, seek the respondents' opinions and general attitudes regarding the financial services that are being provided by the Libyan commercial banks; and third, determine the opinions and general attitudes of the respondents towards the establishment of Islamic banking in Libya.

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[47] Kumar, Ranjit. *Research Methodology; A Step by Step Guide for Beginners*, p. 126.
[48] Ibid, p. 127.
[49] Ibid.
[50] Burgess, Thomas. *A General Introduction to the Design of Questionnaires for Survey Research*. University of Leeds. May 2001, pp. 3-4.
[51] Ibid.

2.8.2 Questionnaire Preparation Stages and Drafts

The preparation of the questionnaire involved many drafts and stages. The first draft was drawn up in English in the winter of 2005, and then reviewed and assessed by the researcher's academic supervisor. The questionnaire was quite short. Some areas proved problematic and insufficient and some questions needed to be removed and additional ones incorporated.

In the light of research sensitivity, the researcher read and reviewed many research methodology books and incorporated ideas into the design of the questionnaire. In addition, the researcher also considered and reviewed the previous experiences of other researchers. Later on, modifications were made and a second draft was reviewed and assessed by the researcher's supervisor. Other academic staff members in the department were consulted on the questionnaire's design and the draft was modified and reviewed several times.

The final draft was translated into Arabic by an academic staff member in Garyounas University who specializes in English/Arabic translation. This was felt necessary because the majority of the respondents might have been unable to answer or at least have had difficulty in answering, English language questions.

Copies of the questionnaire were distributed and e-mailed for assessment to trusted Libyan people with experience in questionnaire design both within Libya and abroad. They were informed of the purposes of the study and requested to comment on the clarity and comprehensibility of the questions. And, as the drafts were in both Arabic and English, the feedback helped to improve the drafts in both languages. These last drafts were reviewed for advisory opinions and assessed by staff members in the Statistics and Computer Sciences Departments at the Garyounas University in Benghazi.

The purpose of the previous stages and drafts was to ensure that the questionnaire design was convenient for the study's aims and objectives in addition to suiting the nature and circumstances of Libyan society. This was to make the questionnaire easier to answer and

better for analysis. It should be mentioned in this regard that the study's aim in examining the possibility of introducing Islamic banking in Libya played a vital role in stimulating and encouraging expert feed-back.

2.8.2.1 Development of Themes for Analysis

Before choosing a statistical method to analyse the data, it is worth mentioning that there were some differences in the types of response between some questions but, by and large, the same themes emerged. Therefore, it was possible to use the same framework for different types of question. On this basis, the analysis that follows is based on a combined response analysis. Consequently, four themes emerge from these grouped questions:

- The first theme explored the respondents' profile such as age, level of education, and sources of income.
- The second theme concerned respondents' banking background: this theme dealt with the banking services, including issues such as quality of services, client relationships with their banks, and new services.
- The third theme involved respondents' attitudes towards banking interest and securing loans based on interest.
- The fourth theme investigated the respondents' attitudes towards establishment of Islamic banking in Libya. This theme formed the backbone of the study and concerns information gained about Islamic banks, cultural acceptance of Islamic banking principles, and actual practical acceptance of Islamic banking services.

2.8.2.2 The Conditions of the Questionnaire Design

Designing a questionnaire for a society like Libya's is never easy. This is because of the characteristics and circumstances of the society. In addition, no research has been done on the

subject of Islamic banking in Libya and little on the present Libyan banking system. Therefore, it was necessary to consider several conditions during the questionnaire's design. Accordingly, the questions were designed to satisfy at least the following conditions: first, the questions must be constructed in such a way that they were relevant to the themes of the study; second, all respondents must be given the assurance of anonymity so as to give free answers. Therefore, there was no scope for divulging any confidential information such as names; third, according to the previous conditions, open-ended questions were restricted to making comments, or adding information on specific questions. On the other hand, open questions which would require writing skills to express a respondent's feeling were deemed not appropriate, and regarded with suspicion by some respondents; fourth, regarding the earlier conditions, the questionnaires were distributed in random to the respondents.

2.8.2.3 Questionnaire Design and Layout

The questionnaire was an exploratory exercise in which the opinions of respondents were sought to obtain their attitudes towards the Libyan commercial banking system and the possibility of establishing an Islamic banking system. Indeed, to design a questionnaire in accordance with the study's objectives and for distribution in the Libyan society was not an easy task. Careful attention was given to the matter and many factors were considered in the composition of the questions in the belief that this would eliminate vague, biased, erroneous and irrelevant answers. Thus, in deciding how precisely to ask each question, every effort was made to use clear, simple, precise and direct words. This led the researcher from time to time to use a series of questions to meet one objective. Moreover, short questions were commonly used, as long questions take up more of the respondents' time and lead to ambiguity. Consequently, questions on similar topics were grouped together. In other words,

one can say that the questionnaire was designed to be largely sequential. Therefore, additional questions emerged from earlier.

The questionnaire was developed over a fairly extensive period of time during which several experts were consulted for advice and suggestions. As a result, the final draft was split into the following three parts.

First, the profile aim was to study aspects of the respondents' backgrounds, such as age, qualifications, marital status, gender and sources of income. All the background questions were tick questions. The questions Q.1- Q.6 were included in this part.

Second, the background was designed to explore the respondents' own banking environment such as length of experience, reasons for opening bank accounts, frequency of visits to their banks, methods of obtaining information about their bank accounts and general banking activities. Q2.1-Q2.18 were incorporated in this part of the questionnaire.

The questionnaire proceeded to consider the respondents' attitudes on interest and Islamic banking. The wording and the questions of this section were chosen carefully to be precise, clear and unbiased as the subject is considered highly sensitive for discussion and investigation in Libya. However, the third part of the questionnaire was built on Q3.1-Q3.24. This part can be considered as the cornerstone of the questionnaire.

In the second and third parts of the questionnaire, and to save time, multiple choice answers were offered to each question. It was also considered appropriate to offer open responses to provide for a greater variety of opinions. However, the questionnaire concluded with an open question to give the respondents another opportunity to offer suggestions or additional information.

A covering letter was attached explaining the purpose of the study and the procedure for completing the questionnaire. Moreover, respondents were requested to co-operate by providing accurate replies to all questions. The statement "This questionnaire is not a will and

has no legal effect. It is simply a tool to help draft your opinions after you complete the questionnaire", was included in the covering letter. This was to encourage respondents to answer all the questions.

2.8.2.4 The Pilot Study of the Questionnaire

The questionnaire was designed to assess practical attitudes and beliefs. Therefore, before the final questionnaire was produced and distributed, a pilot study in three stages was carried out by selecting respondents at random. The pilot study at every stage of the piloting was carried out as it would be performed in the main study. At every stage the questionnaire was sent out to small groups of people consisting of between 35 and 40 respondents within the city of Benghazi.

The purpose of conducting the pilot study in three stages was to reveal any weaknesses or contradictions in the questions, and to correct them prior to the main survey while at the same time testing and improving reliability and validity where the questions posed elements of vagueness and difficulty. It was also essential to asses the length of time respondents might need to complete the questionnaire. In this the researcher had two purposes in mind: to maximise response rate and minimise error frequency. Finally and most importantly to test the questionnaire's ability to do the job for which it was designed;

However, at every stage points emerged, indicating that changes needed to be made before the final draft of the questionnaire could be completed and distributed. Moreover, the positive reactions of the pilot study were taken into account in constructing the final questionnaire.

2.8.2.5 Questionnaire Distribution and Collection

To minimise any misunderstanding of the questionnaire's purpose, which could result in vague and biased responses, the questionnaire was handed out to the respondents by the

researcher. Some of the respondents were already known to the researcher, which eased distribution and collection and allowed her to add further information on the aims and purpose of the research which could be considered to a large extent as highly sensitive.

Most questionnaire copies were completed at the respondents' workplace, but some were taken home for completion. A third group was contacted and interviewed either at home or by telephone. The main reason for this was that these people were very busy.

2.8.2.6 The Questionnaire Sample

Researchers usually cannot make direct observations of every individual in the population they are studying. The term population or study population refers simply to all members of the group or society that researchers are interested in[52]. Sampling is the process of selecting a group from the population to form a basis for estimating, studying and predicting facts, attitudes or outcomes regarding the population in general. The result of the previous process can be called the sample[53]. Therefore, "the sample is a sub-set of the population that is usually chosen to include and represent all members of the population, to achieve the purpose of the study"[54]. Lee stresses that sampling is always a theoretical matter before it is a technical one[55].

.8.2.7 The Sampling Method

This study is for research purposes, the sample was chosen at random from Libyan citizens who are either users or non-users of the Libyan commercial banks services. The city of Benghazi was selected for the study on the basis of the criteria listed below. The target population for the study consisted of males and females, aged 20 years or more, who had

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[52] Kumar, Ranjit. *Research Methodology; A Step by Step Guide for Beginner*, p. 156.
[53] Ibid.
[54] Burgess, Thomas. *A General Introduction to the Design of Questionnaires for Survey Research*, p. 3.
[55] Lee, Raymond. *Doing Research on Sensitive Topics*, p. 60.

attained an average level of education, such as secondary level or higher, and who were already living within the borders of Benghazi.

2.8.2.8 Sample Size

The size of a sample is frequently a matter of concern. According to Lee, in the case of sensitive topics, however, an adequate reflection of the population is not always possible[56]. In general, the sample size decision must be made on a case-by-case basis, considering the variety of goals to be achieved by the particular study and taking into account numerous other aspects of the research design[57]. This is because of several aspects which may not be obvious to the researcher before the research has begun[58]. Examples of possible difficulties in research can include the amount of information and data available as well as the sensitive nature of some research all of which are products of complex patterns of social and political organisations. A further aspect of this research may be that sampling is also a political issue. In addition, little statistical data regarding the Libyan population is known or available.

In the light of these aspects as well as three other factors, which are the limitation of resources, the lack of a post-coding system to use and the fact that no reliable list of names of the banks clients was available, the Simple Random Sampling Technique (SRS) was used. SRS is one of the most commonly used methods of selecting a sample. The randomisation of this technique means that each element in the population is given an equal chance of being selected. In particular, the sample size (n) was selected by using the fishbowl draw procedure[59].

According to Rosccoe, sample sizes larger than 30 and less than 500 are appropriate for most types of research. On the other hand, Lee mentions that in the case of sensitive research the

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[56] Lee, Raymond. *Doing Research on Sensitive Topics*, p. 60.
[57] Ibid.
[58] Ibid.
[59] Kumar, Ranjit. *Research Methodology: A Step-by-Step Guide for Beginners*, p. 171.

size of the sample has to be decided by the number of possible responses[60]. Bryman states that decisions about sample size are affected by considerations of several aspects such as time and cost. According to him, there is no straightforward answer to the question regarding sample size[61].

Distribution and collection of the questionnaire proved particularly difficult in the light of the previous considerations and aspects. The questionnaires were distributed on 13 March 2006 but it was not possible to collect the completed copies until 1st of July 2006.

The researcher was able to send out questionnaires to a total of 713 respondents all of whom were Libyan citizens. The return level of questionnaires was 360 out of 713. It must be emphasised that despite the tremendous efforts of the researcher, the sensitivity of the research topic led many of them to refuse to answer or complete personal questions such as sources of income and number of bank accounts. This lack of a simple understanding of the questionnaire's purpose led the researcher to discard some questionnaires. The questionnaire was carefully checked by the researcher in order to ensure that the questions had been properly and completely answered. 140 questionnaires were finally completed and found suitable to be considered. In other words, 48% of the original number of questionnaires distributed was returned, 40% of which will be considered in the study.

This return rate can be considered acceptable for data analysis. According to Smith, in practice, researchers never obtain responses from 100% of the sample[62]. Having such a rate of return does not necessarily mean that the sample is biased, because there was no known reason for non-response. Moreover, this can provide a fair representation of the total population especially where most of the respondents are well educated.

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[60] Roscco, J.T. *Fundamental Research Statistics for the Behavioural Sciences*. New York: Holt, Rinehart and Winston. 1975, p. 295.
[61] Bryman, Alan. *Social Research Methods*, p. 93.
[62] Smith, T.W. The Hidden 25 Per Cent An Analysis of Non-Response On The 1980 General Social Survey. *Public Opinion Quarterly*. 47. 1983, pp. 386-404.

Because of the sensitivity of the study, it should be noted that, no questionnaire was distributed through the post or by any other agency, all questionnaires were delivered by the researcher. The need for such a distribution system had a considerable implication for cost and time over the data collection period.

2.8.2.9 The Geographical Distribution of the Questionnaire

The questionnaire is an excellent way to obtain data from large numbers of people in a selected geographic area. Libya is one of the rare countries in the world in that its population is relatively homogeneous in terms of ethnicity, language and religious affiliation. Thus, any segment of the country's population can accurately represent the population as a whole.

The city of Benghazi is a good example of the Libyan population's homogeneity. This is because during its history people from everywhere in Libya have migrated and moved to settle there. Therefore, because the population of the city offers a good cross-section of the country's population in general, an acceptable analysis sample could be made from the population of Benghazi.

However, Benghazi, like most cities in the world, is growing rapidly. The city has been transformed in the last century from a small settlement to a modern commercial city with a population of nearly one million. In the last two decades the city became the first to host a private commercial bank in the country. This step was sanctioned in order that the private sector could attain a more important role in the country's economic development.

2.8.2.10 Questionnaire Data Analysis

Qualitative research is subjective, and generates rich and in-depth information normally presented in the form of words. Choosing the correct data analysis technique is one of the most difficult tasks of the research process. According to Marshall and Rossman, analysis of

qualitative data is not simple, and although it does not require complicated statistical techniques of quantitative analysis, it can nonetheless be difficult to handle the usually large amounts of data in a thoroughly systematic and relevant manner. Marshall and Rossman offer this graphic description: "Data analysis is the process of bringing order, structure and meaning to the mass of collected data"[63]. Having the full transcript is essential to make sure that the researcher does not leave out anything of importance by only selecting material that fits the researcher's own idea[64].

When choosing of the most suitable data analysis technique, a number of different factors have to be considered, such as the type of questions, the nature of the data, and the assumptions that must be met for each of the different statistical techniques. Moreover, identifying the data analysis techniques used in other related studies should also help a researcher in choosing the correct one[65].

Regarding this study, no related studies were found to help in choosing the correct statistic technique for examining and comparing the reliability of data already gathered by the questionnaire. In addition, the main objective of this study is to explore the general attitudes of the respondents towards Islamic banking implementation in Libya.

It is clear that a descriptive statistical method was the best and most suitable approach in analysing the data for this research, to give a general quantitative indication of a trend towards Islamic banking services and principles. As Lane said, "Descriptive statistics are numbers that are used to summarize and describe data"[66]. They can be used to describe patterns and general trends in a data set. According to him, in most cases, descriptive statistics are used to examine

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[63] Marshall, Catherine, and Rossman, Gretchen. *Primary Data Collection Method: Designing Qualitative Research*. London: Sage. 1995, p. 111.

[64] Hitchock, Hitchcock, and Hughes, David. *Research and the Teacher: Qualitative Introduction to School-Based Research*. 2ed Ed. London: Routledge, p. 294.

[65] Need to mention in this regard that the researcher could not find any study similar to hers in Libya. The one she found pertaining Muslim country was conducted in Kuwait in 1988 and titled: Islamic Banking, A case study of Kuwait by Abdulahman Haitham Shouukat Kabbara, at Loughborough University. It was a Library-based study on political considerations.

[66] Lane, David. Descriptive Statistics. *Connexions Module*. 2.7 July 2003, p. 1.

or explore one variable at a time[67]. He went on to state that the relationship between two variables can also be described as with correlation and regression[68]. In other words, by using descriptive statistics the researcher tries: first, to describe the basic features of the data in the study; second, to simplify large amounts of data in a sensible way, and most importantly, to describe what the data show.

The implementation of descriptive statistics required the researcher to construct a database (access), and define the enquiry processes considering each updating response as required. This was done by using the Visual Basic V.B.6 programming language and its SQL tool to construct the response templates. This structured database enabled the researcher to treat the data for many purposes, especially analysis.

2.8.2.11 Reliability and Validity of the Questionnaire

The challenges of achieving reliability and validity are among the most difficult faced by researchers. Yet the use of reliability and validity are common in quantitative research, and now they are being reconsidered in qualitative research. This is because every piece of research aims to produce an answer to a scientific question. According to Simon, there is no simple rule for deciding whether or not a questionnaire is valid and reliable. He states that the decision calls upon researcher judgment and scientific wisdom. He went on to mention that reliability and validity depend upon the purpose of the study and persuading other researchers that the questionnaire is valid[69].

It should be mentioned that in the three stages of the pilot study, an attempt was made to create an informal atmosphere so that the respondents felt free to ask questions and thus allow an impression of overall content to be gauged by the researcher.

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[67] Lane, David. Descriptive Statistics. *Connexions Module*, p. 1.
[68] Ibid.
[69] Simon, Julian L. *Basic Research Methods in Social Science*, p. 25.

2.8.2.11.1 Validity of the Questionnaire

The questionnaire used for this study is an exploratory exercise. Its main aim is to gain specific information about a representative sample of a particular population. The questionnaire results will be used to understand the attitudes, beliefs or knowledge of this population. Data is only useful if it actually measures what it claims to be measuring and in this respect the concept of validity refers to 'the degree to which a research accurately reflects or assesses the specific concept that the research is attempting to measure'[70].

As mentioned earlier, one of the basic purposes of conducting the pilot study in three stages is to assess questionnaire validity. In three stages the questionnaire validity was investigated by the use of random samples. In other words, the target samples for the pilot study were aged 20 years or over, attained an average level of education of secondary level or higher, and were already living within the borders of Benghazi.

As the questionnaire consists of questions regarding the respondents' attitudes and beliefs thought to be important to investigate, the questions were designed to measure the construct (questionnaire content). This is largely a 'common-sense' assessment, which relies on the knowledge of the way people respond to questionnaires. Consequently, face validity and in-depth discussion are used to assess the validity of the questions, which are concerned with how a particular measure or procedure appears. This is an acceptable way to gain information about the design of a questionnaire.

In three stages respondents were asked to complete the questionnaire. The researcher then interviewed each respondent to ascertain whether their responses agreed with the verbal description of their attitudes and beliefs. In order to asses the repeatability and validity of the questionnaire, an identical questionnaire was piloted on two occasions two weeks after the interview. At the end of the second pilot stage, there was an opportunity for respondents to

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[70] Simon, Julian L. *Basic Research Methods in Social Science,* p. 25.

express their views on the four themes of the questionnaire which were considered most significant and relevant for the present research. These themes included: (i) the respondents' profile; (ii) banking background; (iii) attitudes towards interest; (iv) attitudes towards the establishment of Islamic banking in Libya.

The researcher was able to overcome the problems which emerged from the questions. Thus, in the third stage, responses showed considerable agreement with the verbal descriptions of their attitudes and beliefs as expressed during the interviews. When asked if there were attitudes or beliefs of importance not covered by the questionnaire, the majority of respondents said there were none. However, the agreement between respondents on the modifications to the questionnaire was significantly greater than expected. No changes were made after the final pilot study stage as it was felt that the majority of problem issues had been addressed and it was uneconomic to undertaken further piloting. As responses to the pilot questionnaires were assessed as satisfactory and significant, the questionnaire was distributed.

2.8.2.11.2 Reliability of the Questionnaire

Another major aim in repeating the pilot study was to allow for reliability analysis. It is important that considerable efforts are made in assessing reliability of a questionnaire. In general, "reliability refers to whether a particular research technique will yield the same results if applied repeatedly to the same objects"[71]. Cooper states qualitative methods are not necessarily less reliable than quantitative methods. Therefore, a well-designed qualitative investigation can be much more reliable than a quantitative method. Moreover, he states that a valid test is always reliable, but a reliable test is not necessarily valid. This is because

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[71] Cooper, Cecily D. *Not Just A Number Thing: Tactics for Improving Reliability and Validity in Qualitative Research.* Marshall School of Business. Southern California University, p. 6.

reliability is much easier to assess than validity[72].According to Keline, the real appropriate range of results to be assessed are those that are neither too easy nor too difficult for the sample under study. The indices quoted by him suggest that between 20% and 80% of the sample should answer items correctly[73].

There are four general classes of reliability estimates, each of which estimates reliability in a different way. Inter-ratter reliability is one of those measurements which is used whenever a researcher use humans as a part of research measurement procedure. The estimation is based on the correlation of scores between two or more assessors who rate the same instrument[74].

The questionnaire was designed to assess practical knowledge and attitudes. Thus an analysis of reliability could not be undertaken on individual questions because of the altered phrasing, content and number of many questions. Instead the scores for each questionnaire theme were measured. Simple measurement like inter-ratter or inter-assessor can reveal a good deal. The reliability percentage of a questionnaire is calculated by dividing the number of agreements by the number of agreements plus disagreements for each theme.

2.8.2.11.3 Tabulation of Data

Following the completion of the questionnaire and its collection on 1 July 2006 the data base management system was created and the programming language Visual Basic version 6 was used. This language was designed to be easy to learn and use. It also has the flexibility to respond to fairly complex applications. The data base management was utilised to: a) display the distribution of responses to each question in the questionnaire; b) save time and find a logical relationship between the responses; c) compare different group responses; e) help in presenting most data in a relatively simple way that can be understood by the non-researcher.

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[72] Cooper, Cecily D. *Not Just A Numbers Thing: Tactics for Improving Reliability and Validity in Qualitative Research*, p. 6.
[73] Kline, P. *The Handbook of Psychological Testing.* London: Rotledge, 1993, p. 45.
[74] Ibid, p. 60.

However, one-way tabulations were used to study frequency and percentages of response. For ease of data handling and analysis the values that responses can take are designated by numeric codes. The data base management allows data to be shown in a rectangular table where each row represents a 'case', i.e. a specific respondent and his data. Each column represents a specific question response, i.e. the data relating to that question for all respondents.

2.9 The Difficulties Faced During Research

As the study developed, the researcher faced several problems, the nature and difficulties of which varied. The researcher feels it is worth mentioning them so that they may be avoided by future researchers. These difficulties included:

a) Scarcity of information and statistics regarding the Libyan banking sector, due to the lack of a National Data Base and Information Centre. This meant that the researcher had to depend largely on interviews and the questionnaire to obtain information;

b) The lack of understanding by the interviewees of the purpose of the scientific research;

c) Although interviews went smoothly, with some interviewees and respondents seeming very friendly and co-operative, some respondents nevertheless refused to complete the questionnaire, or asked the researcher to fill in it. Moreover, many interviewees refused to permit tape-recording or note-taking during their interview;

d) Securing appointments required major networking and personal connections without which many interviews could never have been conducted and continued; and

e) Many interviewees and respondents consider Islamic banking a religious matter, and thus there should be no links between religion and the banking industry. During the field work they asked as many questions about Islamic banking as they answered. This was time

consuming. However, despite all these problems, the researcher was able to complete the interviews and questionnaires and obtain the necessary information.

2.10 Summary

This chapter has been concerned with a description of the research methodology design. The methodology objectives have been stated and the overall research strategy and procedures outlined and the questionnaire and interviews were selected as being the most effective tools for obtaining the required data.

The chapter has highlighted the interviews conducted in the Libyan commercial banking system: a detailed account has been given of the sample, the design of the questions, data collection and the approach to analysis. However, the chapter has also explained the design of empirical research explaining how the questionnaire was conducted in Benghazi, Libya.

Chapter Three

Islamic Banking: An Introduction

3.1 Introduction

It is evident that the banking industry has played a major role in economic development since the inception of organized economics. Banking institutions with the facilities and services they provide have all come into being in response to the human need for organising economic and financial life. These needs will go on multiplying as economies progress, and knowledge and technology advances.

Islamic banks are part of a broader Islamic financial spectrum which includes securities, insurance and other non-banking organisations, all of which have multiplied over the years. However, Islamic banking, as a specific form of banking, has emerged as an alternative to conventional banking. Its main aim is to cater for the needs of Muslims who believe that the activities of conventional banks are incongruent with their religious and moral tenets.

The first seminal study devoted to the establishment of Islamic banking was published in the 1940s. The contribution of economists at that time was insignificant for three reasons. First, most of these writers were Islamic scholars or journalists with little knowledge of economics; second, the former colonial rulers of Muslim countries had excluded Islamic religious teaching from the curriculum; third, there were no arrangements for producing trained economists who had direct access to Islamic sources. Furthermore, according to Khurshid, the earliest references in English to the subject had to rely on secondary sources[75]. According to Wilson, "an experimental local Islamic bank opened in the late in 1950s in a rural area of Pakistan and charged no interest on its lending. The institution was backed by a small number of pious landowners who were prepared to deposit funds without the reward of interest". Wilson went on to state that "credit was advanced to other poorer landowners for agricultural

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[75] Khurshid, Ahmad. (Ed). *Studies in Islamic Economics*. Leicester: The Islamic Foundation, 1980, p. 220.

improvement. No interest was charged for the credits, but a small fixed administrative fee was levied to cover the operating expenses of the bank"[76].

In the middle of the 20th century there were several unsuccessful experiments with small Islamic banks in Malaysia and Pakistan. In 1963, *MitGhamar,* a small village in Egypt, witnessed the first acknowledged successful establishment of an Islamic bank. Due to fear of suppression from the political regime in the country at that time, this bank was promoted without an Islamic image, as the regime might have viewed it as an expression of Islamic fundamentalism. However, this approach led to the creation of the Nasser Social Bank in 1972, whose objectives were more social than commercial[77].

In the mid 1970s, the first inter-governmental Islamic development bank was successfully established in Jeddah along with several commercial banks such as the Dubai Islamic Bank. During the latter part of the 1970s, the banking systems in Pakistan and Iran were largely islamised.

However, in the 1980s, conditions became less favourable for the Islamic banking movement and the number of banks decreased. Currently, there are about 176 Islamic institutions worldwide with assets totalling more than US$ 147 billion with an annual growth rate of about 15%[78].

According to Schaik[79], Islamic banking can be defined as "a form of modern banking based on Islamic legal concepts developed in the first centuries of Islam, using risk- sharing as its main method, and excluding financing based on a fixed predetermined return"[80]. Dar and Presley believe[81] that "Islamic banks are similar to conventional banks, and act as

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[76] Wilson, Rodney. *Banking and Finance in the Arab Middle East*. Byfleet: Macmillan Publisher Ltd. 1983, p. 75.

[77] Ghannadian, Farad, and Goswami, Gautam. Developing Economy Banking: The Case of Islamic Banks. *International Journal of Social Economics,* 2004, 31(8), p. 740.

[78] Ibid, p. 741.

[79] Schaik, Diederik. Islamic banking. *The Arab Bank Review*. April 2001, 3(1), p. 46.

[80] Ibid.

[81] Dar, Humayon, and Presley, John. *Lack of Profit Loss Sharing In Islamic Banking: Management and Control Imbalances*. University of Loughborough. 2000/01, p. 6.

intermediaries and trustees of other people's money with the difference that the system shares profits and losses with its depositors''[82].

The provision of non-interest based banking is the main aim of Islamic banking. Islamic banking needs to be in line with two basic criteria. First it should be in conformity with *sharia* and Islamic moral norms; second, it should help in achieving the socio-economic objectives of an Islamic and human society[83].

This chapter aims to provide an overview of Islamic banking. The first section gives a snapshot of the basic principles of the Islamic banking system. The second section considers contracts from an Islamic perspective while the third section reviews methods of financing in Islamic banking. The final section summarizes the discussion.

3.2 The Basic Principles of Islamic Banking

Islamic banking is based on four principles.

3.2.1 Prohibition of Interest

The first principle of Islamic banking is the prohibition of *riba,* which is the main and basic difference from conventional banking. In today's western and capitalist world, interest plays a very significant economic role, and therefore for the capitalist system it is unthinkable that any financial system could function without the interest component. Thus, interest has been viewed in the capitalist system not only as an essential part of the price mechanism in savings and investments but also as an important policy instrument for governments.

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[82] Dar, Humayon, and Presley, John. *Lack of Profit Loss Sharing In Islamic Banking: Management and Control Imbalances*, p. 6.

[83] Muhamd, Abulhasanp . Nik, Mustaphap, and Nik, Hassan. *Developing and Finance in Islam.* Kuala Lumpur: University Press, 1999, p. 157.

2.1.1 Classical and Neo-Classical Views on the Payment of Interest

Mannan argues[84] that in the western world there is no clear answer to the question of why interest is paid. He goes on to indicate that there are broad differences of opinion among economists concerning the theory of interest. Mannan considers that classical and neo-classical theorists such as Adam Smith, Ricardo and others treated interest as the reward which the borrower paid to the lender as his profit. This is because the former would make use of the latter's money. He believes that the classical economists failed to explain how to relate variable profit to fixed interest[85].

The neo-classical economists regard interest rates as a fundamental factor that stimulates demand for investment and motivates a willingness to save. According to them, the interest rate is determined by the supply and demand for loanable funds. However, the Islamic economists criticize this view on the ground that, instead of explaining why interest is paid, the neo-classicists explain how it is determined without noting the fact that fixation of interest in advance curbs the instinctive mobility of thrift and growth[86]. Therefore, the question of what interest is and why it is paid in the conventional system, remains unanswered.

3.2.1.2 The Definition of Interest in Islamic Economics

There have been several attempts in Islamic economics literature to investigate the nature of interest and its impact. As a consequence most Muslim economists believe that interest is *riba*. Thus it is prohibited according to *Sharia* law, the backbone of Islamic economics.

Since God permitted trading and forbade *riba*, the prohibition of *riba* for Muslims is clear, and this cannot be questioned. A number of Muslim economists believe that *riba* is simply a special case of unjustified enrichment. Many Muslim economists such as Siddiqi believe that

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[84] Ayub, Muhammad. *Islamic Economics: Theory and Practice (Foundation of Islamic Economics)*. Cambridge: Hodder and Stoughton, 1986, p. 120.
[85] Ibid.
[86] Ibid, p. 133.

Islamic finances are open to any innovations that are in congruence with its fundamentals. It is not a closed system and it has no regional, ethnic, or class affiliations[87].

The important question concerning *riba* is how Muslim economists can make this prohibition of *riba* clear for non-Muslims, and how they can explain its prohibition by God. More clarification is needed on the severe impact of *riba* on society and economics.

According to Lewis and Algaoud[88], there are four social reasons for the prohibition of *riba.* Firstly, since *riba* appears to be an easy way to earn money, it leads moneyed men to rely on this as an easy means to avoid the drudgery of work to earn their livelihoods. Secondly, a *riba* contract is designed to enable the rich to take in an excess of the principal, which is against equity and justice. Consequently, in the modern era where the banking industry plays such a significant role, wealth will circulate among the rich as they are able to borrow from banks due to their ability to offer collateral to the banks. Thirdly, the result of this is that there will be a widespread of envy, selfishness, miserliness, greed, malevolence and mutual aversion between society members. This kind of contract leads to profiteering relationships between individuals, and the gap between the rich and poor will become even wider, which may automatically and fundamentally disturb social stability. Consequently, on this ground there is much support for the prohibition of interest, even among non- Muslims[89].

Some researchers put forward economic reasons in addition to religious and social reasons to explain the severe impact of interest on economics. They argue that as a predetermined cost of production, and due to the inflexibility of interest in loss situations, interest tends to prevent full employment, and lead to bankruptcies. They also contend that international monetary crises are largely due to the institution of interest. This is due to the fact that banks are only interested in recovering their capital together with interest. Thirdly business cycles can be

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[87] Siddqi, Mohammad. *Comparative Advantages of Islamic Banking and Finance.* Presented at Harvard University on Islamic Finance, 6 April 2002, p. 5.
[88] Lewis, Mervyn K, and Algaoud, Latifa M. *Islamic Banking*, Cheltenham: Edward Elgar, 2001, p. 37-38.
[89] Ibid.

attributed in some measure to the phenomenon of interest discouraging innovation, especially in respect of small-scale enterprises[90]. Chapra summarizes the argument regarding interest as the principal reason why Islam has delivered such a harsh verdict against interest because "Islam wishes to establish an economic system where all forms of exploitation are eliminated[91]". He went on to mention that "the difficulty to understand the prohibition comes from a lack of appreciation of the whole complex of Islamic values, and particularly its uncompromising views of socio-economic justice and equitable distribution of income and wealth[92]".

3.2.1.3 Profit and Interest

Though interest is prohibited in Islam, it has recognised normal profit. In respect of interest the lender becomes unconcerned with the use of the loan after it is secured and the interest guaranteed. In the case of profit, the provider of the money remains involved in and concerned with the use of the money by the user throughout. Thus profit is the reward of a successful undertaking while interest is not the result of any productive effort[93]. Risk in this situation is the missing element because interest is fixed and certain, and profit as a payment for capital is uncertain and unknown[94]. In Islamic economics risk must be shared between the two parties to the contract.

In actual fact, there is a little disagreement over the definition of what constitutes *riba*. Baldwin and Wilson list questions which need to be answered about the prohibition of *riba* in practice. For instance, should the prohibition apply to all interest, or are interest charges for business loans permissible, since the borrowers are seeking profit?[95]

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[90] Muhamd, Abulhasan. Nik, Mustaphap, and Nik, Hassan. *Developing and Finance in Islam*, p. 160.
[91] Chapra, Umer M. The Nature of Riba in Islam, p. 8.
[92] Ibid.
[93]Muhamd, Abulhasanp.Nik, Mustaphap, and Nik, Hassan. *Developing and Finance in Islam*, p. 118.
[94]Ayub, Muhammad. *Islamic Economics: Theory and Practice,* p. 118.
[95] Mallat, Chibli. (Ed). *Islamic Law and Finance*. London: Graham and Trotman, 1988, p. 173.

In practice, a distinction is usually drawn between nominal and real interest. The real interest rate is the one where inflation has been factored in. In contrast, nominal interest or actual interest rates are where the effects of inflation have not been accounted for. However, some Islamic economists believe that it is real interest that should be prohibited[96]. In this vein, two views can be distinguished, the modern view and the orthodox view.

The modernist view is a minority view which focuses on the "moral rationale" behind the prohibition of *riba* in determining what *riba* is and what it is not. Modernists believe that the underlying reason for the prohibition of *riba* is to protect the less well-off from the exploitation of their needs. According to this view, *riba* is more than interest while not all interest is *riba*. Going by this definition, a certain rate of interest may be *riba* if it is demanded from someone who uses the money to meet his basic needs[97]. Wilson supports[98] this view and explains the distinction between borrowing for economic reasons and borrowing for financing social needs. He says that in the latter case, interest could be unjustified. On the other hand, it may not be *riba* when it is demanded from a rich man or a corporation where money is used in business or investment[99]. Many Islamic scholars dislike this distinction, and believe also that small business should not be treated differently from individuals.

Contrary to the modernist view, the orthodox view is the popular view among Muslims. It has sufficient historical support to support their views and it focuses on the literal prescriptions of Islam. In this view, all interest is *riba*, but *riba* is more than interest. Therefore, *riba* can be defined as "monetary advantage without a counter value, which has been stipulated in favour of one of the two contracting parties"[100].

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[96] Wilson, Rodney. *Islamic Business Theory and Practice.* London: The Economist Intelligence Unit, 1984, p. 25.
[97] Schaik, Diederik. Islamic Banking. *The Arab Bank Review.* April 2001, 3(1), p. 47-48.
[98] Wilson, Rodney. *Islamic Business Theory and Practice*, p. 22.
[99] Ibid.
[100] Schaik, Diederik. Islamic Banking, p. 47.

3.2.1.4 Profit and Loss Sharing (PLS)

Islam has prohibited *riba* by encouraging Muslims to invest their money and become partners in business. Consequently, the partners will share in both profits and losses instead of becoming creditors. This is the second principle of Islamic banking

The prohibition of interest does not imply that capital has no place in the Islamic economy. In fact, Islam recognizes the role of capital in production and its entitlement to a reward[101]. Accordingly, the provider and the user of the capital should share the risk of business returns equally, whether the projects concern industry, agriculture, services, companies, or simple trade deals.

Profit and Loss Sharing (PLS) dominates the theoretical literature on Islamic Finance[102], and within Islamic law it is the most prominent form of finance. It is an example of cooperation on the basis of equity, justice and equality which are the essence of Islam. The PLS principle was first mentioned by Qurishi [103]. It can be defined as a "contractual arrangement between two or more transacting parties, which allows them to pool their resources to invest in a project to share in profit and loss"[104]. In the case of PLS, the relationship between the parties is different from an interest-based one where the borrower should take all the risks while the lender gets a fixed reward without bearing any risk apart from that of the borrower's default. Even in this case, the lender has the right to sell the collateral that the borrower has offered. Wilson believes that in some cases, this arrangement does cause harm to the borrower and his relatives, thus Islamic scholars had proposed PLS[105]. However, based on a profit-loss sharing scenario, there are two methods of financing namely *Mudaraba* and *Musharakha*.

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[101] Abdul Kader, Radiah. *Performance and Market Implications of Islamic Banking (A Case Study of Bank Islam Malaysia Berhad.* Ph.D. thesis. University of Durham, 1993, p. 51.
[102] Ibid, p. 4.
[103] Khan, Monzer, and Khan, Tariqullah. *Principles of Islamic Finance: A Survey.* Islamic Research and Training Institute, Islamic Development Bank. 1409 H, p. 20.
[104] Dar, Humayon, A, and Presley, John. *Lack of Profit Loss Sharing In Islamic Banking: Management and Control Imbalance*s, p. 4.
[105] Wilson, Rodney. *Islamic Finance Theory and Practice*, p. 4.

3.2.2 Making Money from Money

The primary function of money is to allow people to spend and consume, and to transfer real goods and services from country to country and from private to public. According to some economists, the originator and matters of money are ambiguous. For example Tcherneva stated[106] that "the story of money-its origin, nature and functions is among the most misrepresented stories in economics. Hence, a wide range of issues related to money, from inflation to interest rates, from fiscal policy to the multiplier, need revisiting and reinterpretation"[107].

According to Islamic thought, money is not a commodity and must be viewed as a medium of exchange which decreases the cost of transactions. As money has no intrinsic value, it should not be used to raise more money, either by fixed interest payments, such as in banking, or by being lent to someone else. This view has some similarity to the idea of "fiat money" in orthodox theory, which means that money only has nominal, and no real value, since it is not backed by gold[108].

In the Islamic view, human effort, risk, and initiative are more important than the money used to finance it. Moreover, Islamic economists consider money as potential capital rather than capital before use. Consequently, money should not be hoarded rather it should be invested and used to lead to more purchasing power.

3.2.3 *Gharar* or Uncertainty

"The Arabic word *gharar* means, risk, uncertainly and hazard."[109] . A good translation of *gharar* in English is uncertainty[110], such as "the sale of probable items whose existence or

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[106] Tcherneva, Pavlina. Money: A Comparison of the Post-Keynesian and Orthodox Approaches, *Oecomicus*, IV, Winter 2001, p. 109.
[107] Ibid.
[108] Ibid, p. 110.
[109] M, Junaid. Basics and Definitions. Concepts in Islamic Economics and Finance. [On line]. Available from: http://cief.wordpress.com/2006/02/13/definition-of-gharar/. [Accessed on 20 November 2007]

characteristics are not certain, due to the risky nature which makes the trade similar to gambling"[111].

Islamic banking has emerged to achieve justice and equity, which are the essence of Islam and Muslim etiquette. Any transactions in Islamic banking should be free from gambling, risks or speculation and *gharar*. However, what this means is that all parties in the transaction must know their rights and obligations. As a result, a balance between them will be maintained which may protect the weak party in the contract from exploitation. Therefore, Islamic economists believe *gharar* is another element that should be avoided in Islamic transactions.

The modern example of *gharar* is what is known as short-selling, which means the buying and selling of stocks that one does not own. In general, *gharar* encompasses all cases of trade which involve the sale of items that do not exist.

Elgari considered *gharar* as a legalistic concept. He mentions that it is significant to emphasise the difference between risk and *gharar*. The latter "concerns the contractual relationship when a contract may be risky for one party and not risky for the other"[112]. He believes that people by their nature are prone to accept different levels of risk. As a consequence, some people are called risk-takers and others are risk-averse. However, risk can be desirable only when it stimulates productive efforts and value–adding activities. Islam prohibits risk only when it may be a channel to make one party profit at the expense of the other party, which leads to *gharar*. The prohibition of all sources of unjust enrichment is one of the most important teachings of Islam in establishing justice and eliminating exploitation.

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[110] El-Gamal, Mahmoud. *A Basic Guide to Contemporary Islamic Banking and Finance.* Rice University. June 2000, p. 6.
[111] Ibid, pp. 6-7.
[112]Iqbal, Munawar, and Elgar, Edward. *Islamic Banking and Finance: New Perspectives on Profit-Sharing and Risk.* Cheltenham: Edward Elgar, 2000, p. 38.

3.3 Contracts: An Islamic View

A contract is a legal written agreement between individuals or companies. It stipulates what each party must do for the other. It is the most significant way in which Islam ensures that all parties have every opportunity to understand what they are getting themselves into when they sign a contract.

According to Islamic scholars a contract is a device ensuring the connection of the future to the stability of the known past[113]. Thus, the nature of a contract works as a hedge against uncertainty[114].

In the pre-Islamic period, and since writing then was often not possible, contracts were often concluded by a witnessed exchange of words. This was considered to be sufficient to tie the contracting parties together. Nevertheless, complex contracts were usually written and witnessed.

Given the increasing number of transactions, written contracts are considered necessary in today's business world. This forces authorities worldwide to legislate and provide various forms of contract which determine how capital is raised, how contracts are dissolved, and who bears the risks of failure. All of these aspects must be in writing and registered with official agencies. In practice "banks design extremely detailed contracts, thereby severely limiting the managing partner's freedom to act. Banks try to minimise all chance for abuse of their funds"[115] .

Islamic business contracts can be classified into three broad categories. The first concerns direct financial accommodation and the basis of such contracts is the profit-loss sharing principle and the output sharing principle. The second covers indirect financial accommodation, which is similar to the first in some respects, and is based on the mark-up

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[113] Delorenzo,Yusuf. The Religious Foundations of Islamic Finance. In: Archer, Simon, and Abedlkarim, Rifaat. (eds). *Islamic Finance: Innovation and Growth*. London: Euromoney Books and AAoifi. 2002, p. 26.
[114] Ibid.
[115]Schaik, Diederik. Islamic Banking. *The Arab Bank Review*, p. 50.

principle, lease-based principle, and advance-purchase principle. Finally, there are other forms of permissible contracts such as direct investment, the financing of development charges, rent-sharing in connection with business and domestic housing construction or the purchase of accommodation[116].

Based on the previous classification of contracts, Islamic banking can provide several methods for acquiring assets or financing projects. These methods of finance can be broadly grouped into three categories: trade finance, lending finance and investment finance.

3.4 Methods of Finance in Islamic Banking

Islamic banks offer services to their clients similar to those provided by conventional banks. However, due to the differences in principles and the elimination of *riba*, the Islamic banking industry has developed methods of accepting deposits and lending funds to customers which accord with their principles and the prohibition of *riba*.

3.4 .1 Trade Finance

As mentioned earlier, trade financing is one of the methods used by Islamic banks to provide financing services to their clients. This method can be classified into mark-up or *murabaha*, leasing, or *ijara*, sell and buy back and letters of credit.

3.4. 1. 1 *Murabaha* or Mark-Up

Literally, the word *murabaha* or mark-up simply means a sale with profit. In more detail, it is "a cost-plus in which a client, wishing to purchase equipment or goods, requests the Islamic

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[116] Abdul Awwal, Sarker. Islamic Business Contracts Agency Problems and the Theory of the Islamic Firm. *International Journal of Islamic Financial Services*. No date. 1(2), p. 4.

bank to purchase the items and sell them to him at cost plus a declared profit"[117]. It is used by the Islamic banking system for the investment of surplus funds on a sale and repurchase basis similar to a "repo" or repurchase agreement in conventional banking in which the client or the bank sells a security to the bank or the bank's client and agrees to repurchase it on a specific date at a specified price. According to Wilson, *murabaha* is the most commonly used method of Islamic finance[118]. Warde adds it accounts for 80 to 95% of all investments by Islamic institutions[119]. The commodity resale time will be determined by the bank in its contract with the client before making the initial purchase. Regarding the period of *murabaha,* Wilson mentions that credit is provided for a fixed period of time, generally from 90 days to 180 days at a maximum. Thereafter, if the client needs to purchase the item and he is not in a position to purchase the commodity, some flexibility can be allowed in the contract. Thus the date may be postponed and an additional premium may be charged for any extension[120].

According to Lewis and Algaoud, the difference between interest and *murabaha* is that *murabaha* "is not explicitly related to the duration of the loan but instead computed on a transaction, basis for services rendered and not for differing payments"[121]. In fact, in a *murabaha* transaction the bank's role is more than the role of a classic financial intermediary. The bank first acquires the asset for resale at profit[122]. Then the bank resells the commodity to the client, which may be delivered to him either by an overseas or domestic producer at a specific price. In the process the bank bears certain risks between purchase and resale, such as a sudden fall in price, or the client refusing to accept the goods. Therefore, the bank carries responsibility for the goods until they are safely delivered to the client. This is what makes the

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[117]Fuad Al-Omar, and Abdel-Haq, Mohammed. *Islamic Banking: Theory, Practice and Challenge.* Karachi: Oxford University Press, 1996, p. 15.
[118]Wilson, Rodney. *Islamic Business Theory and Practice*, p. 29.
[119] Warde, Ibrahim. *Islamic Finance in the Global Economy.* Edinburgh: Edinburgh University. 2000, p. 133.
[120] Wilson, Rodney. *Islamic Business Theory and Practice*, p. 29.
[121] Lewis, Mervyn K, and Algaoud, Latifa M. *Islamic Banking*, p. 53.
[122] Need to mention that the bank does not need to handle or store the commodity; the bank only handles the transaction document.

murabaha transaction legitimate in Islamic banking[123].When a *murabaha* sale is made on a deferred payment basis it is called *murabaha-bi–muajjal*[124].

Most western exporters find *murabaha* to be a satisfactory financing method as it guarantees speedy payment without risk[125]. Moreover, "the bank's clients may end up paying a little more to the bank for the commodity (with the premium inclusive) than they would have done if they had tried to purchase the commodity themselves"[126]. Wilson claims that the bank always has the ability to obtain discounts on any purchases it makes on behalf of any clients. In addition, if the bank purchases commodities on behalf of a number of clients at the same time from the same supplier, the sale will thus be larger and may result in greater discounts[127]. This method of financing not only enables western exporters to use customary credit lines for other purposes as mentioned by Wilson, but it may also give the bank's clients and the bank a chance to use the surplus funds for other investments.

Warde has criticized *murabaha* for two main reasons. Firstly, since the process determines the profit in advance, it makes *murabaha* a low risk for the bank's clients. However, sometimes the bank asks the client to offer collateral. Thus the bank earns a profit without bearing risk. Secondly, it could be argued that *murabaha* format imitates conventional bank activity by using semantics to hide the truth that this kind of transaction is similar to interest. As a result, a growing number of Islamic banks and Islamic financial institutions have attempted to change their pricing strategies so that the mark-up is always in proportion to interest rate[128]. The main criticism seems to be the lack of a pricing standard generated from *sharia* principles. In other words there is no ceiling for mark-up rates which may be charged by banks. The following section considers leasing, or *ijara,* as another finance method.

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[123] Lewis, Mervyn K, and Algaoud, Latifa M. *Islamic Banking*, p. 5
[124] Need to mention that this kind of Murabaha is common in Libya, especially in the gold trade
[125]Wilson, Rodney. *Islamic Business Theory and Practice*, p. 28.
[126] Ibid.
[127] Ibid, p. 29.
[128] Warde, Ibrahim. *Islamic Finance in the Global Economy*, p. 133.

3.4. 1. 2 *Ijara* or Leasing

The word "*ijara*" is the equivalent of leasing in English. It is the fastest growing activity of Islamic financial institutions and is increasingly used in retail finance especially for home mortgages, cars and household needs[129].

Leasing is a financing technique where "an individual, short of funds may approach another with a surplus (the financier) to fund the purchase of a productive asset. The financier may do so by buying and renting it out to the one who needs the asset"[130].

Many factors have caused the rapid increase in the use of this financial instrument. According to Al-Omar and Abdel Haq, one of the most important factors is that it is an acceptable method in the view of Islamic jurists since it meets certain conditions. For example, both parties know clearly in advance the services that the asset is going to provide and also the reasons for renting[131]. Wilson mentions that rent may be paid by the client monthly or quarterly and payments cover all or most of the original purchase price[132]. Furthermore, both parties know their responsibilities and liabilities. For instance, the asset remains in the ownership of the lessor who is responsible for its maintenance during the rent period. However, the leasing contract is terminated as soon as the asset ceases to provide the service. Moreover, the contract is still valid if the asset becomes damaged during the period of the contract while the lessor has the right to cancel the contract if the asset proves less valuable than expected[133].

In banking language, as an alternative to a *murabaha* contract, leasing can be a source of either short or medium-term finance. In this mode of contract between the customer and the

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[129] Warde, Ibrahim. *Islamic Finance in the Global Economy*, p. 134.
[130]Fuad Al-Omar, and Abdel-Haq, Mohammed. *Islamic Banking: Theory, Practice and Challenge*, p. 14.
[131] Ibid.
[132] Wilson, Rodney. *Islamic Business Theory and Practice*, p. 29.
[133] Fuad Al-Omar, and Abdel-Haq, Mohammed. Islamic Banking, Theory, Practice and Challenge, p. 15.

bank, the latter plays the role of lessor and the client that of the lessee. Thus there seems to be a similarity between *murabaha* and leasing contracts in that in both the bank's client seeks the bank's agreement to fund the purchase of the asset.

The difference between the two systems is that the conventional lessee pays a specified rental and a fixed rate of interest over the period of the contract, whereas in Islamic banking, the bank and the lessee have to share the risk in the case of damage to the leased assets[134]. However, in the leasing contract the bank decides who is going to be the owner of the assets at the end of the validity of the contract.

3.4. 1.3 *Ijara wa Iktina* or Hire Purchase

In a hire purchase contract between the bank and its client, the bank consents to purchase the asset and rent it to the client who will become the owner of the leased asset at the end of the contract period. Although this hire-purchase contract is becoming popular, it depends basically on the expected useful life of the asset, and whether the client needs to possess it at the expiration of the lease, or will prefer to replace it with an updated version[135]. Wilson mentions that this form of contract is popular in the Islamic world because of the ability of the rental to be offset against corporate tax and *Zakah*[136].

3.4. 1.4 *Bai-al-Inah* or Sell and Buy-Back

In contrast to hire purchase, the client in a sell and buy-back arrangement sells an asset on deferred payment, and then the asset is immediately repurchased by the bank's client for cash at a discount. However, in addition, the bank can also sell the client an asset on a deferred payment basis and the asset is immediately repurchased by the bank for cash, also at discount.

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[134] Alam, Mohamed. Institutionalization and Promotion of Saving Habits Through Bai-Muajjal Mode of Financing. *Managerial Finance.* 29 (2/3). 2003, p. 9.
[135] Wilson, Rodney. *Islamic Business, Theory and Practice*, p. 29.
[136] Ibid.

This kind of sell-and-buy back contract or *Bai-al-Inah,* is generally known as a sale based on the transaction of *Nasi'ah* (delay).

Here the parties enter into two separate agreements. Firstly, the client sells the asset to the bank which buys it at a specified price agreed by both. Upon the conclusion of the first agreement, the ownership of the asset is transferred to the bank. The asset is not required to be delivered unless both parties agree and the proceeds receivable by the bank's client under the first agreement shall not exceed the nominal value of the asset. The second agreement is a forward purchase agreement whereby the bank promises to sell the asset back to the client who will buy it at a particular price on a specified future date[137]. According to Rosly and Sami,[138] this mechanism has been the subject of many arguments by Muslim scholars and it is unacceptable to a majority of them[139]. Thus *arrahnu* contracts or Islamic Pawn Broking services may be alternatives to this method of finance. Nevertheless, they are popular with both financial institutions in general and clients.

An *arrahnu* contract provides the clients with the option to obtain cash to fulfil any urgent needs, which is the same as the function of hire purchase, and the asset that is sold and bought back by the client has nearly the same role as collateral in the hire purchase contract. Obviously, in an *arrahnu* contract, the likelihood of the banks suffering a loss is very limited since the bank can seize the assets if the loan is not repaid.

3.4. 1.5 Letters of Credits (LC)

Legally, a letter of credit is "a letter addressed by a bank, at the insurance and responsibility of a buyer of merchandise to a seller, authorizing him to draw drafts to a stipulated amount

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[137] No Author. *Malaysia Toward an Islamic State: Malaysia Islamic Money Market.* [On line]. Available from: www://inwestart.go.dmkproject.co. [Accessed on 18th April 2005].
[138] Rosly, Saiful, and Sami, Mhamood. The Application of Bay' Al-Ianh and Bay Al-Dayn in Malaysian Islamic Bonds: An Islamic Analysis. *Journal of Islamic Financial Services.* 1(2), p. 8.
[139] Ibid, pp. 8-9.

under specified terms and understanding conditionally or unconditionally to provide eventual payment for drafts"[140].

However, there are three principles governing the use of the letters of credit. Firstly, the bank is responsible for dealing with documents only. Secondly, the terms and conditions of the letter of credit construction must be met. Thirdly, the letter of credit is considered to be independent of other contracts such as sales contracts or any other agreements between the parties to the transaction[141] .

There are three banks with different responsibilities involved in this kind of legal transaction. These banks are the issuing bank, whose role is to examine the documents and guarantee payment to the seller if the documents presented comply with the terms and conditions set out in the letter of credit; the advising bank which works as a foreign intermediary bank between the issuing bank and the confirming bank. The basic responsibility for this bank is sending the documents to the issuing bank, and it is not obliged to pay where the issuing bank refuses or delays paying the seller. The seller usually seeks a local bank to ensure that the letter of credit is valid. The confirming bank functions as a channel of payment to the seller after checking the country and the bank of origin. This procedure follows confirmation of the letter of credit from the seller by the advising bank. Mostly the confirming bank plays the role of an advising bank[142]. There are three forms of letters of credit. Each one has advantages and disadvantages. The first is a revocable credit letter which is unacceptable. It is rarely used since it can be changed or cancelled by the buyer without prior notice to the seller. The second form is the irrevocable credit letter. This is the most widely used form in international trade. However, in conventional trade it is more expensive because the issuing bank is liable for guaranteeing the

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[140] *Letter of Credit.* The Electric Law Library's Lexicon On. Available from: http;//www.lectlaw.com. [On line]. [Accessed on 15th April 2005].

[141] Chtterigie, Amit. More on Letter of Credit- Chosen Look at Some Key Terminology. *FAIDA.* 11(8), July, 2001.

[142] D, Noha. *Understanding and Using Letters of credit, Part 1.* [On line], available from: http:// www.crfonline.org/orc/cro/cro-9-1. [Accessed on 22nd April 2005].

credit. Irrevocable credit letters can be divided into two types: the irrevocable confirmed credit, and the irrevocable unconfirmed credit. The first is used when the seller is unfamiliar with the issuing bank and insists on an irrevocable confirmed letter. It is also used when trade is conducted in highly risky regions where there are fears of war or financial instability. Here the advising bank guarantees to pay the supplier of the issuing bank when the issuing bank fails to honour the transaction. For these reasons, confirmed credit costs more[143]. In unconfirmed irrevocable credit which is the second type of irrevocable credit, guarantees are fewer than in the first kind because the buyer's bank that issued the credit is the only bank responsible for payment to the seller. Meanwhile, the bank's seller is obliged to pay the purchaser after receiving payment from the buyer's bank. In this case the seller's bank simply acts on behalf of the issuing bank and therefore bears no risk[144]. The third form of a letter of credits is the special letter of credit. Here, there are several special letters of credit designed to meet the specific needs of buyer, seller and intermediaries. Special letters of credit usually involve increased participation by banks, thus financing and services charges are higher than those for basic letters of credit. Examples of this kind of letter of credit are standby letters of credit, involving letters of credit, and red-clause letter of credit, etc[145]. From the earlier consideration above it is obvious that the transactions risks of using letters of credit are shared by the buyer, seller and banks. Thus in conventional banking the more the banks assume risk by guaranteeing payment, the more they will charge for providing the service[146].

In general, the Islamic banking system is acutely aware of the importance of letters of credit in international trade as they are perfect guarantees for importers and exporters. Adbul Gafoor sees *sharia*-style letters of credit as "where the bank guarantees the import of an item using its

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[143] *Letter of Credit (L/C)*. [On line]. Available from: http:// www.nalcorp.com/glossary/bodyi.htm. [Accessed on 20th April 2005].
[144]Ibid.
[145] *Letter of Credit (L/C)*. [On line].
[146]Ibid.

own funds for a client, on the basis of sharing the profit from the sale of this item or on a mark-up basis"[147]. Some Islamic scholars suggest two other *sharia*-compliant alternatives for traders who resent having to share part of their profit with their bank. There is the letter of credit-*wakalah* where the bank's client appoints his bank as a representative to undertake a transaction on his behalf. In this case the bank acts as the agent of its client, and the bank's client has to pay a fee and commissions for its service. There is also the letter of *granatee-kafalah. Kafalah* in general refers to "a guarantee provided by a person to the owner of a good, who has placed or deposited his good with a third party, whereby any subsequent claim by the owner for his good must be met by the guarantor or the third party"[148]. Islamic banks use *kafalah* to issue bank and shipping guarantees. As surety, the bank's client gives the bank some form of collateral or deposit, and pays a fee for the service[149]. Both *wakalah* and *kafalah* contracts show the similarity between Islamic and conventional banking in which both of them charge fees for the services rendered.

3.4. 3 Lending

Islamic banks are not the only source of loans. Any financial company or individual can offer funds for needy persons or companies. The difference is the absence of interest in Islamic banking transactions.

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[147] Adbul Gafoor, A. *Interest Free Commercial Banking*. Kuala Lumpur: A. S. Noordeen, 1991, p. 5.
[148] *Trade Finance: Islamic Trade Financing*. [On line]. 2005. Available from: http://www.amby.com.my/e/tf/a/mloc. [Accessed on 18th April 2005].
[149] Sudin, H, Norafifah, A. and Saudra, L. P. Bank Patronage Factors of Muslim and Non- Muslim Customers. .*International Journal of Bank Marketing*. 12(1). 1994, p. 33.

3.4. 3. 1 Loan with Service Charge

Some Muslim scholars allow Islamic banks to charge fees. According to Al-Omar and Abdel-Haq[150] this service charge is not profit nor is it equivalent to interest, since the charge may not be proportional and may not exceed 2.5%. It usually falls within the range of 1 to 2%.

These service charges are permitted to cover actual costs of such items as rental of properties, wages and stationary[151]. Loans with service charges are frequently granted by Islamic banks to governments and charity institutions to finance their activities, and subject to a maximum set by the authorities[152]. This kind of loan can also be used to cement and facilitate existing business relationships, such as for clients with cash-flow problems, customers with interest-free blocked savings accounts which are in need of short-term finance; in the case of *musharaka* between an institution and a client, the institution's participation may be divided into two parts. The first part is a share in the partnership capital, and the second is provided through this kind of loan. However, the main aim of this loan is to help needy people in order to make them self-sufficient, raise their income, and improve their standard of living. In this kind of loan, borrowers are obliged to repay the bank.

3.4. 3. 2 *Quarad Elhasan* or Noble Loan

Unlike loans with a service charge, *quarad elhasan* is a noble loan. It is a loan without a service charge or interest. Each Islamic bank is expected to set aside a quota of its funds to provide this kind of loan to the needy and economically weaker members of society, who are not unable to obtain loans or financial assistance from any other source[153].

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[150] Fuad Al-Omar, and Abdel-Haq, Mohammed. *Islamic Banking Theory, Practice and Challenges,* p. 11.
[151] Ibid
[152] Adbul Gafoor, A. *Interest- Free Commercial Banking*, p. 6.
[153] Metwally, M, M. Economic Consequence of Applying Islamic Principles in Muslim Societies. *International Journal of social Economists*. 24(7/8/9), 1997, p. 953.

3.4. 3. 3 Overdrafts

Another form of lending provided by Islamic banks is the overdraft, which is also provided by conventional banks. The difference between overdrafts in Islamic banking and in conventional banking thus merits close consideration.

The word overdraft in general means "the account holder withdraws more money from a bank account than has been deposited in it"[154]. This lets the clients "go into the red". There are two types of overdraft: an authorised overdraft of an agreed amount between the bank and the client; and an unauthorised overdraft in which the client exceeds his overdraft limit. In both cases the client will be charged high interest rates.[155]. Rogers asserts that the number of people who use overdraft facilities has declined recently. Indeed, the number of overdrafts at the West Pac and National banks in Australia has halved over the last three years. The change is partly driven by interest rates amounting to 8% for unsecured business. Rogers argues, though, that these rates are a poor guide to the actual rate a business could expect to pay for such an overdraft[156]. However, the size of the margin on an overdraft depends on three factors: the situation of the client's business; the size of the client's existing loans with his bank; and the bank's perceptions of risk in the client's business.

In contrast, fees and charges for taking out and setting up overdrafts are cheaper. For instance in 1997 they were estimated at between 0.93 and 1.12%[157]. Some economists insist that overdraft charges penalise consumers for genuine mistakes rather than the poor handling of their money, and it is unfair on customers who only occasionally run into debt. On the other hand, overdrafts are extremely profitable for banks.

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[154] www. Banknetindia.com,[Access on 12th April 2005].
[155][online]. Available from:www.1stop-finance.co.uk/glossa. [Accessed on 12th April 2005].
[156] Ian, R. Overdraft Over the Hill. *Sydney Morning Herald*. 24. 2001. [On line]. [Accessed on 20th April]. Available from: http://www.moneymanager.smh.com.au.
[157] Ibid.

Obviously, this kind of financial method contains an element of *riba*. Schaik mentions, however, that an overdraft is possible on current accounts or interest–free loans. He goes on to say that, in practice, not all Islamic banks allow overdrafts and some charge fees[158].

3.4.3 Investment Financing

In terms of investment, Islamic banking has adopted several methods which are in some aspects different from those adopted in conventional banking. These methods can be broadly categorised into four basic types: *mudaraba*, *musharaka*, investment on the basis of an estimated rate of return, and *istisna* (manufacturing).

3.4.3.1 *Mudaraba* or Trust Financing

Mudaraba, or trust financing, is one of the major Islamic banking concepts. It is defined as "an agreement between a lender (*rabb al-mal*) and an entrepreneur (*mudarib*) on a profit-loss sharing basis according to a predetermined and agreed ratio"[159].

Mudaraba is, thus, a method of profit and lose sharing finance. The first reference to *mudaraba* in the financial literature was given by Qurish[160]. His conceptualisation has been criticized by Kahf[161] on the grounds that it is ambiguous, since he proposes that capital will be provided by one party, used by another, and profits or losses will be shared between the two parties[162]. Choudhury claims that *mudaraba* is more than a principle. It acts as an institution since it replaces the interest on capital[163]. This kind of contract was allowed after the ban on

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[158] Schaik, Diederik. Islamic Banking, p. 50.

[159] Haron, Sudin. Ahmad, Norafifah, and Planisek, Sandra. Bank Patronage Factors of Muslim and Non – Muslim Customers. *International Journal of Bank Marketing.* 12(1). 1994, p. 33.
[160] Khan, Monzer.,and Khan, Tariqullah. *Principle of Islamic Financing: A Survey.* Islamic Research and Training Institute Islamic Development Bank. 1409 H, p. 18.
[161] Ibid.
[162] Ibid.
[163] Madsdudul, Alam. *Contributions to Islamic Economic Theory*, New York: St Martin Press, 1986, p. 73.

riba to enable the owner of capital to find a way to pursue profits, and for the lender to find ways to improve his standard of living.

According to Lewis and Algaoud, the significant features of *mudaraba* can be summarized as follow. Firstly, the *mudarib* becomes a trustee for the capital given to him by way of *rabb al-mal*, and the *mudarib* may utilise the capital in an agreed manner, and then return it to the *rabb al-mal*. Secondly, in *mudaraba* contracts profits are divided between the parties on a proportional basis, and may not be used to provide lump-sums or guaranteed returns to *rabb al-mal*. Moreover the *mudarib* may keep for himself what remains of the profits. Thirdly, in terms of liability and responsibility, the *rabb al-mal* is not liable for losses beyond the capital he contributed and he is not allowed a role in the management of the enterprise; however, the *mudarib* does not share in any losses except for the loss of his time and effort[164].

Mudaraba contracts can also be classified as simple, complex, restricted or unrestricted. In a simple or classical *mudaraba*, two parties may be involved in the contract, an investor and entrepreneur or worker, or there may be more than one party on each side. The number of parties may vary according to the situation. In this kind of *mudaraba*, the mixing of the personal capital of the *mudarib* with *mudaraba* capital is not acceptable. On the other hand, a complex *mudaraba* contract may take several forms. The investor may be in partnership and the worker may also be in partnership. In this kind of *mudaraba,* the mixing of the personal capital of the *mudarib* with *mudaraba* capital is fundamental because the parties share the capital.

However, *mudaraba* contracts can be restricted or unrestricted. In unrestricted absolute *mudaraba*, the capital is handed over and neither the type of work, nor location, time or quality of work are determined. In contrast, in a restricted *mudaraba*, for example, the

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[164] Lewis, Mervyn K, and Algaoud, Latifa M. *Islamic Banking*, p. 41.

mudarib may be restricted from engaging in certain activities or taking the capital to specific places.

At present, some Islamic banks have created and developed the *mudaraba sukuk*, a kind of restricted *mudaraba* which is an acceptable instrument for establishing an active secondary market. In this structure, an Islamic bank offers "*mudaraba sukuk* participation or certificates to the investors who participate in these funds or investment transactions"[165]. This enables instrument Islamic banks and their clients to invest their surplus cash funds for short periods of a few days, without compromising Islamic principles. It is worth mentioning that this kind of *mudaraba* is for restricted time duration in which the business may or may not be specified according to the agreement between the parties.

In terms of cancellation, *mudaraba* contracts will be automatically cancelled in case of death, insanity, or by either party provided that the other party is informed of the decision and so long as it will not be disadvantageous to the other party[166].

Translated into banking language, the *mudaraba* contract has three parties instead of two: the depositors as financers, the bank as an intermediary, and the entrepreneur who demands the capital. The bank works as a *mudarib* when it receives funds from depositors and as *rabb al-mal* when it pools them for the entrepreneurs (*mudarib*). The bank cannot require any guarantee from the *mudarib* to return the capital or to return it with profit for this would nullify the contract. The bank cannot interfere in the management or take part in the daily operations of the investment. However, it is possible to ask for a third and independent party to guarantee the capital. The bank can also determine: activities, location, and duration of the project. Also the bank can keep an eye on the investment without harming the performance of the entrepreneur[167].

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[165]M, Yousef. Liquidity Management and Trade Financing. In: Simon, A, and Rifaat, A. A. (eds). *Islamic Finance Innovation and Growth*, pp. 170-171.
[166] Ibid, p. 172.
[167]Lewis, Mervyn K, and Algaoud, Latifa M. *Islamic Banking*, p. 43.

Warde criticizes *mudaraba* contracts on the grounds that they create managerial and regulatory problems that have yet to be fully mastered. For instance, on the one hand the *mudarib* may ask for more money than he needs, or may engage in high-risk activities knowing that he will not be committing his own money. On the other hand, the bank may also take advantage of a *mudarib* who is pressed for cash, or of depositors who know little about the transaction, by transferring the risk to the other party. To minimise risks, he suggests that the bank has to ensure that its funds are properly spent, and the venture being financed is properly monitored. However, the *mudarib* must prove that he is highly qualified in the business he conducts, and that he enjoys a good reputation within his business community[168].

3.4.3.2 *Musharaka*

Unlike *mudaraba* the word *musharaka* means a profit-sharing joint venture, designed for limited commercial activities of long duration. *Musharaka* can be defined as "a form of partnership where two or more persons combine either their capital or labour together, to share the profits, enjoying similar rights and liabilities"[169]. Under this financing technique, additional finance is provided to parties which already have some funds for investment. In contrast with *mudaraba*, "the ratio in which the finance-provider shares the profit of the business with the party receiving the additional funds is fixed and predetermined"[170]. Losses will be shared according to the precise proportion of the capital invested by each party. Moreover, all parties are entitled to participate in management, but are not necessarily required to do so. Thus, *musharaka* may take two forms. The first is called *mufawoda* which means a limitless, unrestricted, equal partnership, where each party is the agent and the guarantor of the other, and in which both have equal in rights of disposition and management. The second form of *musharaka* is *shirkah al-ian*, which occurs when two or more parties

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[168] Warde, Ibrahim. *Islamic Finance in the Global Economic*, p. 137.
[169] Lewis, Mervyn K, and Algaoud, Latifa M. *Islamic Banking*, p. 42.
[170] Al- Omar, Fuad, and Abdel-Haq, Mohammed. *Islamic Banking Theory, Practice and Challenges*, p. 13.

contribute to a capital fund, either with money or by labour, and where each partner is the agent but not the guarantor of his partner[171]. This form of *musharaka* is similar to a limited partnership.

In banking language, under *musharaka,* the bank structures a partnership with an existing business in order to establish a limited liability company. Both share the profits and the losses that the new venture generates, and which are separated from the profit generated by the two original companies. In most cases there may be small profits at the beginning of the project. These partnerships may be considered as long-term in nature[172].

3.4.3.3 Financing on the Basis of an Estimated Rate of Return

As with *musharaka*, the bank estimates the expected rate of return it is being asked to finance, and provides financing on the understanding that at least that rate will be payable to the bank. In some cases this rate is negotiable. If the project ends in higher profits than estimated, the excess goes to the client. However, in the case of losses, the bank will take their share of them, and if the profit is less than that estimated, the bank will accept the lower rate[173].

3.4.3.4 *Istisna* or Manufacturing

The fourth method of investing surplus funds is *istisna*. This method of investment is different from the previous methods of *musharaka* and *mudaraba*.

According to Lewis and Algaoud, *istisna* is a contract between the bank and the client which can be defined as "a contract for production of specified items where a person or company asks the bank for finance to manufacture such items with inputs provided by the maker at an

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[171] Lewis, Mervyn K , and Algaoud, Latifa M. *Islamic Banking*, p. 43.
[172] Wilson, Rodney. *Islamic Business Theory and Practice*, p. 27.
[173] Noha, D. *What is Islamic Economic? Part 2.* [On line]. 2003. Available from: http:// www.arabfinance.com.[Accessed on 20th April 2005].

agreed price"[174]. Sarker, sees an *istisna* contract as "a contract of acquisition of goods by specification or order where the price is paid progressively in accordance with the progress of the job"[175]. *Istisna* as an exceptional mode of sale which allows deferment of payment and delivery of the commodity.

Istisna may be a good chance for opening up new possibilities in business contracts. For example, this kind of contract could be used to build a new house where payments to the builder are made as building progresses. Moreover, since this *istisna* contract involves manufacturing, it can also be used to finance huge projects such as aircraft manufacturing, factory installation and others construction projects.

Comparing the different methods of investment suggests that *istisna* reduces the likelihood of a bank facing the financial obstacles encountered in *murabaha* and *musharaka*, because payments are paid progressively as the job proceeds. As a result the bank can revoke payments when the client does not meet the contractual conditions or if the project does not achieve its objectives.

3.5 Summary

Islamic banking has existed for over thirty years, so a review of its achievements is overdue. Islamic banks are not charitable organisations, and therefore they must seek profits just as conventional banks do. While this is their primary goal, their main objective is not maximise profits but to achieve a reasonable rate of return. We can easily understand the nature of Islamic banking, not by comparing it with conventional banking, but by analysing the value system behind it. The core of Islamic banking lies in the prohibition of interest or *riba*.

In the harsh environment of today's global economy, Islamic banks must compete with conventional banks. Accordingly, some flexibility must be given in terms of the implications

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[174]Lewis, Mervyn K , and Algaoud, Latifa M. *Islamic Banking*, p. 56.
[175] Addul awwal, Sarker. *Islamic Business Contracts*, p. 7.

of modern theories of interest in order to afford Islamic banks a way to offer and develop new financial methods which accordance with *Sharia* law and allow the system to meet the needs of their depositors and shareholders.

Nevertheless, while Islamic banks have focused primarily on short-term, trade-oriented transactions which offer a combination of low risk and high profit, it is vital for them to overcome the limitations discussed above and consider new long-term modes of transaction in order to prosper in today's highly competitive and globalized banking industry.

Chapter Four

Institutional Aspects of Islamic Banks and their Role as Financial Intermediaries

4.1 Introduction

The philosophical axiom of the Islamic economic system states that Islamic banking is an ethical and equitable system that derives its morals principles and values from Islam. From the very early stages of Islam, the authentic financial intermediation systems in Muslim lands facilitated the mobilization of their entire capital resources for financing agriculture, crafts and manufacturing.

By the time of the Abbasid Caliph, *Al_Muqtadir* (295-320 AH/908-933AC)[176], financial intermediations were known as *sarrafs*, which were already performing most of the basic functions of modern banks. They had their own markets, which were similar to the financial markets of today. These markets were not only used by Muslims but also by Jews and Christians as well. However, since they were not banks in the technical modern sense of the term, some Islamic economists have preferred to call them "bankers without banks"[177].

Chapra mentions that owing to certain historical circumstances, the Islamic system of financial intermediation lost its technological and economic vitality. Thus, the system was displaced by Western financial institutions[178]. However, the independence of Muslim countries has, on the one hand, led to the revitalization of Islamic financial systems, and on the other has resulted in the gradual resurrection of most of the institutions lost during the colonial area including the intermediary financial ones.

Recently, many Islamic banks have started to perform the typical functions of conventional financial intermediations. Examples of these functions are asset transformation, the conduct of orderly payments and brokerage.

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[176] Chapra, Umar. *Bank Without Interest: Is It Conceivable?*. [On line]. Available from: http://www.zb.eco.pl/zb/163/original/economy.htm. [Accessed on 26th May 2005].
[177] Ibid.
[178] Ibid.

In fact, Islamic banks not only channel resources from capital surplus to capital deficits they undertake an education role through spreading saving and investment awareness among people, by training them in how to use interest-free loans and rationalising expenditure. Indeed, Islamic banks also have other roles to perform, such as preparing their clients psychologically and socially to accept an Islamic banking system[179]. Islamic banks, beside their financial role, have to assume moral and educational duties.

To this end, two approaches have been adopted by Muslim countries in accommodating Islamic banking and financial institutions in their existent system. Some have opted to eliminate interest from the operations of all their financial institutions, while others, including some non-Islamic countries, have allowed the establishment of Islamic banks alongside conventional interest-based finance institutions, namely a dual system.

The main aim of this chapter, hence, is to provide an overview of the role of the Islamic banks as financial intermediaries. The chapter is divided into five sections. The first provides a brief introduction about the regulation of Islamic banking. The second considers the *Sharia* Board, its supervision role, duties, appointment procedures, number of members and various other guises. The third examines the types of Islamic banks. The fourth looks at the range of Islamic banking accounts such as current accounts, saving accounts and special investment accounts, while the fifth provides a summary of the chapter.

4.2 Regulation of Islamic Banking

The financial markets can be broadly classified into three functionally distinct categories: first, depository institutions such as commercial banks, finance companies, savings and loan associations and credit unions; second, contractual saving institutions like pension funds and

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[179] Elnaggar, Ahmed. Islamic Banking Potential for Domestic Saving Mobilisation. *Islamic Bank International.* February/March 1988, No. 581, p. 9.

insurance companies; third, investment intermediaries like mutual funds and fund managers. Since banks are vital to consumers, businesses and communities, they were the earliest institutions that were regulated by governments.

Compared with other financial institutions, there are four major reasons why banks are subject to regulation and supervision. The first is related to the nature of bank contracts. The second is the systemic nature of banks' business. The third is the crucial and central role that banking systems play in the financial systems, particularly in their clearing and payments systems. The fourth reason is the moral hazard associated with lending and safety net arrangements that apply to them[180].

However, the term regulation in this context refers to the supervision of banking and other similar organisations. However, banking regulation involves two basic objectives. First, maintaining systemic stability to avoid the collapse of a significant part of the financial system, and second, and more importantly, to protect small and less informed investors, who are financially unsophisticated[181].

In most countries, particularly in emerging countries, the central banks are the sole supervisor and the regulatory authority of a country's monetary policy. However, the nature of the relationship between the central bank and the ruling regime varies from country to country and from time to time.

There is a general agreement that the concept of a modern central bank did not appear until the 20th century[182]. Historically, since the establishment of the Bank of England in 1694, the role of the central bank has been changed. Between 1870 and 1914, the central bank's primary function was to issue currency and notes based on the country's reserves of gold. However, in the aftermath of WW II, governments world wide assumed control of their central bank.

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[180] Jerry, Jordan. *The Functions and Future of Retail Banking*. [On line]. Available from: www.develandfed.org/Research/com96/091596.htm. [Accessed on 27th May 2005].
[181] Ibid, p. 21.
[182] Heakal, Reem. *What are Central Banks?*. [On line]. Available from: http://www.investopedia.com/articles/03/05703.asp. [Accessed on 20th April 2005].

Consequently, central banks lost their independence. One of the basic reasons was that the countries with newly-acquired independence (such as Middle Eastern countries) opted to take control of the economies of their countries[183].

Nowadays, most central banks are government-owned yet distinct from the Ministries of Finance[184]. Central banks have to achieve two basic functions. First, at the macroeconomic level, they regulate inflation and price stability through controlling the money supply and by their monetary policy. Second, at the microeconomic level, the central banks work as the lender of last resort, by requiring commercial banks to keep agreed deposit reserves ratios. However, not all central banks require commercial banks to deposit reserves[185].

According to Wilson, central banks in the Middle East have minimal independence from government. Therefore, they function as agents of their governments. Wilson goes on to say that the governors of these banks consider themselves as technocrats. The basic role of these central banks is to advise their government on their borrowing alternatives. He mentions also that such advice is generally related to methods of borrowing rather than the total amount borrowed[186].

The differences between the nature of Islamic and conventional banks will not reduce the need for regulation of Islamic banking. Regulation regarding Islamic banking acts as a firewall to ensure strict compliance with *sharia*. Such disclosure regulations would increase confidence in the sector, which is very important in developing and promoting *sharia* conformity.

However, except mainly for the Gulf Region, some central banks in the Middle East lack understanding and experience of Islamic banking transactions. Nor do they have the legislation or means of procedure to supervise an Islamic banking industry. This tension

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[183]Heakal, Reem. *What are Central Banks?*.
[184] Ibid.
[185] Ibid.
[186] Wilson, Rodney. *Banking and Finance in the Middle East*. London: Financial Times. 1998, p, 51.

between Islamic banks and some central banks in the region make the latter less willing to support Islamic banking. The CBL is a clear example.

As patrons of the banking communities in their countries, in their detailed March 1981 report on "Promotion, Regulation, and Supervision of Islamic banks", the governors of the central banks and monetary authorities of the members of the Organisation of the Islamic Conference (OIC), along with other relevant authorities, aimed at setting up adequate guidelines for the regulation, supervision, assistance and promotion of Islamic banks[187]. Aziz maintains that the basic challenge facing the regulator is how to formulate a regulation framework which will comply with *sharia* principles. He believes that any obvious approach to regulate Islamic banking should have regard to two conditions. First, it should consider and adopt the existing international regulatory standards where they are in line with *sharia*. Second, the regulators should care about the unique characteristics of Islamic banking when developing a separate regulatory framework[188].

The extent to which Islamic banking is under the authority and jurisdiction of central banks varies from one country to another. In some Islamic countries, the existing banking regulations are based on western banking models. Thus conventional banks can exist in these countries. Wilson provides several explanations for the existence of these banks. The first probable explanation is that *sharia* is the general law of these countries but not the law for the banking industry, so *sharia* cannot apply to foreign banks or banks which deal in foreign transactions. The second possible explanation according to Wilson is that these countries are Muslim countries and that all banks operating in them are considered to be Islamic by definition thus obviating the need for setting up another banking system called Islamic banking[189].

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[187] Special address by Dr. Zeti Aziz, Governor of the Central Bank of Malaysia, at the 2nd seminar for Central Banks and Monetary Agencies on AAIFI's Accounting Standards, Kuala Lumpur, 29th May 2002.
[188] Ibid.
[189] Wilson, Rodney. *Banking and Finance in the Middle East*, pp. 51-52.

However, in a number of other Islamic countries, there are problems related to the existing Islamic banking regulations. These problems, if not solved, may discriminate against the clients of Islamic banks. One of these problems relates to taxation law which allows the inclusion of interest, because it is considered as an item of cost. While it excludes the Islamic banks' share of any profits from customers costs. Second, whenever the central bank asks Islamic banks to settle their operations immediately as part of general credit policy they cannot comply. Third, Islamic banks cannot access either national or international money markets, whereas conventional banks can. Finally, another problem which faces the Islamic banks is the lack of a lender of last resort, which would give confidence to Islamic banking in general[190].

The recent rapid growth in Islamic banking is forcing the status quo to change. Many central banks have reconsidered and now accept the concept of Islamic banking. They are serious in issuing specific laws and regulations to oversee and establish Islamic banks. Moreover, many governments in the Middle East are willing to rescue Islamic as well as commercial banks which get into trouble[191]. As a result, Islamic banks do not have to bear the costs of deposit protection schemes similar to those of their counterpart commercial banks. This allows Islamic banks to make profitable use of their funds, which they can place with the central banks to meet legislative and liquidity requirements.

On the other hand, in other Muslim countries, the regulatory authorities are becoming increasingly determined to exercise control over their Islamic banks. They have implemented large-scale transformation of their banking systems to conform to Islamic principles. However, Persley and Dar see over-regulation of Islamic banking in some of these countries

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[190] Wilson, Rodney. *Banking and Finance in the Middle East*, p. 56.
[191] Ibid.

as restricting the Islamic bank portfolios to fixed-return modes to minimise the risk of their failure[192].

Since they are not able to guarantee returns on deposits, which is the main objective of commercial banking regulations, Islamic banks have initially faced difficulties in operating in non-Islamic and in some Islamic countries. This has led some regulative authorities to not consider Islamic banks, by definition, as banks and to regard them as outside their jurisdiction. Therefore, no regulatory body operating in accordance with Islamic principles exists.

However, to be able to survive in these countries Islamic banks have resorted to many indirect ways of doing business, for instance by setting up unit trusts and investment companies. This has led the regulatory authorities in some of these countries to reconsider the situation of Islamic banking and gain a deeper understanding of the working techniques and the philosophy of the industry. England is a clear example.

Indeed, in the last few decades, Islamic banking has attracted the attention of many international financial institutions and prestigious centres of education. Consequently, the attitudes of the regulation authorities and public opinion world-wide gradually have improved their understanding towards Islamic banking. It seems that one of the basic factors that has created this better understanding is the similarity between the sector and ethical banking.

4.3 International Islamic Institutions for Standardization and Regulation

In the past, the lack of international Islamic accounting standards has meant that Islamic banks and other Islamic institutions have been subjected to conventional audits. These conventional audits are sometimes carried out by conventional firms or accountants. Out of this need, intensive efforts have been made by some Islamic states to establish formal entities

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[192]Dar, Humayon, and John, Persely. Management and Control in Islamic Financial Institutions. *Arab Banker*. Summer 1999. VI (3), p. 29.

to support the development and enhancement of the regulatory supervision of the industry. The beginning came with the Organisation of Islamic Conference (OIC), followed by such other organizations as the Accounting and Auditing Organisation for Islamic Financial Institutions (AAOFI). The organization was established in 1990 and registered in March 1991 in Bahrain as an international autonomous non-profit making corporate body. The main objective of the organisation is to prepare and develop accounting and auditing standards for the Islamic finance industry, taking into consideration international standards and practices, and the need to comply with the *sharia*. The organisation has made significant progress in recent years towards standardising the diverse accounting procedures of different Islamic institutions and is working with regulators to implement a uniform regulatory regime.

With regard to achievements, the organisation has issued many financial accounting standards, auditing standards, governance standards and codes of ethics. It had also issued a Statement on the Purpose and Calculation of the Capital Adequacy Ratio for Islamic Banks. By preparing issuance and interpretations of *sharia* standards for Islamic institutions, the AAOIFI takes part in efforts to harmonise concepts and application among the different *sharia* supervisory boards of Islamic financial institutions. However, the AAOIFI's standards are currently adopted, mandatory and implemented in many Islamic countries such as Bahrain[193].

The Islamic Financial Services Board (IFSB) is another important instance of Islamic organisations that are expected to play a significant role in developing international prudence and supervisory standards, and best practices for Islamic financial institutions. The organisation is based in Kula Lumpur and was established in November 2002. The purpose of the IFSB is to develop standards to address the risks associated with Islamic financial products. The organisation collaborates with the Islamic Development Bank (IDB), the central

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[193] Fuad, A. O, and Mohammed, A. H. *Islamic Banking Theory, Practice, and Challenges*. Karachi: Oxford University Press. 1999, p. 104.

banks, the monetary authorities of several IDB member countries, the International Monetary Fund (IMF) and the AAOFI[194].

4.4 *Sharia* Boards

As mentioned early, the distinctive feature of Islamic banks has been the existence of a legitimate control body, a Sharia Supervisory Board, in addition to a board of directors. According to *Abu Hanifa* (founder of the *Hanifa School*), "every merchant must be accompanied by a scholar whose advice will allow him to avoid *riba*"[195]. According to the AAOIFI, a *sharia* board can be defined as "an independent body of specialised jurists in *fiqh almua'mat* (Islamic commercial jurisprudence)"[196]. Thus, the main purpose of the *sharia* board seems to be the giving and enhancing of credibility to the operations of the Islamic banks in the eyes of their clients. This can be done by authenticating their legitimacy from the *sharia* point of view[197]. Most boards even in Islamic banks, or Islamic financial institutions meet quarterly, a few monthly and some annually[198]. According to Vogel, there is no equivalent in other religious cultures or banking systems[199].

It is argued in some quarters that the promotion of Islamic finance and banking can be related to the contribution and vision of a number of Islamic scholars. However, in the early stages of Islamic finance and banking, many *sharia* advisors were not qualified in Islamic commercial law. They were isolated from law and modern financial theory and practices. It is possible to say that they were reputable individuals whom their societies accepted and recognised. This was because of their good general knowledge of Islam and the major role they had in their

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[194] Fuad, A. O, and Mohammed, A. H. *Islamic Banking Theory, Practice, and Challenges*, p. 104.
[195] Warde, Ibrahim. *Islamic Finance in the Global Economy*. Edinburgh: Edinburgh University Press. 2006, pp. 24-27.
[196] Accounting, Auditing and Governance Standards for Islamic Financial Institutions 1424-5H/2003-4, Accounting and Auditing Organization For Islamic Financial Institutions, p. 5.
[197] S, Ramadan. The Experience of the Jordan Islamic Bank. (Chapter 6). In: Wilson, Rodney. (Ed). *Islamic Financial Markets*. London: Routledge. 1990. Chapter 6, p. 1.
[198] Warde, Ibrahim. *Islamic Finance in the Global Economy*, pp. 226-236.
[199] Ibid, p. 20.

societies, even though, academically they were not trained in Islamic commercial law and related disciplines. However, the name and reputation of the scholars on these *sharia* boards is still one of the most influential factors in directing client choice ever since Islamic banks first opened or, over time, as the banks have established a reputation as solid financial institutions and brand names and images have become important[200].

It is worth noting here that besides understanding *sharia* issues, the ideal *sharia* adviser should be able to understand issues pertaining to other legal and economics frameworks. The number of advisers who command expertise in *sharia* law and other related disciplines, such as law and economics, is still low. A recent survey of thirty *sharia* boards revealed that although all members were trained in Islamic law only about half of them, also held a degree in business and economics[201]. However, recently, many *sharia* education and training programmes have included positive law as well as finance and accounting[202]. Moreover, some financial institutions remedy such shortages by inviting experts on economics and law to their *sharia* boards. Some argue that, in some circumstances, these invited members may not have enough freedom to voice their opinion since they do not have full membership of the board[203]. One can say that having a *sharia* committee of respected *fiqh* scholars who can endorse the bank's activities, is seen as a crucial factor in ensuring the institution's reputation and success. It is worth mentioning, however, that Warde suggests four conditions should be considered and taken into account by *sharia* board members to ensure their freedom to voice their opinion. First, they should not be subject to the authority of the board of directors. Second, the General Assembly should fix their remunerations. Third, they should be appointed by the General Assembly, as is the case of the auditors. Fourth, the body with should have full executive authority over means and jurisdiction. Finally, and according to AAOIFI standards,

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[200] Wilson, Rodney. The Evolution of the Islamic Financial System. In: Archer, Simon, and Abdelkarim, Rifaat, (eds). *Islamic Finance Innovation and Growth*. London: Euromoney Books and AAOII, 2000, p. 121.
[201] Warde, Ibrahim. *The Role of Sharia Boards: A Survey*. Sun Francisco: IBPC. Working papers. 1998.
[202] Wilson, Rodney. Retail Development and Wholesale Possibilities, p. 77.
[203] Ibid, p.78.

the *sharia* supervisory board should not include directors, or significant share holders of the Islamic financial institution[204]. The AAOIFI standards on the appointment of members of *sharia* board stress the point that the authority to appoint them must be rested in the annual general meeting of all shareholders of the Islamic banks in order to ensure that they are free from any undue influence by the management who should have no authority to appoint or to dismiss them[205].

The remuneration and conditions of employment of *sharia* members are usually decided at the shareholders' meetings. In a few cases the bank's executive management may make the decisions[206]. However, the management board can also appoint *sharia* board members for more than five years[207].

It is also important to mention that in some countries law and actual practice may not conform with the standards of the AAOIFI. The standards advocated by the AAOIFI for *sharia* appointments, may not be applicable at the level of central banks in many countries. Therefore, the power to appoint *sharia* advisors in these countries may be held by the governments, or central banks[208].

According to the AAOIFI standards, a *sharia* board shall consist of at least three members[209]. Some have argued that odd numbers on a *sharia* board are to be preferred. This number usually varies from one to nine[210]. In practice, many Islamic banks have *sharia* boards which consist of only one or two advisers. This situation usually occurs in respect of new Islamic banks, which are still at the development stage. It is also acceptable in the case of Islamic

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[204] Accounting, Auditing and Governance Standards for Islamic Financial Institutions 1424-25H/ 2003-4. Accounting and Auditing Organization for Islamic Financial Institutions, p. 6.
[205] D.B, Mohd. The Sharia Supervisory Board and Issue of Sharia Rulings and Their Harmonisation in Islamic Banking and Finance (chapter 6). In: Archer, Simon, and AbdelKarim Rifaat, (eds). *Islamic Finance Innovation and Growth*. London: Euromoney Books and AAOII. 2000, pp. 78-79.
[206] Warde, Ibrahim. *Islamic Finance in the Global Economy*, p. 227.
[207] D.B. Mohd. The Sharia Supervisory Board and Issue of Sharia Rulings and Their Harmonisation in Islamic Banking and Finance, p. 79
[208] Ibid.
[209] Accounting, Auditing and Governance Standards for Islamic Financial Institutions 1424-5H/ 2003-4, Accounting and Auditing Organization for Islamic Financial Institutions, p. 6.
[210] Warde, Ibrahim. *Islamic Finance in the Global Economy*, p. 227.

windows provision or when there is no urgent or compelling need to have three *sharia* advisers[211] . However, many of these banks can appoint more than one adviser later, as the volume of business and *sharia* issues requiring attention increases.

In theory, *sharia* boards should generally perform legal and religious roles, rather than an accountancy role. The reality is more complicated. However, in the same way as auditors, *sharia* boards certify and examine the balance sheets, profit and loss accounts and review the investment and financial activities of the Islamic banks. On the other hand, *sharia* boards may also issue *fatwas*, as needed and requested by the Islamic banks, or their clients. For instance, *sharia* boards decide whether the fees charged by the Islamic banks could be rated as *riba*, or whether a new financial regulation is religiously acceptable[212]. As a consequence, some can argue that the *sharia* boards in some situations are too closely associated with a banks' executive management, a situation that cannot be ignored in terms of regulatory prudence.

According to the AAOIFI standards, the process by which the *sharia* board members achieve any decision is of prime importance. It seems the normal way by which executive management control business is by holding a joint meeting with the *sharia* board in which management controls the agenda and thus can present the matters which they think are important and need to be debated. They have also realised that most *sharia* advisors are part-timers and will frequently either fail to turn up or are insufficiently skilled to argue successfully against the full-time professional experts on the executive management[213]. However, one can assume that there is no ideal relationship between the Islamic bank executive management and their *sharia* boards. There may be too many factors which can affect their relationship.

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[211]D.B, Mohd. The Sharia Supervisory Board and Issue of Sharia Ruling and Their Harmonisation in Islamic Banking and Finance, pp. 79-80.
[212] Warde, Ibrahim. *Islamic Finance in the Global Economy*, p. 227.
[213] D.B, Mohd. The Sharia Supervisory Board and Issue of Sharia Ruling and Their Harmonisation in Islamic Banking and Finance, p. 81.

Warde has raised a number of issues in connection with *sharia* boards. As *sharia* board members derive their principal income from their membership of a *sharia* board, some of them may legitimise quite dubious operations. Membership can affect their independence and credibility. One related issue is that different boards have different interpretations of what is permissible or not in the *sharia*. Consequently, some *sharia* boards in some Muslim countries tend to be more lenient and tolerant than boards in other Muslim countries. Furthermore, differences in historical tradition and practice, and the intensity of competition, meant that many *fatwas* issued in one country are not recognised in another. It is worth mentioning here that Islamic banks in both Islamic and non Islamic countries have formed their own religious boards. As a consequence there is no universally accepted central religious authority[214].

However, it is interesting to note that according to Wilson some non-Islamic institutions which offer Islamic finance and banking facilities seldomly use a *sharia* adviser or have a *sharia* board. They argue that they do not have enough businesses to justify the appointment of an Islamic authority[215]. Moreover, Warde also mentions that, in some circumstances, *sharia* boards are not really necessary. They may be considered a financial drag on the operations of these financial institutions as most Islamic bank employees are versed in Islamic law and practices[216].

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[214] Warde, Ibrahim. *Islamic Finance in the Global Economy*. Edinburgh: Edinburgh University Press. 2006, pp. 226-227.
[215]Wilson, Rodney. Retail Development and Wholesale. (chapter One). In. Wilson, Rodney. *Islamic Financial Markets*. London: Routledge. 1990, p. 13.
[216] Warde, Ibrahim. *Islamic Finance in the Global Economy*. Edinburgh: Edinburgh University Press. 2006, pp. 227-229.

4.5 Forms of Islamic Banks

The term Islamic finance provider refers to any institution which provides some form of Islamic financial services, such as commercial banking, investment banking, insurance and other financial services that can operate in accordance with Islamic principles[217].

It may be useful to mention here that the establishment of Islamic banks and Islamic windows was in response to the need of many Muslims and non-Muslims who regard it as a religious and moral duty to refuse banking with interest-based banks. This has long given Islamic banks and other Islamic financial institutions in some Muslim countries a monopoly of banking services.

During the 1990s Islamic banks started to become more resourceful and go global. This can be attributed to increased integration with international markets. The Islamic services have reached out to investors and clients directly. This has increased competition for their services. Moreover, it has led many conventional banks in the west and Islamic countries, who had not previously offer Islamic services to open Islamic windows and dedicated Islamic branches.

However, there is no standard way of categorising Islamic banks but, in terms of services provided, Islamic banking service providers can be divided into two broad categories: Islamic banks and Islamic windows[218].

4.5.1 Islamic Banks

Islamic banks represent the majority of the Islamic financial institutions which are spread world-wide in both public and private sectors. The first Islamic commercial bank was established in 1974 in the United Arab Emirates (UEA), the Dubai Islamic Bank[219]. Islamic banks usually have a start-up capital which derives from their founder and shareholders in

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[217] No Author. *Islamic Finance in the Middle East: Surveying, the Landscape.* [On line]. Available from : http://www.econresearch.com/datapark/industry/hs02p4a.html. [Accessed on 20th May 2005].
[218] No Author. *Islamic Finance in the Middle East: Surveying, the Landscape*, p. 43.
[219] Iqbal, Zmair. The Development of Financial Institutions and Future Challenges. In: Archer, Simon, and AbdelKarim, Rifaat, *Islamic Finance: Innovation and Growth,* p. 42.

addition to the money clients deposit into their accounts[220]. In terms of ownership structure, Islamic banks can be classified into international banks, joint-venture banks, and privately-owned banks, where ownership belongs either to shareholders in public companies, to holding companies, or privately by wealthy families or individuals. Islamic banks, like conventional commercial banks, offer basic retail and consumer-finance products to finance personal needs such as automobiles, home improvements, or leasing (*ijara*) and hire purchase (*murabaha*)[221].

In practice, most Islamic banks have an organisational set-up similar to their conventional counterparts, structured wholly on Islamic principles and which deal only with Islamic instruments[222]. In terms of recruitment, it seems that Islamic banks employ the best person for the job regardless of colour, creed, gender or ethnicity. They are committed to equal opportunity policies.

In the last thirty years, Islamic banks have grown in number. In practices, the average size of total assets is still small compared with the average size of total assets of banks in the conventional system. Moreover, the size of total assets of the largest Islamic bank amounts to meagre one per cent of the total asset of the largest bank in the world[223]. According to Iqbal, more than 60% of the Islamic banks have a total asset size that is below the minimum economic size (US$ 500 million) and no Islamic banks is in the list of the top 100 banks in the world[224]. He goes on to claim that Islamic banks have been well positioned to attract deposits from Muslims[225]. However, it is seems that Islamic banks have missed out on a huge segment of investors who are non-Muslims investors but are looking for or ethical banking.

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[220] [On line]. Available from : http:// www.Islamic-bank.com/islamicbanklive/faqs/1/home/1/home.jsp. [Accessed on 20th May 2005].

[221] Iqbal, Zamir. *The Development of Financial Institutions and Future Challenges*, p. 45.

[222] Dar, Humayon, and Persely, John. Economic Research Paper No.00/24. *Lack of Profit Loss Sharing in Islamic Banking: Management and Control Imbalances.* Loughborough University, p. 7.

[223] Iqbal, Zamir. The development of Financial Institutions and Future Challenges. In: Archer, Simon, and AbdelKarim, Rifaat. (Eds), *Islamic Finance: Innovation and Growth*, p. 46.

[224] Ibid.

[225] Iqbal, Zamir. Islamic Financial Systems. *Finance & Development*. June 1997, pp. 42-45.

4.5.2 Islamic Windows

In general, the term "Islamic windows" refers to "conventional banks that have divisions dedicated to Islamic financial services"[226]. Iqbal sees Islamic windows as "special facilities offered by conventional banks to provide services to Muslims who wish to engage in Islamic banking"[227]. Aziz refers to these entities as the "bank within a bank"[228].

Many conditions have to be fulfilled when conventional banks and financial institutions attempt to set up Islamic windows. Yaquby, for instance, has summarized as having five basic characteristics: first, there should be a *sharia* supervisory board for any institutional investment body; second, the funds of the Islamic window must be completely segregated. Therefore, there should be separate accounts, books and computer programs for these services; third, the management of financial institutions which undertake Islamic windows should be fully convinced of their importance and concerned to implement services which comply with *sharia* teachings. Fourth, the conventional financial institutions require guarantees to protect Muslim investors' funds against trespass, negligence and fraud; fifth, conventional banks must comply with values such as transparency and clarity to avoid confusion, misunderstanding and ambiguity. This can be done by using, for example, the AAOIFI standards as a guide[229].

4.6 *Sharia* Compliant Bank Accounts

As commercial banks, Islamic banks render similar services to their clients as do their counterpart conventional banks. Some Islamic thinkers believe that in the harsh environment

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[226] No author. *Islamic Finance in the Middle East: Surveying, Landscape.* [On line]. Available from: http://www.econresearch.com/datapar/Industry/hso2p4a.html. [Accessed on 24th May 2005].
[227] Iqubal, Zmair. Islamic Financial Systems.
[228] Zeti, Aziz. *Corporate Governance and Aspects of the Regulatory Framework.*
[229] Yaquby, Nizam. *Requirements to be Fulfilled when Conventional Banks Set up Islamic Banks, "Windows" or "Islamic Funds".* [On line]. Available from: http://www.citibank.com/clib/articles/pdfs/Islamwin.pdf. [Accessed on 24th Agust2005].

of the global economy, Islamic banks must take account of strategic decisions which involve socio-economic and moral considerations. Beside, Islamic banks also have an important role to encourage their customers to use financial intermediation rather than rely on cash transactions. Thus, to achieve these goals Islamic banks provide four main types of account: current accounts; savings accounts; investment accounts and special investment accounts. On the one hand, these accounts are similar to those rendered by conventional banks. On the other hand, they are in contrast to conventional banks in that payments and deposits are made according to the principles of *mudaraba*, or profit/losses sharing. The features of these accounts are outlined below.

4.6.1 Current Accounts

Current accounts have been approved by *sharia* scholars to ensure sharia compliancy. The Islamic basis of current accounts derives from the principle of *al-wadiah* (trust or safe keeping) and *qard al-hasn*[230]. These accounts will be liquid and payable on demand for the depositors. Furthermore, no fees are normally charged, apart from the expenses incurred as a result of keeping the accounts such as postage, telephone charges, etc which are debited to the accounts.

Islamic bankers argue that since Islamic banks borrow money which will be shown as a liability, it is the Islamic banks' obligation to return the amount loaned without any return to depositors, even though the banks have utilized the deposit. Based on this, the funds accumulating in these accounts should only be used to balance liquidity for short-term transactions for which the Islamic bank should accept responsibility.

Customers normally use current accounts for their every day transactions. Deposits may be made by cash, cheque or direct account transfer. In the same way as a conventional banking

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[230] Volker, N. The Performance of Islamic Banks. In . Mallat, Chibli. (Ed). *Islamic Law and Finance.* London: Graham & Trotman. 1988. chapter 7, p. 130.

system, current accounts in Islamic banks are offered with cheque books, multi-functional bank cards and international payments, allowing the Islamic banks' clients to withdraw and spend as they please. However, no overdraft facilities are available in most Islamic banks where accounts are overdrawn for Islamic banks are unable to charge a penalty fee on the account. On the other hand, Islamic banks will charge administrative fees for items such as returned cheques and letters of notification. No minimum balance is required by some Islamic banks and if the account is consistently misused, the bank will close the account. However, when a bank's clients find themselves in need of cash to meet unexpected expense, such as medical bills, or a wedding, a client can apply for a *tawarruq* loan[231].

4.6.2 Saving accounts

Many economists see the savings generated by banks from small savers as a major source of capital. This is because of its low cost source in terms of fees and convenience. Thus an enthusiastic and dynamic group of savers is very important for developing a nation's economy and banking sector.

The main aim of holding savings accounts in conventional banks as well as investment accounts is to keep customers' good will[232]. In addition, the provision of deposit insurance by governments has made these accounts more highly valued by customers[233].

One can claim that these factors make it difficult for Islamic banks in a dual system to attract worth customers. However, to a large extent this is not accurate. In general, Islamic savings accounts are similar to savings deposits in traditional commercial banks except that they do not earn a return. Although profit is not the main aim of savers, the Islamic banks always try

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[231] *More Notes on Current Account. Islamic Bank of Britain.* [On line]. Available from: http://www.islamic-bank.com/islamicbanklive/currentaccount1/hq---. [Accessed on 15th August 2005].
[232] Wilson, Rodney. (Ed). *Islamic Financial Markets*. London: Routledge. 1990, pp. 22-23.
[233] Benston, George J. What's Special About Banks?. *The Financial Review*. 39. 2004, p. 16.

to foster savings awareness among their individual clients and encourage them to pool their money[234].

There are a number of different methods of operating saving accounts in Islamic banks. Lewis and Algaod mention three: accepting savings deposits on the *al-wadiah* principle; treating savings deposits as *qard al-hasn* deposits (benevolent loans); and integrating savings deposits in various ways with investment accounts[235].

In order to encourage deposits in saving accounts, and with the approval of the sharia scholars, accounts holders can be rewarded in a number of ways. Moreover, when a debtor settles his debt, the *sharia* allows his creditors a bonus in the form of increasing the size of their deposit or by rewarding them in some other way[236].

Thus some Islamic banks apply this principle on current accounts and saving accounts. In some cases savings accounts depositors may be granted the special privilege of drawing funds for financing some small project or purchasing productive or durable consumer goods. This will be on either a *mudaraba* or interest-free basis. In other cases Islamic banks offer their clients one or more of the following prizes such as non-fixed bonuses in cash or kind such as gold coins, cars or reduced bank charges. They may also guarantee the nominal value of their clients' deposits after profit sharing[237].

According to El-Asher, in some cases, a return on saving accounts which ranges between 3 and 6% is regarded as a gift from the Islamic banks. It is distributed at the discretion of a bank's directors who have the right to determine how much can be distributed, or if there

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[234] Elnaggar, Ahmed. Islamic Banking Potential for Domestic Saving Mobilisation. *Islamic Bank International.* February/March 1988, No. 581, p. 9.
[235] Lewis, Mervyn, and Algaod, Latifa, . *Islamic Banking.* Cheltenham: Edward Elgar. 2001, p. 47.
[236] Butterworth Editorial Staff. *Islamic Banking and Finance.* London: Butterworths. 1986, p. 105.
[237] Lewis, Mervyn, and Latifa, Algaod. *Islamic Banking*, pp. 47-48.

should be any distribution at all[238]. However, some Islamic banks allow their customers to withdraw from their accounts without penalty or notice[239].

4.6.3 Investment Accounts

The investment account is the focal point of funding in the Islamic banking system. They are a second type of deposit account, as well as a savings account. Both are considered as critical sources of funding for Islamic banks which use these accounts to contribute to investment enterprises besides using their own funds. So the account holders become indirect stockholders but with no guarantee on the value of their accounts.

Billah defines investment as an activity which involves the apportioning of money for allocation to various types of business in search of profit[240]. There are two types of investments open to investors. They can invest either in physical assets such as gold, coins and other tangible assets, or they can invest in financial assets such as stocks, bonds, and mutual funds. El-Naggar indicates that, in general, investors are stimulated by profit: they look to raise their standard of living and continuously seek more profit[241]. However, as there is a difference between the savers and the investors, Islamic banks deal with them on this basis, by trying to find a system which allows them to pool their resources in order to satisfy their needs more efficiently.

Investor, too, have a range of criteria which they use in their desire to maximise the returns on their assets; for example, they can acquire knowledge about the activities of the enterprises in which their money is to be invested and to worry before taking each step. Second, now that they are better advised, especially from the *sharia* point of view, they have more expertise in

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[238] El-Asher, Ahmed. Egypt: An Evaluation of the Major Islamic Banks. (Chapter 4). In. Rodney, Wilson. (Ed). *Islamic Financial Markets*. Routlege, London: Routlege. 1990, p. 66.
[239][On line]. Available from: http://www.islamic-bank.com/islamicbanklive/IAshariacompliant/1. [Accessed on 8th October 2005].
[240] Billah , Mohd Ma'. *Islamic Fund Management and ITS World View*, p. 3.
[241]El-Naggar, Ahmed. Islamic Banking Potential for Domestic Saving Mobilisation. *Islamic Bank International.* February/March 1988, No. 581, p. 8.

choosing their investments. Third, thanks to the greatly improved sources for obtaining information on the strength and weaknesses of the market, they have better opportunities to invest wisely backed up by their previous knowledge. However, investors do face a serious problem which is usually difficult to solve. Once their problem has been defined, they may well be confronted with the problem of having to decide from a range of options. Mostly they prefer to diversify their investments. This step will help them balance risk. Most importantly they will aim for a profit even if it is small. Investors do not like to leave their money idle[242].

According to Ghannadian and Goswami there are ambiguities in the distinction of the nature of investment account holders and the bank stockholders[243]. On the other hand, Billah mentions that investors are not involved in managing the operations of the Islamic banks. As a consequence, they are not entitled to any salaries or wages. They are only entitled to the profits and losses generated by the banks[244]. Thus, they are not representatives in shareholder meetings or on the banks boards.

However, it seems that investors miss their right to participate in managing their funds, which is considered as natural form the point of view of control. In contrast Chapra and Tariqullah see that depositors in general and investors in particular would be able to safeguard their interest more effectively if they were allowed to participate actively in shareholders meetings. Also if they have their representatives on the banks' boards of directors or the regulator can ensure greater transparency so that the depositors know what is going on and are thus able to play a greater role in safeguarding their interest[245].

However, in the Islamic banking system, investment accounts are called participation accounts or PLS (profit and loss sharing). The conditions attached to these accounts differ

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[242] Mohd Ma', S. B. Islamic Fund Management and ITS World View. [On line]. Available from: http://www.islamic-insurance.com. [Accessed on 27th May 2005], p. 4.
[243] Farhad, F. Ghannadian,and Gautam, G. Developing Economy Banking : The Case of Islamic Banks. *International Journal of Social Economics.* 31(8), 2004, pp. 740-752.
[244] Mohd Ma', S. B. *Islamic Fund Management and ITS World View,* p. 3.
[245] Chapra, Umer, and Khan, Tariqullah . *Regulation and Supervision of Islamic Banks*. Jeddah. Saudi Arabia - 1421H(2000), p. 24.

from those for savings accounts by virtue of the possible duration of deposits. They also differ for accounts with fixed levels of deposit and to funds which cannot be withdrawn from investment accounts where notice must be given in advance (usually one month for small a mount, and three months for larger). The moral standing and the record of the client play a significant role in determining the conditions attached to any help given. Moreover, the Islamic banks offer advice about how the investors should reorganise their financial affairs.

Most importantly, the investors may lose some or all their funds in the event of a bank making losses. It is worth mentioning that the liabilities which appear on an Islamic bank's balance sheet in general consist of two types of deposits in addition to shareholder equity and accounts are renewed automatically unless notice of withdrawal is given by the bank.

However, Wilson notes that depositors who do not use *riba* banks make comparisons between the returns on investment accounts with Islamic banks and those on time and savings accounts with *riba* banks, because they do not want to feel they are in any way being short-changed, or even exploited, because of their religious beliefs. He goes on to say, for them the choice is not between the types of bank, but whether to use a bank at all[246]. Thus, the actual average rate of return on investment accounts in some Islamic banks ranges between 9.0 and 12.5% which is nearly always competitive with the rates of interest in conventional banks[247].

4.6.4 Special Investment Accounts

Special investment accounts are another kind of account. These are directed towards larger investors and institutions for specific lengths of time and usually operate under the *mudaraba* principle. The main difference between these accounts and other investment accounts is that special investment accounts are usually related to a specific project and the investors have the

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[246]Wilson, Rodney. Competition in Islamic Banking. In. Wilson, Rodney. (Ed). *Islamic Financial Markets.* London: Rout ledge. Chapter 2, 1990, p. 22.

[247] El-Asher,Ahmed. Egypt: An Evaluation of the Major Islamic Banks. In. Wilson Rodney. (Ed). *Islamic Financial Markets.* London: Routledge, 1990, p. 63.

opportunity to invest directly in a preferred project carried out by an Islamic bank. In contrast to normal investment accounts, the maturity and the distribution of profits for each special investment accounts are negotiated separately with the yield directly related to the success of the particular investment project.

Beside their range of accounts, Islamic banks world-wide offer a full range of fee-paying retail services that do not involve interest payments, including cheques, spot foreign exchange transactions, fund transfers, travellers cheques, safe-deposit boxes and the other normal services of modern banking.

4.7 Summary

Islamic banking is an open sector for everyone, provided that once they have walked through the door they comply with its Islamic and moral principles, and deal honestly. The prime aim of Islamic banks should be to serve not only Muslim clients but all people wherever they live or whatever their situation who seek ethical banking.

Institutionally, an important step in an Islamic bank is to set up a *sharia* board which is made up of three to five Islamic scholars. The board's role is vital for Islamic banking either as a full-blown Islamic bank or as a window in other banks. They examine the banks' documentation and confirm that the products comply with *sharia* law.

It seems that the most difficult part in introducing a new financial product is gaining the approval of the *sharia* board, but this is essential if the product is to succeed. Therefore, it is necessary to specify clearly the role of the *sharia* board. Generally speaking, the regulation and supervision of Islamic banks in most Muslim and non-Muslim countries are similar to those in conventional banks.

In terms of services, Islamic banks provide normal banking services similar to those provided by conventional banks. Islamic banks obtain their funds from the public through Islamic

current and investment accounts. However, the majority of Islamic banks' transactions centre on retail or trade financing. These services and transactions are structured in accordance with various *sharia* principles such as *mudaraba, musharaka* and others. It seems that by improving and broadening their services Islamic banks can strengthen the links between them and their clients and thus be successful in building up their asset base.

The Islamic banks' task as intermediaries between depositors and borrowers is to generate information on prospective borrowers and their investment projects. This information helps the banks to estimate risk better and decide whether to finance the project

Chapter Five

The Libyan Commercial Banking Sector

5.1 Introduction

During its history, the banking system in Libya has been subject to fundamental changes. The changes relate to the banking system, its quality of service provision, as well as the regulation and supervision of its activities.

In the Ottoman era the Libyan economy was mostly dependent on trade and agriculture. To improve its economic performance, the Ottoman government, established a banking system designed to reflect the importance of agriculture and trade to the Libyan economy. As a consequence, in 1868, the first Ottoman agriculture bank was established in Benghazi. It was followed by another in Tripoli. Moreover, in 1906 and 1911 two branches of the Ottomani Bank were opened in Tripoli and Benghazi respectively[248].

According to Abedlmalek[249], in 1907, the work of the Banco di Roma allowed Italy a peaceful penetration to build up its interests and influence in Libya without provoking military repression and the bank invested largely in local agriculture, electricity, mineral prospecting and shipping[250].

In the 1950s, all the commercial banks in Libya were branches of foreign banks: three had their head offices in Italy, two in Great Britain and one each in Egypt, Jordon and France[251]. However, on 24 December 1951 the day of the independence, there were only two banks offering primary banking services. One of them was Barclays Bank which, as a result of Libyan membership of the sterling bloc had taken on the responsibility of issuing Libyan currency in the absence of a Libyan Central Bank. Moreover, banking activities were mainly

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[248] Abedlmalek, Jamal. *Development of Libyan Banks*, Benghazi: Epl House, 2005, p. 14.
[249] Ibid, p. 15
[250] Ibid.
[251] Ibid, pp. 15-16.

out of Libyan hands, apart from a small number of borrowers and depositors. Thus the Libyan people found themselves lacking skills, education and experience in the field of banking[252].

In November 1963, a ministerial decision was issued by the government that 51% of the shares of each of the four branches of the foreign banks were to be taken over by the Libyan government through nationalisation policies and that these shares were to be sold to Libyan investors. Khader saw this procedure as part nationalization[253].

On 22 December 1970, the government had issued a law which first, fully nationalized the remaining foreign ownership in the Libyan banking sector, as well as reorganizing the commercial banks. Second, in order to put an end to the capitalist monopolies in the banking sector, the government determined LD 5000 as the ceiling on the nominal value of what a person and his relatives up to the fourth level of kinship might own in the capital of any bank[254].

In 1979, the private sector in Libya was nearly abolished and suspended as a result of the government introducing various socialist-style measures. This meant expanding the public sector and cutting-back the private sector. As a consequence, most of the private sector activities came to be run by the state[255].

On 2 September 1993, to get rid of non-profitable companies and services, the government issued Law No. 9 which provided for both privatisation of state assets, and a greater role of the private sector in the economy. This can be considered as a dramatic turnaround in government policy[256] and a return to the past.

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[252]Khader, Nuri. The Development of Banking System in Libya. In: Kamal, Bichara, K, and El-Wifai Bashir, E. (Eds). *The Economic Development of Libya.* London: Croom Helen, 1987, p. 188.
[253] Ibid, p. 184.
[254] Ibid, p. 183.
[255] El Fathaly, Omar. Moute, Palmer, and Chackeria, Richard. *Political Development and Bureaucracy in Libya.* Lexington: Lexington Books, 1977, p. 94.
[256] The Economist Intelligence Unit. *Libya Country Report, No1, 1992.* London: The Economist Intelligence Unit, p. 5.

In the light of this brief discussion, the main aim of this chapter is to give an overview of the Libyan commercial banking sector. Moreover, the information in this chapter is mainly based upon the banks' published accounts audits of which were not satisfactory and on interviews conducted by the researcher. Much recent information is not available. The financial statements of most Libyan commercial banks for the year 2004 have yet been published.

The chapter is divided into eight major sections. The first provides a brief introduction about the commercial banking sector in Libya. The second considers the Central Bank of Libya (CBL) as the sole supervisory and regulatory authority of the banking system in Libya. The third examines the privatisation of the Libyan commercial banks. The fourth looks at the Libyans commercial banks and the fifth inspects the Libyan commercial banks' accounts. The sixth investigates the duties of the Libyan commercial banks towards the CBL and their clients while the seventh focuses on the state-owned commercial banks. The final section summarizes the discussion.

5.2 Commercial Banking Sector in Libya

The financial service industry in Libya is considered a developing industry, since the value of the banks in the industry is quite small and it consists of local banks and no foreign banks. However, generally speaking, the commercial banking sector in Libya comprises two types of commercial bank, the state-owned commercial banks and the private commercial banks. In addition there is the Central Bank of Libya (CBL) which is considered as the coordinator and watchdog of the sector. However, the Libyan commercial banking industry employs approximately 15,000 people[257].

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[257] No Author. Libya implements measure to improve banking sector. 2.2.2006. [On Line]. Available from: http://www.Libyaninvestment.com/archive/2006-02-03-07.php. [Accessed on 15th May 2006].

5.2.1 The Central Bank of Libya (CBL)

Worldwide, governments are responsible for making rules that are designed to protect their economies and make them stable. In this context, the role of the central banks is to represent the governments. They are responsible for issuing the rules and guidelines on how banks should conduct their business. However, the banks adapt these rules after studying them and assessing the benefits they perceive for their business.

Nevertheless, the CBL is the primary regulatory authority. It controls all banks and banking activities in Libya. On 24 December 1951, after Libyan independence was achieved, an international commission was established. It was given some of the responsibilities which are normally performed by a central bank[258].

On 26 April 1956, the National Bank was established to replace the Libyan Currency Commission. It had an authorized capital of £1,000,000. At that time the National Bank had the sole right to issue currency, hold the deposits of the federal and provincial governments and oversee ordinary commercial banking activities[259]. Branches of the National Bank opened in Sebha, the principal city in the province of Fezzan (south Libya) on 1 April 1957; another branch was opened in Benghazi, the country's second largest city, in the north-east of Libya on August 12th of the same year; followed by a fourth branch in Byada in central north-east Libya which was made the new capital of the country at that time. The National Bank was administered by a board of directors which consisted of the governor, the deputy governor and five directors[260].

The National Bank of Libya performed most of a central bank's customary activities, but it could not be considered a fully-fledged central bank. There were several reasons for this: first,

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[258] Habib P,Heneri. *Politics and Government of Revolutionary Libya*. Montreal: Le Cercle du Liver De France Ltee. 1975, p. 257.
[259] The International Bank for Reconstruction and Development. *The Economic Development of Libya*. Baltimore: Johns Hopkins Press. 1963, p. 40.
[260] Kubbah, Abdul Amir. *Libya Its Oil Industry and Economic System*. Baghdad: The Arab Petro-Economic Research Centre. 1964, p. 51.

the Banking Law of 1958 left to the Libyan Ministry of Finance not only regulation of the cash reserves held by the commercial banks but several other regulatory and supervisory functions which could usually be entrusted to a central bank; second, the legal framework of the Libyan banking system appeared to be tied to contractual commitments entered into with the British Government[261].

By the Banking Law of 1963, the CBL replaced the National Bank. It is 100% owned by the state and is the supreme monetary authority in Libya. Accordingly, the CBL enjoys the status of an autonomous institution. The law also stipulated that the objectives of the CBL should be to maintain monetary stability in Libya and promote sustained growth in the economy in accordance with the government's general economic policy for the country.

With regard to the Banking Law No. 1 of 2005, the CBL is now under the auspices of the Secretariat of the General People's Congress. Its authorized capital has been increased to LD 500 million. The board of directors comprises the governor, the deputy governor and six other members who usually represent other finance and economic interests[262]. Its head-quarters are now situated in Tripoli. However, the bank also has three branches. They are located in Benghazi, Sebha and Sirte[263].

The functions of the CBL have grown since its establishment. These functions can be summed up as: a) issuing and regulating the currency; b) managing and controlling the foreign exchange reserves; c) supervising and regulating the activities of the other banks; d) acting as a banker to the commercial banks; e) acting as a banker to the state; and f) promoting economic development through ensuring the financial system is stable[264].

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[261] Abedlmalek, Jamal. *Development of Libya Banks*, p. 53.
[262] Ibid.
[263] The Central Bank of Libya. [On line]. Available from: http://www.cbl-ly.com/eabout.htm. [Accessed on 4th June 2006].
[264] Ibid.

5.2.1.1 The Central Bank of Libya and the Basel Committees on Banking Supervision

In responding to the drastic changes in the international financial systems, in 1974, the Basel Committee was established by the world's major national financial systems (group of ten countries[265]). The governors of these countries' central banks cooperated with each other to formulate mechanisms for the exchange of information, the determination of supervisory responsibility and the creation of minimum standards. The main objective of the committee is to strengthen the ability of national authorities to supervise their banks in both their national and international activities, and to narrow and close the gaps in international banking supervision[266]. The committee does not possess any formal supranational supervisory authority. Therefore, its conclusions do not and were never intended to have legal force[267].

Wood mentions that since the mid-1970s, there can be little doubt that the work of the Basel Committee has changed greatly the international financial system[268]. According to him, "The success of the committee has been limited[269]".

The CBL has obliged all the banks to increase their capital to LD 33,333,000 by the end of 2006[270]. In order to apply Basel Committee standards, the General People's Congress in Libya has allowed a special exchange rate for the banks *i.e.* 1 LD is equal to US$ 3.33. This is to ease the way for Libyan banks to amass the capital required.

According to some bankers' thinking, however, difficulties are still there due to the poor state of the Libyan market as well as to the weak purchasing power of the people[271]. Thus the capital required to meet the conditions and requirements of these committees cannot be met in the current circumstances. Moreover, many Libyan bankers see that the procedures which

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[265] The committee's members come from: Belgium, Canada, France, Germany, Italy, Japan, Luxembourg, the Netherlands, Spain, Sweden, Switzerland, United Kingdom and United States.
[266] Bank for International Settlement. [On line]. Available from: http://www.bis.org/bebs/aboutbcbs.thm. [Accessed on 16th September 2005].
[267] Ibid.
[268] Wood, Duncan. *Governing Global Banking: The Basel Committee and the Politics of Financial Globalisation.* Hants: Ashgate Publishing Limited, 2005, p. 4
[269] Ibid, p. 2.
[270] Interviews.
[271] Ibid.

have been taken by the CBL to reconstruct and develop the banking sector according to the Basel Committee are not clear but considerably ambiguous. Consequently, there is a difference between reality and intention[272].

It should be said in this regard that some banking staffs are still not familiar with the Basel Committees and their rules. This may reflect the fact that the CBL has not made much of an effort to explain the Basel Committees' rules or introduce them to the banking sector. Or it might mean that the CBL is not serious about implementation of the Basel Committees' rules.

5.2.2 The Libyan Commercial Banks

The commercial banks are state-owned banks, national banks owned by stock holders, or enterprises owned by companies called bank holding companies which can be defined as "institutions which accept deposits, make business loans and offer related services"[273]. However, the commercial banks are institutions which are run to make a profit and which offer these services to individuals and companies. It seems that the primary concern of these banks is receiving deposits and lending to businesses and individuals. In other words they can be named commercial because they specialize in loans to commercial and businesses of every size[274].

The Libyan Banking Law No. 1 of 2005 has defined a commercial bank as "any company that ordinarily accepts deposits in current demand accounts or time deposits, grants loans and credit facilities and engages in other such banking activities"[275]. According to this law, a commercial bank must assume the form of a Libyan joint-stock company with a paid-up

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[272] Wood, Duncan. *Governing Global Banking: The Basel Committee and the Politics of Financial Globalisation,* p. 4.

[273][On line]. Available from: http://www.investorguide.com/igup1-types-of-accounts.htm. [Accessed on 4th June 2006].

[274] [On line]. Available from: http://www.investorguide.com/igup1-types-of-accounts.htm. [Accessed on 5th June 2006].

[275] Banking Law No. (1) Of 1373 P.D. (2005), Chapter 2-Section 1. The Establishment and Supervision of Commercial Banks, p. 23.

capital of at least LD 10 million, divided into shares. The value of each share shall not exceed LD 10 and shares may be held by ordinary citizens and public and private legal entities[276]. The private banks, however, may also acquire shares of the capital of the state-owned commercial banks. The shareholders have the right to participate in the general assembly of the commercial banks. Each shareholder has voting rights, according to the percentage of his share of the bank's capital with a maximum permitted holding of 4%[277].

In terms of management, a commercial bank is directed by a board of directors comprising between five and seven members. The remunerations of the board of directors are set by resolution issued by the bank's general assembly. The bank's charter stipulates the tenure of the chairman and the members of the board of directors. However, it is the board of directors who select the chairman from among its members. The general manager of the bank is appointed on the recommendation of two other members of the board of directors. All financial remuneration of the employees in each commercial bank, especially in the private commercial banks, is determined by decision of the bank's board of directors. There is need to mention here that the salaries that are paid by the state-owned commercial banks are subject to Law No.15 of 1981.

The Libyan commercial banks are members of various regional banking organisations such as the Union of Arab Banks and the Union of *Magreb* Banks. Domestically, they are also members of the Society of Libyan Banks. However, no interviewee mentioned that any Libyan commercial bank belonged to any international organisation.

With regard to the number of the banks, some bankers think that the number of the Libyan commercial banks is large in comparison with the number and level of services which they provide. On the other hand, others think that the number of the Libyan banks is small, and does not meet the requirements of the Libyan market. They attribute the small number on

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[276] Banking Law No. (1) Of 1373 P.D. (2005), p. 24.
[277] Ibid.

banks to the prohibition of establishing private banks or opening branches of foreign banks in Libya under the previous Law. However, as mentioned earlier, the commercial banks of Libya can be divided into two categories, state-owned commercial banks and private commercial banks.

5.2.2.1 The State-Owned Commercial Banks

After the first of September revolution 1969, the decision was taken to raise the national shareholding in foreign banks to 51%. All foreign banks operating in the country at this time were subjected to this decision. However, Barclays Bank and Banco de Roma decided to procrastinate implementing this decision and demanded a joint equal share management between the two parties involved: the banks and the Libyan government. The procrastination of the British bank and the Italian bank did not last for long, as all foreign banks became fully nationalized and owned by the state. Moreover, all of them were given a new name in Arabic[278].

The commercial banks of Libya encountered certain difficulties and obstacles during their transformation. However, perseverance of their employees at that time in performing their duties towards the nation met with general approbation. Libyan bankers had learned their banking skills in the 1950s and 1960s from UK, US and Italian bankers who had all enjoyed success in their banking operations in Libya. They were distinguished by strict management which made the banking services provided by Libyan commercial banks competitive with those offered by the international commercial banks at that time[279]. The expertise of the Libyan managements matched that of their international banking competitors. They were well

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[278] Interviews.
[279] Ibid.

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known as the finest bankers amongst Arab bankers. Consequently, they were involved in the creation of some of the leading Arab financial institutions following the 1973 oil boom[280].

After the banks underwent nationalisation, all their business was transferred to the public sector. The state-owned banks played a key role in the financing of many public sector companies, but they were not shareholders. Recently, the banks have been allowed to participate or buy shares in these companies[281].

To promote banking amongst the Libyan population, the state banks' activities have not been limited to the main cities, but have also covered the rural areas. According to Alwaddan there are three reasons for this: first, the government believes that the rural areas play a very important part in the country's development; second, in this way the government through this would limit the migration from the countryside to the cities; third, the government used this opportunity as a tool to gain political support and increase employment[282].

In terms of banking services, for many years the function of state-owned commercial banks in Libya was seen as a means of processing government salaries. The banks are still using manual systems of banking for new technology has not yet completely found its way into these banks. Basic transaction facilities are available to customers such as account balances and a simple payroll system for employees but there is no kind of networking between the banks' headquarters and their branches. Customers have to wait in queues to make withdrawals from or payments into their accounts. They have a cheque books to use but they are used when making a withdrawal. Confidence in the banking system in general was further undermined after the currency was reformed in 1980 with only one week allowed for exchange[283]. However, many people said and still say "We are not going to save or deposit

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[280] Libya Has The Finest Bankers In The Region But The Worst Banks. *Business Middle East.* [On line]. Available from: http://libyainvestment.com/archives/2004-03-16.php. [Accessed on 21 May 2005].
[281] Interviews.
[282] Alwaddan, Abubaker. *Banking Reforms and Banking Efficiency in Libyan Commercial Banks: A Non-Parametric Approach.* PhD. Thesis, Northumbria University, June 2005, p. 140.
[283] Interviews.

our money in a bank. Let us keep our money in our pocket". Most Libyans, hence, still prefer to carry out their transactions in cash.

To keep up with the rest of the world, the CBL is trying to introduce the SWIFT system of transferring money through the use of the technology worldwide. This can be done only by the use of modern technology and communication systems[284].

It seems that the adoption of new technology nowadays is a part of the CBL propaganda to improve confidence in the banking sector but it has failed to produce any tangible results as a consequence of the weak infrastructure in the country in its communication systems and poor internet provision. However, as mentioned earlier there are now five state-owned Libyan banks and are old state-owned commercial bank has become the National Commercial Bank (NCB).

5.2.2.1.1 National Commercial Bank (NCB)

The NCB was formed in 1970 to take over the commercial operations of the CBL and to incorporate the Libyan operations of the two foreign commercial banks, the Istiklal Bank, formerly Banco di Napoli, and the Oroba Bank, formerly the Arab Bank[285]. The NCB is based in Baida and has a relatively large network of 60 branches and agencies and more than 23,000 staff. The paid up capital of the bank is LD 35 million[286]. The bank has six main clients. Mostly they are dealing in the oil and gas industry and cement and pipes. However, it seems that because of this historical connection with the CBL, relatively few foreign companies now in Libya use the bank. The bulk of its clients are national companies and enterprises[287].

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[284] Twati, J.M, and Gammack, J.G. *The Impact of Organisational Culture Innovation on Adoption of IS/ IT: The Case Study of Libya.* The 2004 International Research Conference on Innovation in Information Technology. Griffith Business School. Griffith University. J.tawti@griffith.edu.au and j.gammack@griffith.edu.au.
[285] Interviews.
[286] National Commercial Bank, *Thirty Two Annual Report to the Board of Directories of 2002,* p. 33.
[287] Interviews.

5.2.2.1.2 Sahara Bank

The Sahara Bank is one of two banks in Libya which has been recently privatised. The bank paid up capital is LD 126 million. The CBL owns 82% of the capital and 18% is owned by private shareholders[288].

Before nationalisation, the bank was owned by Bank of America, Banco di Rom, and Banco di Sicilia with Libyans holding a majority 51% of shares. Sahara Bank is a Tripoli-based bank. The bank has the smallest network amongst the five state-owned banks, with only 45 branches and agencies. The bank was the only state-owned bank to have a March 31st financial year-end (Italian fiscal year system). Recently, it has changed the date to December 31st in common with the other banks in the country[289]. It is worth mentioning here that as of July 2003, the bank is among 73 banks in the Arab region which were included in The Banker list of the top 1000 International Banks in terms of tier-1 capital.

5.2.2.1.3 Umma Bank

The Umma Bank was established in 1970. It took over the Libyan operations of Banco di Roma, which had served the political purpose of Italy. In fact, the bank played a fundamental role in the invasion of Libya and the depression of the national economy. The Umma Bank is based in Tripoli and has an average size network of 55 branches and agencies. The bank has more than 2,500 staff[290]. The bank started its work with a capital of LD 15[291]million which was raised to LD23 million by decision of the chairman of the board of directors and its

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[288] The Central Bank of Libya. [On line]. Available from: http://www.cbl.com. [Accessed on 9th May 2005].
[289] Interviews
[290] Interview with Mr Abdulfathah Ghaffar, the General Manager of Umma Bank. [On line]. Available from: http://www.unitedworld-usa.com/reports/Libya/interview-15.asp. [Accessed on 10th May 2006].
[291] [On line]. Available from: www.umm-bank.com/english/pages/historical-Brief-php. [Accessed on 2ed March 2006]

general manager in 1987[292]. Recently, its capital has risen to LD100 million to meet the criteria set forth by Basel I and II regarding capital adequacy[293].

5.2.2.1.4 Wahada Bank

In contrast to other state-owned banks, the Wahada Bank is Sirte registered, although most of its head-offices functions are in Benghazi. The Wahada Bank was formed in 1970 to take over the Libyan operations of four foreign banks: Bank of North Africa, the Kafila Al-Ahly Bank, the Nahda Arabia Bank and the Societe Africane De Banque S.A.L. However, at the time of nationalisation, there was some local ownership. In 2001 the bank's paid up capital was LD 36 million but has now risen recently to LD 108 million. The CBL owns 87% of the bank's capital and 13% is owned by shareholders[294].

5.2.2.1.5 Gumhouria Bank

The bank was formed in 1969 to take over the Libyan operations of Barclays Bank. It is based in Gharyn. The bank has 81 branches and agencies around Libya. This is considered as the largest network among all the banks,[295] operating in Libya[296]. According to its balance sheet on 31st December 2004, its paid-up capital is LD 40 million[297].

5.2.2.2 Libyan Private Commercial Banks

For a long time Libya only used to allow state-owned banks, until Law No. 1 regarding banks, currency and credit was issued in 1993. The law can be considered as a very advanced step towards banking reform. Since that time the private sector has started to break the mould of

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[292] [On line]. Available from: www.umm-bank.com/english/pages/historical-Brief-php. [Accessed on 2ed March 2006]
[293] Umma Bank, Financial Statement at the end of 31/12/2005.
[294] Wahada Bank. Thirty First Annual Report to the Board of Directories (31/12/2001), p. 38.
[295] Gumhouria Bank. [On line]. Available from: http://www.gumhouriabank.com. [Accessed 8th March 2006].
[296] Interviews
[297] Gumhouria Bank, Balance Sheet on 31-12-2004.

government ownership and now it is possible for the private sector to invest in the banking industry. It is now possible to say that all new banking regulations compared with those in the past, support and encourage private banks to emerge in a very sound environment. For instance, in the past, it was necessary to have at least 100 shareholders to create a bank. Nowadays it is down to 25 shareholders, which reduces the inconvenience for forming a new bank[298]. This is considered as a positive, encouraging movement towards privatisation and reform. However, the CBL still maintains tight regulations regarding capital and legal reserves[299].

Significantly, the private banks do not consider that the monetary authorities are under any legal obligation to support them in extremis. The private bankers believe that the banking authority and regulator may regard private banks as too small to support if they run into difficulties[300]. For instance the CBL placed constraints on the private commercial banks on the sale and purchase of foreign currencies from August 2003. These constraints last for more than 28 consecutive months[301]. These transactions were considered one of the basic sources of revenue. However, the sale of foreign currencies was enabled through the liquidation of inward international transfers to the private banks and some amount bought locally. The sale of private banks notes through the liquidation of inward international transfers was also subject to some constraints from the CBL by limiting these sales to their head-quarters[302]. The Central Bank of Libya also constrained the liquidation of the treasury notes which were held by the commercial banks including those by the private commercial banks and which generated lucrative tax-exempt revenue[303].

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[298] Interviews.
[299] Ibid.
[300] [On line]. Available from: http://www.bankerme.com/bme/2003/apr/bank-profile.asp. "BCD brings the pioneer spirit to Libya"- bank profile. [Accesses on 28 December 005].
[301] Interviews.
[302] Ibid.
[303] Ibid.

It is obvious that nowadays the main purpose for the private banking sector in Libya is to raise and improve banking services in the country. They try to fulfil the duties of the commercial banks on a par with those of the other commercial banks worldwide. The private commercial banks' focused philosophy is concentrated on what Libyan customers are seeking from a bank and what foreign investors are looking for in terms of banking services[304]. Thus, they give loans, discount bills, collect cheques and issue letters of credit, "LC's", and bills for collection as well as providing foreign and local letters of guarantee.

The private commercial banks are always aspiring to provide the latest in banking services. In addition to the conventional banking services and the services provided to some of major local and foreign companies, the banks provide a bundle of differentiated new services: phone banking, travellers' cheques in Libyan dinars, safe-deposit boxes, internet services, touch-screen services, drive-in banking and automatic teller machines.

The private banks in Libya have a reputation for high quality in providing their customers with the best products and fast services. The banks do that for several reasons: first, and most important to keep their customers happy; second, to attract more customers to their banks; third, the limitation of services rendered by the state-owned banks gives opportunities to the private banks to render services of more diversity and multiplicity[305]. Thus, they provide modern services like ATM machines, transfers money and travellers' cheques, as well as internet banking. They have also provided their clients with appropriate financial advice[306]. Most of these products and services are available in all Libyan private banks. However, the private banks do not restrict their advertisements on new services and products. They use all the available advertisement facilities. It is worth mentioning here that most of these products and services are not available in the state-owned banks.[307].

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[304] Interviews.
[305] Ibid.
[306] Ibid.
[307] Ibid.

To a certain extent the existence of private banks in Libya has created competition between them and the state-owned banks. Not only in terms of banking services, but also in their efforts to persuade the managers of the state-owned banks to pay greater attention to their financial statements, and their profits and losses. This is not to draw the attention of these banks or their clients to themselves. It is in order to signal their ability to perfectly and effectively manage their institutions[308].

It can be argued that the private banks in Libya are still tiny by comparison with the five state-owned banks. However, their influence is disproportionate to their size. It is possibly to say that the private banking sector in Libya is growing very fast and may shortly be able to be considered too big, too strong to fail. For example, Abdulmalek sees the transfer of private and merchant accounts to private banks as a clear sign that innovative services and a commercial customer-focused philosophy are certainly what Libyans need from a bank[309].

Compared with the state-owned banks and international standards, the private banks' asset quality is relatively strong. Most loans are of good quality, including real estate loans secured by mortgages and the banks have their focus trained on the long-term facilities[310]. Credits problems are negligible compared to the other banks[311]. However, some Libyan bankers point out that the rapid horizontal expansion of the private banks in the form of opening new branches and agencies may lead the banks to lose control[312]. However, two banks have so far taken advantage of legislation to open and two more received licences in 2005. The Bank of Commerce and Development (BCD) led the way.

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[308] Interviews.
[309] [On line].Available from: http://www.bankerme.com/bme/2003/apr/bank-profile.asp. "BCD brings the pioneer spirit to Libya"- bank profile. [Accessed on 12 December 2005].
[310] Interviews.
[311] Ibid.
[312] Ibid.

5.2.2.2.1 Bank of Commerce and Development (BCD)

Bank of Commerce and Development (BCD) was the first private bank to open in Libya since the revolution of 1969. The bank was established on 12th November 1995 as a joint-stock company and started operations on 9th June 1996. It is currently one of four private-owned commercial banks operating in the Libyan market which has long been dominated by the state-owned commercial banks[313]. The BCD can be considered as the first step which broke the pattern of government ownership. Moreover, bank has paved the way for other commercial private banks to participate in creating a healthy, relevant, modern banking sector in Libya.

The bank is based in Benghazi, Libya's second largest city, because the founders considered that the city's market was not well served by state-owned commercial banks, none of which is formally based in the city. Moreover, the founders and the chairman who is considered the driving force behind the bank and the private banking sector in general, were educated in Benghazi which would then have been the natural base of their personal contacts at that time[314]. However, most of the bank's business goes through Tripoli.

According to Article 3 of the bank's basic regulation, the longevity of the bank is ninety nine years renewable automatically[315]. The objective of the bank is to exercise all banking, financial and development financing operations including complementary or otherwise normal, financial or development activities[316].

The bank's policy of compliance with local and international standards of banking capital adequacy has encouraged the bank's general assembly to increase its capital from LD 9

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[313] Bank of Commerce and Development. [On line].Available from: http://www.bankofcd.com/index.asp?page=3. [Accessed on 21 March 2006]

[314] Interviews.

[315] Bank of Commerce and Development. [On line]. Available from: http://www.bankofcd.com. [Accessed on 9th May 2005]

[316] *"BCD Brings the Pioneer Spirit to Libya"- Bank Profile.* [On line]. Available from: http://www.bankerme.com/bme/2003/apr/bank-profile.asp. [Accessed on 28 December 2006].

million to LD 20 million. The bank has issued 1.1 million shares at a nominal value of LD 10 per share. In 2003 the paid-up capital increased to LD 17, 317,890,000. During 2004 the bank's capital was fully paid-up in 2 million shares. On completion of the bank's capital the number of shareholders in the bank, both ordinary citizens and juridical persons reached, 2068. Significantly they came from all the different regions of Libya[317].

The number of bank employees increased to 382 employees[318] in the year 2004 comparing with 282 in the year 2003[319]. This increase reflects the growth of the bank's network from 16 branches and agencies in the year 2003[320] to more than 20 countrywide branches and agencies in the year 2004[321].

On 26 of April 2006, the Tripoli main branch was connected to the Benghazi branches by hiring a high speed optical fibre cable[322]. The bank aims at implementing an advanced plan for direct connection of all its branches with the main office. This would enable the bank to provide distinctive services for its clients, i.e. to perform any banking operation, such as payment of a cheque, in any of it branches at the same time, as well as provides other time and efforts saving services related directly to its clients[323].

The bank, however, now faces two new competitors such as Aman Commerce and Investment Bank and Aljma Alarbi Bank. They are becoming increasingly competitive with the BCD. The banks are also providing all modern advanced banking services in simple ways. Moreover, in the immediate future, the BCD will also face new different competitors, which are the foreign banks. These banks may open Libyan branches and poach BCD's best staff and clients[324].

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[317] Bank of Commerce and Development. Eighth Annual Report 2004, p. 14.
[318] Bank of Commerce and Development. Seventh Annual Report 2003, p. 17.
[319] Bank of Commerce and Development. Eighth Annual Report 2004, p. 19.
[320] Bank of Commerce and Development. Seventh Annual Report 2003, p. 17.
[321] Ibid, p. 19.
[322] The Central Bank of Libya. [On line]. Available from: http://www.bcdly.com. [Accessed on 1 March 2006].
[323] Interviews.
[324] Ibid.

5.2.2.3 The National Banking Corporation

In the last two decades, the banking system in Libya, according to Law No. 1 of 1993 regarding banks, money-currency and credit, has witnessed the establishment of new banks named Regional Banks or "*Al-Massaraf Al-Alhiya*". The number of these banks thought to be spreading all over Libya is 48. In 2002 only 44 regional banks had started functioning and 4 were under construction[325].

Each bank has its own board of directors, a complete staff of officers and separate documentation. The mission of Libya's regional banks, beside practising all normal commercial banking activities such as accepting deposits and opening current accounts within their regional boarders, is to collect data on banking and regional business conditions, and to promote economic education, help in promoting and supporting small business, and create new investment opportunities for industry, tourism and general purpose funding.

However, some bankers and academia usually referred to these banks as domestic banks[326] and some of them also believe that Libya is the first country to experience this kind of banking. It is worth mentioning in this context that regional banks is quite an apt name for these banks. However, many other countries have successfully experienced this kind of banking with little difference. Russia and its Central Municipal and Building Bank, which considers banks should serve specific territories beside its numerous municipal banks in the cities, are clear evidence of this[327].

In 1996 the state-owned National Banking Corporation was founded to combine and control the regional banks under its umbrella and undertake their clearing services and international

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[325] Abedlmalek, Jamal. *Development of Libya Banks*, Benghazi. Epl house, 2005, p, 48.
[326] See Al-Wadan.
[327] Soviet Union Information Bureau Finance. [On line}. Available from: http://www.marixists.org/history/ussr/government/1928/sufds/ch11.htm. [Accessed on19March 2006].

activities. In 2002 the subscribed capital of the corporation was LD 31.000.000 and the paid-in capital was LD 11.689.300 million, there were 10.900.000 shareholders by then[328].

However, the interviewees' reported that the transformation made to the organisational structure of the regional banks by the existence of the state-owned National Banking Corporation has severely impacted on the delivery of banking services offered by these banks and the channels which provide them. They mentioned also that the regional banks are following the same strategies as the state-owned banks, such as using public funds instead of attracting private ones. Moreover, they could not identify the banking products in which they have a market advantage, or provide personal services that distinguish them from other banks. This situation does not create any kind of competition between them and the state-owned or private banks. On the other hand, as this kind of banking is considered new in Libya and is somehow not yet fully defined, the figures which appear on the banks' statements of account may not reflect their real potential.

They concluded that the banks could have succeeded had they not: a) suffered mismanagement; b) granted unlimited facilities for customers outside their regions; c) been limited in their operations to certain geographical areas; d) lost clients to the state-owned banks; and e) finally, and most importantly in their view, succumbed to centralisation as a result of the existence of the state-owned National Banking Corporation. This has heavily influenced the cost of the banking services, and the time needed to develop services and attract deposits. Each of these factors has increased the number of regional bank failures. Thus the number of banks decreased by more than 18[329].

However, while not everything worked perfectly, there have been some success stories for other banks to consider. One of these stories is that of the Benghazi Al-Haly Bank. To

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[328] Abedlmalek, Jamal. *Development of Libya Banks*, p. 48.
[329] Interviews.

overcome its early problems, the bank raised its capital and converted to a commercial private bank and renamed itself the Mediterranean Bank.

During the year 2006, the board of directors of the CBL issued several resolutions regarding these banks. These steps have changed the structure, number of banks and the capital of the National Banking Corporation. Resolutions No 1, 49 and 58 of 2006[330], determined the end of March 2007 as the deadline for 4 regional banks to increase their capital or merge with the corporation. 3 regional banks located in the west of the country took the chance and merged, or automatically merged with the NBC. 9 other regional banks still have to resolve their asset deficits and rid themselves of corrupt practices. Finally 3 other regional banks have yet to complete their intended merge with the corporation.

However, recently and in accordance with Resolution No 1, the capital of the National Banking Corporation has been determined by the Board of Directors of the CBL as LD 28,268,070,000 and 21 regional banks must merge and accept supervision and monitoring by the Corporation. Moreover, the corporation itself is to become a fully fledged commercial bank[331].

By the end of March 2007, the number of regional banks that the corporation will supervise will be approximately 36. This will be determined by banks merging with one another or by merging under the NBC's umbrella after the CBL has finalised the conditions required for these mergers. In both cases the CBL has guaranteed sufficient funds to repay loans and credits. However, there is no doubt that the question about the future of regional banks under the aegis of the state-owned National Banking of Corporation is becoming important.

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[330][On line]. Available from: http://www.cbl.gov.ly. [Accessed on 15March 2006].
[331] Ibid.

5.3 The Accounts of Libyan Commercial Banks

In contrast to Libya it is not surprising to hear that in many other countries, citizens do not need banks in order to deposit and safekeep their money quickly and easily. Organisations such as credit unions, mutual funds and brokerages offer cheque and savings services similar to those that the Libyan commercial banks offer. The banks provide these services for different type of clients. Their clients can range from individuals and start-up companies to major corporations.

Generally speaking, before clients open an account with a bank they compare bank performance and the range of services. They will have a list of basic facts to check before they make their choice. They make their decisions on a wide range of services features: level of fees, convenience, proximity of the bank or its nearest branch; length of waiting time to be served when they go; opening and closing times; size; size of the network; minimum size of deposit for an account; account limitations; and access to funds. Such matters are important for different banks have different rules and features[332].

Regarding Libyan commercial banks, in 1989 departments specialized in comptometer affairs and developments were established. It was to these departments that the development task was entrusted. This system was then generalized throughout the commercial bank branches. This procedure prompted a swift progression from a basically manual system of dealing with accounts to the present almost fully automatic computerised system[333]. On this basis other lateral systems were introduced, such as promissory notes, salaries and other systems necessary for avoiding default at that time[334]. In 1991, a new central system was adopted which can control all a bank's records and operations and these can be generalized over all the bank's branches and agencies[335].

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[332] Investor Guide. [On line]. Available from: http://www.investorguide.com. [Accessed on 31 May 2006].
[333] Interviews.
[334] Ibid.
[335] Ibid.

However, in terms of variety, Libyan commercial banks continue to offer a narrow variety of accounts and services. Accounts can be broadly divided into three main types: current accounts, savings accounts and fixed-period deposits or *Al-Wadiah*.

5.3.1 Current Accounts

A bank account can be defined as "an arrangement by which a person or company keeps money in a bank and takes it out when needed"[336]. So, in this context, a current account is "a bank account from which money or cheques can be drawn without notice"[337].

Opening current accounts in a Libyan bank can be made in Libyan Dinar or foreign currency. Current accounts at Libya commercial banks, either state-owned or private, are very similar to those at the international commercial banks. The commercial banks provide them for individuals, public sector companies, and for foreign companies in accordance with the Secretariat of the General People's Committee Decree Number 263 concerning administrative contracts[338] .

Compared with state-owned banks, the private commercial banks are providing all current bank accounts in a most advanced yet simple manner. The current accounts in Libyan commercial banks are characterized by the following: they do not attract interest, the banks provide clients with cheque books, withdrawals are made within the available balance and some banks provide banking card proof that the balance covers the amount withdrawn (private banks).

In the case of salaries, clients are immediately allowed to withdraw up to 50% of their salaries against their next salary. Clients are also granted social loans against guaranteed salaries[339]. The highest loan ceiling has been fixed at LD 10,000. This must be repaid by long-term

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[336] [On line]. Available from: http://www.allwords.com/word-current%20account.html. [Accessed on 2ed June 2006].
[337] Ibid.
[338] [On line]. Available from: http://www.bcdbank.com. [Accessed on 10th May 2006] .And interviews.
[339] Interviews.

convenient instalments. These instalments are equal to 1/3 of a person's salary. Real estate loans are also granted for a period of thirty years under the same conditions.

It needs to be noted that the rising degree of risk in the Libyan society from fraud and theft are caution banks to impose conditions on how they operate current accounts. In addition constant changes in legislation are seen as increasing the risk that funds or deposits may not be returnable. However, the banks are not entitled to seize private properties because the law does not allow it[340]. Consequently, the banks as well as the depositors and shareholders, could lose their money. This has led to the commercial banks holding back on the money that is supposed to have been invested. Nowadays this amounts to billions of Libyan dinars and it is severely and negatively affecting the investment opportunities in the country[341].

In 1986 the banks started their preparations for computerising their businesses. They signed contracts with specialized local companies for preparing a system for current accounts which at that time suffered from the repetitive of drudgery of using NCR machines[342].

5.3.2 Saving Accounts

Keeping money and funds at home causes many daily risks, either from impromptu expenditure or from theft. To safeguard themselves from the nightmare of forfeiture, people deposit their surplus funds in bank savings accounts. By saving, people transfer purchasing power from the present to the future. At the same time, this enables banks to use these funds for various investment projects. These encompass supplying credit to finance construction, manufacturing and services projects. Meanwhile, the funds are still owned by their owners.

In this context, the Libyan commercial banks provide two kinds of savings accounts, one with interest and one without. Because these interest rates are centrally determined by the CBL, they rates are similar across the country. Previously, the interest rate was the limit between

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[340] Interviews.
[341] Ibid.
[342] Ibid.

5% and 6% according to the amount on deposit: from LD 1to LD 20,000 interest was fixed at 6% per annum; from LD 20,000 to 100,000 the interest rate was 5% per annum; over LD 100,000 no interest was paid[343]. Recently, however, the CBL has fixed an interest rate of 3% for all amounts[344].

However, most Libyans still prefer to invest their saving in capital assets such as houses and mainly gold, rather than placing them in banks. These traditional preferences have been reinforced due to previous experiences with the banking system as mentioned earlier and due to higher returns to be obtained on building offices and houses for foreign investors[345].

On the other hand, the lack of suitable local investment opportunities, leads banks to maintain a high degree of liquidity and make little effort to attract local savings[346]. It is worth mentioning here that some private commercial banks encourage young investors such as children by opening special banking agencies[347].

5.3.3 Other Banking Services

In addition to the previous accounts, the Libyan commercial banks also offer other financial services such as letters of credit, especially for contracts after the submission of a visibility study and a check for a sound credit status. The Libyan commercial banks also open letters of credit for commercial transfers including credit splits, with partial cash cover equal to 20% though sometimes the rate may full to 10%.

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[343] Bank of Commerce and Development. [On line]. Available from: http://www.bankofcd.com/index.asp?page=17. [Accessed on 24th May 2006].
[344] Interviews.
[345] Ibid.
[346] Ibid.
[347] Ibid.

Furthermore, the banks transfer money. In the past linking in with some international financial institutions the Libyan commercial banks used to offer some other services, such as travel cheques and credit cards within the limit of LD 10,000[348].

5.4 Duties of the Libyan Commercial Banks

Each Libyan commercial bank, either private or state-owned, has duties towards its clients and the CBL. Every bank must submit its accounts to the CBL which must accord with the format and dead-line stipulated by the CBL. These banks must first, publish monthly statements on its financial position within 15 days of the end of each month; second, publish monthly statements which include details of all advances and financial credits that have been provided by the bank with or without guarantee to any second party; third, provide a copy of each report on the bank's activities to shareholders as well as a copy of each meeting held by the general assembly of its shareholders; fourth, publish a copy of its most recent audited financial statement within four months of the end of its fiscal year; fifth, issue a statement of any change in the members of the bank's board of directors within two weeks of the date on which the change occurs; sixth, the banks should also provide other statements of clarification on transactions executed by the bank; finally, before merging with another bank, or opening a new branch, obtain the approval of the board of directors of the CLB[349].

With regard to its shareholders each bank must display throughout the year and in a conspicuous place at its head office and all of its branches a copy of its most recent, audited financial statement. And it must also publish these statements in the register of actions in a domestic newspaper[350]; second, before distributing profits, each bank has to maintain a capital reserve. The bank must transfer to this reserve capital account no less than 25% of its net profits, until the reserve capital accounts total one-half of its paid capital. It must then transfer

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[348]Interviews.
[349] Banking Law No. (1) of 1373P.D (2005).
[350] A visit to any bank head quarter, branches, or agencies will rarely find supply of these statements.

10% of net profits until the reserve account is equal to paid capital; third, no bank can distribute dividends until after it has subtracted all expenses, including establishment and administration expenses[351].

5.5 Summary

Libya is a virgin environment for all types of business, particularly in the banking sector. It just needs people who can develop and manage its natural resources and people with knowledge and technology skills rather than capital. The monetary authority in Libya is the Central Bank of Libya which is state-owned while at the same time enjoying the status of an autonomous corporate body. It is the bank which also supervises and regulates the banking sector in Libya.

The reorganisation of the commercial banks in 1972 left the Jamahiriya and Umma Banks owned by the CBL. Two other banks, the Sahara Bank and the Wahada Bank are jointly owned by the CBL and the private sector.

Libya is moving towards a variety of economic reforms and a reduction in state control. The country is approaching the fourth year of its five-year privatization plan. The five commercial state-owned banks are listed for transfer to the private sector. However, Libyan commercial banks nowadays are in the process of applying for approval by the Basel Committees I and not II. Moreover, the Libyan parliament has passed a law to allow foreign banking institutions to buy shares in local banks and open branches. Until Law No. 1 of 1993 and its amendments were issued which dealt with banks, Libya did not have real private banking sector. The Bank of Commerce and Development was established in accordance with this Law. It was the first bank wholly-owned by the private sector. It was closely followed by two private banks.

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[351] Banking Law No. (1) of 1373P.D (2005).

Happily the private banks are working hard to bring modern banking services to Libyan corporate and retail customers.

The commercial banks of Libya, in general, are now offering both retail and wholesale banking services and dealing with consumers and business of all sizes and ages. Nevertheless, Libya's commercial banking sector remains underdeveloped. The society is still a cash society and ATM machines have still to become a common sight on the city streets, and other modern banking facilities, which are taken for granted in western countries, are streets ahead of those available in Libya.

Chapter Six

Banking System Reform in Libya: Issues and Consequences

6.1 Introduction

There is no doubt that in developing and developed nations the banking sector plays a vital role in their economic and financial activities. This sector carries out the functions of allocating financial resources, and providing the public with means to save for the future and to borrow to meet current financial needs.

In the developing countries, banks dominate the financial sector, and are considered as the main source for finance in the economy. During the early stage of development, many developing countries' financial systems were characterized by financial repression. This situation led to these countries facing unfavourable economic conditions such as rising unemployment and increased social demands associated with sluggish economic growth.

In facing these difficulties many emerging nations have undertaken several steps to reform their financial systems. The main components of these reforms have been aimed at ending government intervention, and expanding the role of the private sector through deregulation, opening the economies to greater foreign participation in banking sector and financial markets, adopting transparent commercial procedures and harmonizing tax provision.

Many commentators have argued that deregulation and liberalization of the financial sector in general and banking sector in particular may lead to more efficient allocation of resumes and higher economic growth.

Over the last four decades North African countries have also adopted and made significant progress in implementing the foundations of economic reform. In this context it is worth mentioning that North Africa, as a region, comprises a modern day entity of Sub-Saharan countries and Afro-Mediterranean countries. It is a region with essentially Muslim populations and strong political ties to the Middle East.

Economically these countries can be classified into oil and non-oil exporting countries. Four of these countries constitute the Arab Maghreb Union: Morocco, Tunisia, Algeria and Libya. Egypt, on the other hand, is a member in the Council of Arab Mashreq Countries. The aim of these unions is to strengthen economic and cultural ties, ensure regional stability and promote trade between themselves.

The main aim of this chapter is to provide a summary of banking reform in Libya. Therefore, the first section deals with the reform of the financial systems throughout Africa; the second section will relate to the Libyan commercial banking sector. This section will deal with such aspects as staffing, recruitment, training, commercial banks and corporate social responsibility (CSR), the actual work environment, the potential for cheap loans, *Zakah*, bank marketing, the potential for financial markets, the impact of economic sanctions, and privatisation of the Libyan commercial banks. The chapter concludes with a summary. It needs to be mentioned here that due to the lack of published information regarding the activities of the commercial banks in Libya, the researcher, instead, used primary sources, interviews, as source material for this section.

6.2 The Reform of Financial Systems in Africa

According to the Oxford dictionary the noun 'reform' means "change that is made to a social system, an organization, etc. in order to improve or correct it"[352]. On the other hand, economic reform can be viewed as "the process by which a failing economy is changed to bring about economic prosperity"[353]. Accordingly the term can be applied to communist and socialist forms of government[354].

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[352] Oxford Advanced Learner's Dictionary, p. 1067

[353] *Economic Reform*. Free Encyclopaedia. [On line]. Available from: http://en.wikipedia.org/wiki/Economic_Reform. [Accessed on 19th November 2006].

[354] Ibid.

The process of transition is mainly characterised by changes to existing, or the creation of new, institutions. The creation of new private institutions in particular can lead to fundamental changes in the role of the state and the structure of its institutions. This can mean movement from public to private ownership of resources by using restructuring and privatization to create a financial sector[355]. As a consequence, the economy can be liberalized and market force will set prices, lower trade barriers and induce macroeconomic stabilization[356].

However, many of the current banking laws and regulations in Africa are driven by financial crises. Generally speaking, these developing countries seek to increase the depth and stability of their financial systems and bypass the relatively slower or stalled institutional development processes of their existing financial sectors.

According to Bridge and Harvey, at the time of independence, foreign-owned banks dominated Africa's banking sectors. In many African countries, they were the only commercial banks and the national banks had played a very minor role in the market[357]. At this time the new governments believed that these foreign banks monopolised the banking sector and discriminated against African business and African farmers. In other words, and this is a view shared by the new governments, these expatriate banks were unwilling to make the long-term loans necessary for domestic development[358]. This failure was essentially the cause of the first approaches to financial reform by African governments during the 1960s and 1970s.

As a result of the first wave of reform, new foreign bank entry into the sector was very limited, and in the decade following independence government-owned commercial banks

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[355] *Economic Reform*. Free Encyclopaedia. [On line]. Available from: http://en.wikipedia.org/wiki/Economic_Reform. [Accessed on 19th November 2006].
[356] Ibid.
[357] Brownbridge, Martin, and Harvey, Charles. *Banking in Africa*. Asmara: African World Press, Inc. 1998, p. 3.
[358] Ibid, p. 20.

were established in most African countries. Some of these banks were set up by governments, while others were created as a result of the nationalization of the existing foreign banks[359]. These new banks were expected to fulfil developmental and social objectives and make a commercial return on capital at the same time. In several African countries, the state-owned banks gained a significant share of the financial markets but with variable financial performance. However, the lack of guidance on how these banks could achieve their objectives led to poor quality banking services. Moreover, the rapid extension of the state-owned banks' branch networks into the rural areas took place regardless of profitability. Extensive government intervention, however, has caused serious problems to the banking systems and made the microeconomic environment for investment highly unstable[360].

During the 1980s and 1990s, a large number of African countries undertook substantial financial reform to enhance the role of their financial institutions and to improve the investment climate. In contrast to the objectives of the first financial reform wave, financial sector reforms of this era aimed to: reduce government intervention in financial markets; strengthen the performance of financial markets; improve the investment climate to enhance the role of the private sector; and attract foreign investment[361].

Achieving these objectives was not simple because of two particular factors: first, the banking sector in many African countries had been deeply damaged by the first set of reforms; second, the surviving expatriate banks were unwilling to manage large branches which reduced their market share and geographical coverage[362]. However, Brownbridge and Harvey have mentioned that not every country that introduced financial sector reforms faced these difficulties. Some banking sectors remained sound[363].

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[359]Brownbridge, Martin, and Harvey, Charles. *Banking in Africa*, pp. 201-202.
[360] Ibid.
[361] Ibid, p. 6.
[362] Ibid, p. 7.
[363] Brownbridge, Martin, and Harvey, Charles. *Banking in Africa*, p. 9.

6.3 Reform of the Libyan Commercial Banking Sector

Libyan commercial banks, either state-owned or private, now regard banking as their normal full-time professional business activity. Consequently, they accept different types of deposits from the general public and private sector make different types of loans and offer other banking services to their clients. However, Libya is in process of restructuring its banking sector under the influences of the direction of the Basil Committees, as well as upgrading and diversifying its banking services by using information technology and electronic mechanisation.

This reform process is geared towards strengthening the banking sector and attracting foreign investors. It seems that the Libyan banking system has gained momentum since the lifting of UN and US sanctions in 2004. Nevertheless, the rehabilitation of Libyan is considered to be dragging and constrained by a series of reversals. This issue has now moved to the forefront of Libyan banking awareness. The subsequent contexts deal with the obstacles hindering the state from achieving its objectives and being admitted as a new member of the global bankers club.

6.3.1 Staffing

Human resources are essential to planning, managing, developing and delivering banking services. In some developing countries, poor and rich, the banking system in general is suffering from a shortage of skilled men to deliver services and manage the banking sector.

In terms of staffing bankers agree upon the importance of the human factor in the development and progress of banks in general. Some bankers have pointed out that the Libyan banking system used to be staffed with bankers who had skills matching those of with their counterparts in the rest of the world. These bankers safely led the Libyan banking system during the two periods of nationalization and Libyanization.

6.3.1.1 Recruitment

In contrast to the Libyan commercial banking sector, the management of commercial banks world-wide has become increasingly challenging. This is because of two factors: first, the financial markets that used to finance them have changed dramatically in the last decades. As a result, many former concepts and techniques are now seen as outdated[364]: second, commercial banks compete with other banks and non-banking organisations that used to fulfil the role of financial intermediaries. Human resources are one of the most important factors that can keep banks competing effectively and successfully. Therefore, these commercial banks are now seeking and attracting qualified and experienced people. There are now many internal and external sources for suitably qualified personnel. Furthermore, advertising and employment agencies are now being more widely used as external sources of recruiting skilled people. On the other hand, job-posting and bidding are used as internal ways of recruiting skilled people[365].

In the Libyan banking sector there used to be special conditions and criteria according to which staff were appointment in an attempt to guarantee staff integrity and respect for clients. These staff were distinguished by strict management which made the standard service offered in the Libyan commercial banks comparable with those encountered in the international commercial banks. These bankers were respected for their attention to duty and efficiency throughout their external transactions. These people enabled the Libyan commercial banks to gain a good reputation in the world[366].

Recently, in most of the Libyan commercial banks, including the commercial private banks, employees are recruited by one of the following ways: first, qualification and experience; second, previous experience and knowledge, rather than paper qualifications, are now

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[364] Maxwell, Charles. *Financial Markets and Institutions: the Global View*. Minneapolis: West Publishing Company. 1992, p. 3.
[365] Byars, Lloyd. *Human Resource Management*. Boston: Home Wood. 1991, pp. 138-139.
[366] Interviews.

considered more important in appointing people in newly established banks. It is worth mentioning that Banking Law No.5 has limited the use of academic qualifications as a condition for appointing a person in the banking sector; third, due to friendship and social relationship a person may be appointed to a job regardless of his qualification, experience and knowledge. This used to be considered the most usual way to recruit in the banking sector. Fourth, recommendation by someone in a high position or shared political ideology can a person get appointed be appointed. The last can be considered the most common, successful, easy way to recruit people in the banking sector. Moreover, it seems that recruitment in the Libyan commercial banking sector is functioning more because of emotion than logical thought processes. This tends to make the relationship between the banks and their employees more personal and not automatically controlled by regulations. Consequently, the banking sector in general, and the state-owned banks in particular, suffer considerably from over-employment in which most employees are in the state of hidden unemployment. For instance, a bank which would normally be run by 800 employees is actually run by 2200 employees. This constitutes a burden upon these banks and their departments. This is a situation that deters potential foreign investors from entering the market[367].

6.3.1.2 Training

Training is the act or process of being prepared to be taught or to learn particular skills and practise them until the required standard is reached. More precisely, in terms of human resource management, training means "a learning process which involves the acquisition of skills, concepts, rules, or attitudes to increase the performance of employees"[368]. Training employees can be a tremendous drain on an organisation's time and financial resources. On the other hand, training is linked strongly to the growth of an organisation and employee

[367] Interviews.
[368] Byars, Lloyd. *Human Resource Management*, p. 206.

productivity. Moreover, training can have a significant impact in reducing turnover and the need for employee supervision. It can improve job satisfaction and promote commitment to the organisation's future[369]. There are two different types of training. There is the initial training, when employees first join the organisation or start a new role. This helps them to handle their new position and feel valued, challenged and rewarded. Second, on-going training that can be more formal, but does not have to be.

Since training is seen as an expense rather than an investment, it can be considered to some extent optional in the Libyan commercial banking sector. As a result, many training courses for employees in Arab countries during the last twenty-five years were conducted for very short periods of time. This has weakened the language skills of employees, especially in English. It constitutes an obstacle in the way of keeping abreast with the most-up-to date developments in the industry. Moreover, the existence of unskilled employees has forced skilled banks managers to spend their time dealing with trifling matters such as having to handle of English letters. This distracts them from other more important duties as managers. Consequently, many of the Libyan bank experts migrated abroad and work in foreign banks especially in the Arab Gulf countries. This has a positive affect on those foreign banks and deprives the Libyan banks of staff with the necessary banking experience and knowledge of banking customs[370].

Under-estimating the crucial role that training can play in improving productivity and banking services has deprived the commercial banks of first-line employees such as cashiers and the like who are efficient and skilful in dealing with clients and who take good care of their appearance and behaviour as bank employees. Most important, however, is the non-existence of a second row of managers in the Libyan commercial banks who are ready to assume the

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[369] Byars, Lloyd. *Human Resource Management*, p. 206.
[370] Interview.

task of leading these banks during critical times[371]. In addition, many of the bankers in the state-owned banks have expressed great concern about the migration of their banking experts to private banks as well as foreign banks as soon as they enter the investment field in the Libyan economy. This may well contribute significantly in exacerbating employment problems in the Libyan commercial banks whether private or state-owned and their ability to compete with foreign banks[372].

In order to overcome these problems the bankers have suggested carrying out the following: first, training courses for staff should be upgraded in the country or abroad to improve their efficiency. Second, staff should be sent abroad to learn foreign languages especially English. Third, reconsider techniques and criteria during recruitment processes at the Libyan commercial banks; finally, in recent systems, applicable to salaries and the physical work environment, especially in the state-owned commercial banks, need to be reviewed[373].

6.3.2 Banks' Social Responsibility (CSR)

World-wide organisations are aware of the growing demand to develop Corporate Social Responsibility policies (CSR). However, CSR is a term that is used to describe a commitment of how organisations run their business and how it affects their staffs, customers, communities and the sources of their products. Consumers and non-government organisations are considered the main pressure source for determining how companies manage their relations with the above[374].

Recently, the concept of corporate social responsibility has gone beyond the old philanthropy of the past donating money to good causes at the end of the financial year. CSR can be seen today as the business contribution to sustainable development. In other words, corporate

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[371] Interviews.
[372] Ibid.
[373] Ibid.
[374] *Corporate Social Responsibility*. [On line]. Available from: http:www.csr.gov.uk. [Accessed on 20th November 2006].

social responsibility means that companies should contribute to the welfare of the society and not be devoted to maximizing profits. There are a number of ways which can be used by organisations to benefit their societies. They can give money to the arts, fund academic scholarships, support community building initiatives, provide financial help for needy people and improve the quality of life of their workforce and families as well as that of the society at large. This requires organisations to balance their needs to make a profit, reward their shareholders and fulfil their social reasonability. This will directly enhance the reputation of their organisations. The benefits of CSR to business vary depending on the nature of enterprise. This makes social responsibility very difficult to quantify and governments have a responsibility to ensure minimum legal standards.

With regard to the Libyan commercial banks and the CSR, according to the bankers, it can be said that neither the private commercial, nor the state-owned banks bear any social responsibility towards society. They mention also that there are no regulations at the present time to organize this. However, this does not prevent private commercial banks from paying attention to this aspect and taking initiatives. The bankers see these initiatives as insignificant in comparison to the profits which they generate. More than that, they add that the Libyan commercial banks contribute to national initiatives as directed by the CBL.

It needs to be mentioned here that some bankers consider the Libyan commercial banks as profitable organisations which carry no social responsibility. On the other hand, others have been surprised by the concept of Corporate Social Responsibility[375].

[375] Interview.

6.3.3 Physical Work Environment

The workplace plays an important role in increasing the level and quality of work. According to Turnwall, as an important strategic asset, the workplace can bring process, people and technology together to form a common band[376].

In contrast to the private commercial banks, which have modern buildings and enjoy a comfortable work environment suited to their employees' needs, most of the state owned-banks lack a positive working environment. This does not mean that buildings let in the wind or the rain, but they are poorly planned and lack proper maintenance to ensure they are structurally sound, free from hazards and fit for purpose.

It is clear from the interviews and personal experience that a negative environment is one of the factors that have a negative impact not only on the individual employees but on the organisation's productivity and customer satisfaction[377].

6.3.4 The Potential for Cheap Loan

The purpose of economic development throughout the world is improving living standards. This means improving opportunities for the world's population to share in improved living conditions by social and economic development.

Many governments are devising incentive measures to encourage commercial banks to contribute in achieving these targets. As a result, advisory committees have been formed by commercial banks to establish companies which can guarantee, for example, small business loans. Financial support for small businesses will have positive implications for job creation, poverty alleviation and economic growth[378].

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[376] Turnwall, Diane. How The Physical Environment Make Knowledge Design. *The Shoreline Business*. July 2000. [On line]. Available from: http://www.steelcase.com/na/knowledgedesign.aspx?f=10257&=10935. [Accessed on 18th November 2006].

[377] Interview.

[378] Stokes, D,R . *Small Business Management: An Active- Learning Approach*. Great Britain: DP Publication. 1992, pp. 3,4,11.

Furthermore, over the past decades, commercial banks world-wide have issued loans for needy people such as students to help in reducing the number of them dropping out of school due to shortage of money. The commercial banks provide these loans in line with car and house mortgages. On the other hand, many governments have established special funds to compensate commercial banks for bad loans lent to needy people such as students.

According to the bankers neither the state-owned nor the Libyan private commercial banks offer any interest-free facilities despite the demand such services. Furthermore, the Libyan commercial banks do not offer interest-free loans to help set up small projects nor do these private or state-owned enterprises offer interest-free loans to needy people such as students and those with special needs. However, the IMF report of 2006 stressed that encouraging private sector development and, in particular, strengthening small and medium enterprises, is the key to promoting economic diversifications in Libya[379].

6.3.5 *Zakah*

Zakah is one of the five pillars on which Islam is built. It ranks in importance next to prayer. The payment of *zakah* is considered to a large extent the backbone of the financial structure of the Islamic state and one of the keys elements in Islamic economics.

In Islam, the accumulation of property in one or a few hands is not permitted or recommended. However, Islam's prohibition on wealth hoarding is to prevent its accumulation in a few hands. *Zakah* is a compulsory levy and payable by every Muslim whose wealth exceeds the *nisab*[380]. *Zakah* purifies Muslim wealth, which motivates the circulation and distribution of wealth from the affluent Muslims to the needy.

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[379] International Monetary Fund, Report No. 06/136 for 2006. [On line]. Available from: http://www.inf.org/external/ns/search.asp?filter_val=N&NewQuery=report+No.06%2F136%2For+2006&col=SIIEN. [Accessed on 12th October 2006].

[380] Shumo, Eltayeb. *The Theory of Zakah and Its Application in the Sudan (1980-88)*. Ph.D. Thesis. University of Durham, 1990, pp. 146-154.

However, the bankers claim that due to the non-existence of regulations to organize the collection of *Zakah* and because another authority, namely the General Endowments and *Zakah* Affairs Board, carries out this task, irrespective of whether the banks are private or state-owned, it is not for them to carry out the task of colleting *Zakah* from their clients.

6.3.6 Banking Marketing

For many decades, the banking sector had been considered as a service industry and one in which the marketing concept had not been adopted. This is because the banking industry was not customer-oriented. In today's competitive environment, banks now see marketing as a crucial function for them, due to the very nature of the industry. However, according to Owusu, marketing for banks cannot be treated in the same way as, for instance, if they were manufacturing companies. As a result of the double-sided nature of the banking sector, while on the one hand it must attract borrowers and investors, it has to faces marketing problems which are more complex than those which normally face other sectors[381].

However, Owusu points out that the concept of marketing has come to the banking industry about a decade later than to the other industries. Generally speaking, bank marketing so far includes advertising, business development, public relations, market research, product development and service quality. However, bank marketing is also responsible for developing current banking services and products and identifying new ones.

With regard to the Libyan commercial banking sector, departments for the marketing of services exist neither in the private nor state-owned banks. Even if they did exist, they would be part of other departments such as public relations. Some bankers believe that the main reasons for the non-existence of banks marketing departments are two-folds: first, the non-

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[381] Owusu, Nana. *The Adoption of the Marketing Concept by the United Kingdom and Ghanaian Banks.* Ph.D thesis. University of Durham. 1994, p. 8.

existence of a free market; second, the ownership by the state of five commercial banks constitutes a main obstacle in creating a marketing environment[382].

However, some of the bankers claim they have made personal efforts to market their products. They are now sending personal letters to some customers indicating the availability of banking services and facilities. Moreover, they added they now meet clients at special occasions or public events and invited them to visit their banks or branches where they offer these people the opportunity to avail themselves of their services. This can be considered to a large extent as a good indicator showing the growing awareness of the importance of the marketing function even though Libyan banking law makes no reference to the regulatory process of this function.

6.3.7 The Potential of the Financial Market

In the broadest economic view, a market in general can be defined as "a meeting place, a geographical location or an area in which buyers who wish to exchange money for well-defined goods or services, and sellers who have a similar desire to exchange well-defined goods or services for money, can negotiate the exchange"[383]. Most markets operate on a continuous basis during opening hours, implying that trading can take place at any time that the markets are open[384].

A financial market is "a place where, or a system through which, securities are created and transferred"[385]. According to Derek, a financial market is the third component of a financial system[386]. The difference between a financial market and other markets is that no tangible goods or services are exchanged for monetary consideration. However, a piece of paper which

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[382] Owusu, Nana. F. *The Adoption of the Marketing Concept by the United Kingdom and Ghanaian Banks*, pp. 8-9.
[383] Derek, Honeygold. *International Financial Markets*. Cambridge: Woodhead-Faulkner Limited. 1989, p. 1.
[384] Ibid, p.16.
[385] Ibid.
[386] Derek, Honeygold. *International Financial Markets*, p. 17.

is considered as a financial claim will be exchanged between people. This paper can take several forms one of which could be a financial promissory note[387].

Generally speaking, a financial market does not have to have a physical location. Thus shares, bonds and money-market instruments can be traded in what is called an "over-the-counter" manner by using a system of computer screens and telephones. Only financial futures and financial options are still traded in a physical market[388]. However, Maxwell maintains that the main function of the financial markets is to allow savings to be transferred to investment by providing intermediation services in safe and efficient ways. He also states that the financial markets generally reflect the desire and the limitation of the market for its participants and the needs of the country in which it is based. Maxwell goes on to say that people participate in financial markets for a variety of reasons. The basic one is to exchange something they possess for something they need[389].

Financial market participants can be grouped into five basic identifiable groups: individuals, non-financial corporations, financial corporations (depository), financial corporations (non depository) and governments.

Financial markets come in a wide variety of forms. The primary markets are the new issues market and the arena where companies issue and float bonds to gear up. The initial prices of the securities are set rather than determined by the market, unless the security is issued through a tender offer or by auction.

In contrast to the primary market, the secondary market is the arena where traders and investors exchange one form of already-issued security for another. In some cases dealers may exchange cash for security, securities for securities or securities for cash. However, through dealers' purchases and sales, market prices are self adjusting.

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[387] Derek, Honeygold. *International Financial Markets*, p. 4.
[388] Ibid, p. 16.
[389] Maxwell, Charles. *Financial Markets and Institutions: the Global View*, p. 35.

The short-term (money) market and the long-term (capital) market can also be classified financial markets. The short-term market is the arena in which securities with a maturity of one year or less are traded. This market is also known as the money market. On the other hand, the long-term market is the arena in which securities with longer maturities are traded. Traditionally, the long-term market is known as the capital market[390].

On 2 June 2004, the governor of the CBL announced to the Emirate newspaper "*ALBAYAN*" that in two weeks' time a banking section or unit would be opened as a first stage towards a proper financial market. The unit would be the first outlet for the sale of company shares to Libyan nationals. The governor added that experts and specialists in the economic and financial fields would be involved.

As a result legislation was drafted to provide for the creation of a financial market and presented to the Peoples General Committee for approval. On 13 December 2005, a seminar on the role of financial markets in the economic development of Libya was held under the theme "Experience, Future Vision". The seminar was organised by the Secretariat of the General People's Committee for Economy and Trade in cooperation with the Great Jamahiriya Broadcasting Institution. The seminar discussed two main topics: the difficulties which face the establishment of a financial market in Libya and banking initiative trials in Arab countries; and the role of a financial market in privatisation and economic development in Libya. Various academic papers from within Libya and the other participating countries were reviewed.

As the evidence indicates, development of a formal financial market in Libya is still on paper. In fact the existing financial market in Libya is an informal market in which people buy and sell securities direct from the issuing organisations or from each other. The absence of formality clearly makes the exchange process more difficult to implement, although it is not

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[390] Maxwell, Charles. *Financial Markets and Institutions: the Global View*, pp. 35-36.

necessary for there to be a formal market for an exchange to take place. It can be said that the financial market in Libya is similar to an over-the-counter market without computer screens. However, some bankers pointed out that the current commercial banks are able to set up a financial market. They believe that with better communications and fewer regulations, the greater the financial market is likely to be[391].

In contrast, others believe that the present banks in Libya are not able to set up a proper functioning financial market. Moreover, they claim that the banks suffer from a scarcity of staff who understand the factors and forces operating in the financial market and who can keep their attention focused on the foreign currency market. This is because changes in this particular market can have a significant influence on the market's profitability. They also believe that should banks have to operate in the global market place, they will need staff who can speak other languages and understand other economic systems and political ideas as every day in the global market brings an entirely new experience for participants.

Other bankers added that the subjection of most of the Libyan population to the Salary Regulating Law No. 15 of 1981 put Libyan people on the same level from economic point of view. Consequently, most Libyans enjoy almost equal incomes which weakens their ability as small investors to buy shares. Beside, Libyan society is by nature a society given to consumption. Libyans have little awareness of saving and its importance. This has not only negatively affected their purchasing power and propensity to save, but delayed the marketing function of Libyan banks and their potential for establishing a secondary financial market[392].

6.3.8 The Impact of Economic Sanctions

Sanctions are ways of threatening penalties for disobeying a law or rule and they are usually taken by a state, or international organisations such as the UN to coerce another state, or

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[391] Interview.
[392] Ibid.

organisation to conform to an international agreement or norms of conduct. According to Hufbauer and Schott, sanctions generally can take in five forms: diplomacy; political; economic; covert action and military action. Of these kinds of sanctions, economic sanctions have played an important role in economic policy throughout the twentieth century[393].

Since the early 1980s, Libya has been subject to US sanctions over its suspected terror links. According to one report on the impact of the UN sanctions against Libya which was transmitted to the UN secretary in September 1996, substantial damage had been caused to Libyan health, social welfare and infrastructure. The report stated that all the development programmes and plans for these vital sectors had been adversely affected[394]. For example, in April 2003 a foreign ministry document stated that Libya's industry had lost more than $ 55 billion since 1992 as a result of the UN imposed embargos[395].In 2003 the UN moved to remove sanctions which it had imposed in 1992. In addition, in April 2004, the US lifted most of its own sanctions and resumed diplomatic relations.

However, there is still a debate about the impact of the UN sanctions on the banking sector in general and the commercial banks in particular. Some bankers stated that the Libyan banks, in addition to the sanctions imposed by the UN, have suffered economic depression ever since the 1980s and 1990s the last century.

One basic sanction which had a severe impact was the fall in the rate of the number of banking transactions especially with the US and its allies which had helped in implementing these sanctions. Germany and some other Arab countries are good examples. In addition was the inability of the Libyan banks to purchase the necessary technology to enable them to modernise their business.

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[393] Hufbauer, Gary, and Schott, Jeffery. *Economic Sanctions and U.S. Foreign Policy. JSTOR.* Autumn 1985, 18(4), pp. 727-735.

[394]No Author. *Impact of the UN Sanctions Against Libya.* [On line]. Available from: http://www.geocities.com/atheus/8744/impact.htm. [Accessed on 15th November 2006].

[395] [On line]. Information available from: http://www.hartford-hmp.com/archives/27c/367.html. [Accessed on 20th November 2006].

Other bankers pointed out that the period of stagnation which had occurred in the Libyan banking sector cannot be completely attributed to the economic sanctions imposed on Libya especially by the US considering that some commercial banks had been able to transfer their balances from the American banks to other banks in Japan and some other Arab countries. Likewise, the accounts at that time in general were not large and so these bankers believe that the banking sector was one of those sectors that was affected less by the sanctions. They also believe that it was the existence of mediatory countries profited by taking over Libyan business transactions which was the only negative impact[396].

6.3.9 Privatisation of the Libyan Commercial Banks

Governments worldwide have recognised the importance of the private sector in improving their national economies. Thus, they set up joint companies between themselves and their private sector. In addition they have allowed state assets to be sold to the private sector as well as providing more loans for those projects they deemed sound.

It is possible to say that privatisation is currently being implemented around the world, basically to alleviate their common propensity which governments have for economic mismanagement. According to La Porto and others[397], government ownership of banks is common around the world. On average, 42% of equity of the 10 largest banks in a country were still owned by governments in 1995. La Porto goes on to say that government ownership of banks is a common phenomenon in poor countries, as well as in those with poorly defined property rights, heavy government intervention in the economy, and an underdeveloped financial system[398]. So, in this context, it can be said that privatisation is a strategy designed to reduce the role of the state as decision-maker over allocation of resource and as an investor

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[396] Interview.

[397] La Porto, Rafael, L.S, Florencio, and S, Anderi. *Government Ownership of Banks.* National Bureau of Economic Research 1050M, nber working paper series. Available from: http://www.nber.org/papers/w7620. National Bureau of Economic Research 1050M, NBER working paper series, p. 6.

[398] Ibid, p. 6.

and producer of goods and services. On the other hand, it is a strategy that enhances the role of the state as the regulatory agent, in which the state intervenes in the activities of other partially state-owned entities whether they be in the private sector, the mixed sector, or in cooperative foreign-owned ventures.

According to the "Green Book" view of organisational ownership, employees took over the entities they were working in, proclaimed themselves as partners and owners of those organisations, and assumed responsibility for their management. The socialism adopted in Libya considered this as privatisation, and to the benefit of those already working in these companies and sectors[399]. Many thought that socialism and privatisation were not contradictory of one another[400]. Consequently, government control was extended to cover all aspects of economic life, including the banking sector. Thus the private sector ceased to exist except in the agricultural sector. As a result, enormous amounts of capital flew out to the nationalization process in the 1970s, and did not contribute to the economy in any shape or form[401]. This situation put huge pressure on the state as the only provider and guardian of society's needs. Unfortunately, in general, the public sector was not sensitive enough to the increasing cost[402]. Therefore, the various economic sectors did not meet their targets, such as self-sufficiency in food industry[403].

It seems that the interaction between this situation and other international, regional and national factors, forced the state to change its attitude towards privatisation and to accept privatisation as "the process of selling a publicly owned company or asset to the private sector"[404].

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[399] Interview with Dr .Taher Jehami, Secretary of the General Planning Council. [Online]. Available from: http://www.winne.com/mena/Libya/report/2004/vi000.php. [Accessed on 12th May 2006].

[400] Interview with Mr. Abdurrahman Shater, Union of the Chambers of Commerce, Industry and Agriculture. Available from: http://www.winne.com/mena/Libya/report/2004/vi000.php. [Accessed on 19th May 2006].

[401] Interview with Mr. Husni Bey, Chairman H B group, Monday 16th January 2006. [On line]. Available from: http://www.unitedworld-usa.com/reports/Libya/interview22.asp. [Accessed on 10th May 2006].

[402] Interview with Dr. Taher Jehami.

[403] Interview with Mr. Husni Bey. Chairman H B group.

[404] *Dictionary of Finance and Banking*. 3ed ed. Oxford: Oxford University Press. 2005, p. 324.

The privatisation which the country has adopted means that all projects are now better run by the private sector or independent management[405]. Consequently, on 2 September 1992, the government issued Law No 9 which provided for both the privatisation of state assets and a greater role for the private sector in the economy. This was followed by Law No 5 of 1997 regarding the encouragement of foreign capital investment. The Libyan Think Tank believes that the latest law is one of the best foreign investment laws in the world, because it was composed from some of the best experiences that other countries have had with their own laws[406]. The law's objectives can be summarised as: attraction of foreign investors; transfer of foreign technology; training of the Libyan workforce; and the creation of job opportunities. On the other hand, the law also stipulates the need for foreign investors to use local raw materials whenever possible to produce commodities required in the economy[407].

On November 2003, Alqadhafi (the leader of the First of September Revolution) called for the privatization of all the country's economic sectors, including banking, and acknowledged that the public sector had failed, the endorsed a transition to what he referred to as a form of "popular capitalism". This was a clear indictor that Libyan government was serious in its attempt to liberalize and privatize the economy's sectors and on its way to returning to the global economy after the UN ended the sanctions in 1999.

The privatisations objectives announced in Libya in 2003 are improving the national economic performance and the living standards of individuals by expanding the scope for property ownership. Moreover, it seems that another aim the government had was to get rid of non-profitable companies and services. It is obvious that the Libyan government in this situation needed to reform and strengthen the banking system so that it could support economic change and private investment initiatives.

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[405] Interview with Dr .Taher Jehami.

[406] Interview with Mr Rajab Shiglabu, General Director of the Libyan foreign Investment Board. Available from : http://www.untitedworld-usa.com/reports/Libya/interview29.asp. [Accessed on 15th May 2006].

[407] Law No.5 For the year 1997 Concerning Encouragement of Foreign Capital Investment.

On the sidelines of a World Economic Forum regional meeting in Jordon (May 2005), the politically influential son (Saif Aleslam) of Libya's leader, Muammar Gaddafi, said that through the privatisation process, Libya would privatise five commercial banks over the next six months and let foreign banks hold up to 50% and have a say in the management. He also mentioned that foreign banks would be allowed to set up retail operations in the country. Moreover, two of the country's big five commercial stated-owned banks were being prepared for privatisation and CBL would sell the shares of these banks once a stock market had been founded.

The targets which the Libyan government are seeking are far from easy to achieve in a country lacking a skilled workforce, economic feasibility, suffering from serious management problems and without a stock market. Moreover, the privatisation procedures are not realistic and it seems that there is no actual encouragement for privatisation[408]. In addition, some of these banks still have a large portfolio of old problems, which make them unprepared for privatisation[409]. Much information about bad loan ratio details has not been disclosed in subsequent published accounts. Summarised, some of the banks' accounts may look healthy, but they are likely to be greatly under-provisioned[410].

However, Layas states that Libya is not looking for capital as happens in other countries when they undertake a privatisation process. He says that Libya mainly wants foreign investors who can provide technology and good management. He sees these as the main role for partners who seek to invest in Libya[411].

However, globalization and technological developments enable the external world to examine the true status of the Libyan economy and its banking system. Consequently, some potential foreign investors have voiced frustration at the slow pace of economic reform. Others believe

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[408] Interviews.
[409] Ibid.
[410] Ibid.
[411] Interviews with Mr. Mohammed Layas, Chairman and General Manager of Libyan Arab Foreign Bank. [On line]. Available from: http://www.winne.com/mena.Libya/report/2004/vi0.php . [Accessed on 8th May 2006].

that the country needs to address the hurdles to business which stem from a time-consuming bureaucracy and the lack of independent arbitration mechanisms to resolve contract disputes[412]. It is worth mentioning in this context that the foreign investors will not come until they are sure that the private sector is actually involved as well[413]. Due to the regulations in the country the involvement of the private sector in reality is only 30%[414].

Nowadays, some business people in Libya who align with the philosophy of the private sector, say that a foreigner has more privileges in setting up a business in Libya than a local who decides to do the same. Thus, many Libyans are asking for improved investment guarantees to encourage both them and foreign inventors. They also believe that although the country is gradually opening up to the rest of the world and business opportunities do exist in the private sector, there are still a number of obstacles that investors must face. One of these obstacles is corruption. This, along with the considerable resistance towards economic change within the legal framework, needs to be addressed.

In promoting the privatisation program, many entities have been established. The National Investment Company (NIC) is one of these. It was established in 1986 as part of the privatisation process. The company is owned by the people of Libya who are obliged to contribute 1.5% of their monthly salary. Thus, they are them all shareholders. The company has two objectives: the first is to make a success of the privatisation program; the second is to attract foreign investors to join in the process of privatisation[415]. According to the chairman of the company, the program has not yet been 100% activated. But recently the company has become engaged in a policy that contributes to the privatisation programme in the country[416].

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[412] Interview with Mr. Mohammed Elhuwej, Libyan Foreign Investment Advisory and Controlling Board, Tripoli 22nd August 2002. [On line]. Available from: http://www.winne.com/mena.Libya/report/2004/vi0.php. [Accessed on 8th May 2006].
[413] Interview with Mr. Mohammed Layas.
[414] Interviews with Mr. Husni Bey.
[415] Interview with Mr Abdullatif Elkib, Chairman of National Investment Company. [On line]. Available from: http://www.unitedworld-usa.com/reports/libya/interveiw18.asp. [Accessed on 16th May 2006].
[416] Ibid

It is evident that the company is not a private joint-stock company as people are not free to buy or sell their shares whenever they like and also they do not know how much of the company they own.

Together with the National Investment Company (NIC), the Libyan Foreign Investment Board (LFIB) was set up under Article Five of Law No.5 regarding the encouragement of foreign capital investment. The real implementation of the law and the company started in 2000. The General Director of the Libyan Foreign Investment Board believes that the delay in the implementation was due to the novelty of the law, changes of the economy, centralization and sanctions from abroad, all in which have made the situation unattractive to foreign investors[417].

Coupled with the two previous entities the General Board of Privatisation (GBOT) was founded to help in the transfer of public enterprises into private ownership. The board has a five-year plan which started in January 2004. According to its secretary general, the board has so far privatised sixty-five companies. They are mainly from the agricultural and industrial sectors and involve both small and medium-sized companies. The board's plan for privatisation can be divided into three stages. It started by privatising small companies, moved on to medium-size businesses and finally began to tackle large companies. As a Libyan financial market does not exist yet, the board mainly collaborates with the National Investment Company (NIC). The board transfers the companies which are going to be privatised to the NIC which advertises them and then declares their shares to the market. This is now considered the best way of procedure.

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[417] Interview with Mr. Rajab Shiglabu.

6.4 Summary

Libya is moving towards a variety of economic reforms and a reduction in the role of the state. The commercial banks of Libya, in general, offer both retail and wholesale banking services and deal with both consumers and businesses of all sizes and ages.

Like its sister countries in North African, Libya has passed through the same waves of reforms and processes. Nevertheless, the Libyan reform processes seem to be taking place at a slower pace. There are several matters retarding progress: lack of suitable buildings, training, problems with recruitment, the lack of financial and other related markets and the absence of a genuine marketing role for banks. Such factors have severely limited competition between the Libyan commercial whether they be private or state-owned.

The country is approaching the fourth year of its five-year privatization plan and the five commercial state-owned banks are listed for transfer to the private sector. In addition, the Libyan commercial banks nowadays are on their way to applying Basel Committees I and II. Moreover, the Libyan parliament has passed a law to allow foreign banking institutions to buy shares in local banks and open branches. However, Libya needs time to rehabilitate its state owned-banks. These banks are still too weak to be privatised and compete with either local private banks or with foreign banks and they are too weak to apply Basel Committee rules.

Libya still had no have real private banking sector until Law No. 1 of 1993 was issued. However, the Bank of Commerce and Development has been established in accordance with this Law. It was the first bank to be wholly owned by the private sector. It has subsequently by other two private banks which are working hard to bring modern banking services to Libyan corporate and retail customers.

In other words, Libya's banking sector remains underdeveloped. The society is still a traditional cash society and ATM machines and other modern banking facilities have yet to

become a common sight on city streets. As a consequence, the financial base of the society is very limited.

Chapter Seven

Financial Analysis of the Libyan Commercial Banking Sector

7.1 Introduction

The banking industry recently has started to change rapidly world wide. It is continually offering new services, adopting new technologies, following new rules and regulations and facing more and stronger competition. Indeed, many financial institutions, including brokerage firms, mutual funds, insurance companies and leading security dealers, are providing financial services similar to those provided by banks.

Banks, in turn, are challenging these institutional competitors by expanding their services to provide non-banking services such as insurance, investment in mutual funds and many other financial services. This has brought a large number of banks and non-banking financial institutions into direct competition[418]. Thus banks today are under greater pressure to improve their performance and meet the aspirations of their stock-holders, employees, depositors and borrowers[419].

These developments have led to bankers continually reevaluating their policies and assessing their returns and risks in the light of this competitive milieu. For this, the financial services that banks provide and the overall size of banking organizations are reflected in their financial statements. These financial statements are normally used by other banks and the public to evaluate and compare bank performances. The financial ratios such as return on equity (ROE), return on assets (ROA) and earnings per share of stock (EPS) are three of the most commonly used indicators. Most important are the banks objectives and performance goals[420], which determine the most efficient bank. Thus the banks' financial statements are

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[418]Haslem, John. *Commercial Bank Management: Text and Reading*. Reston Publishing Company. Virginia: 1985, p. 6.
[419] Ibid, p. 7.
[420] Stolowy, Herve, and Lebas, Michel J. *Corporate Financial Reporting: Global Perspective*. London: Thomson Learning. 2002, p. 584.

increasingly being scrutinized by investors, stockholders, prospective investors and the general public[421]. The banks' managements, in turn, are finding that they must pay close attention to their stock values which are especially sensitive to changes in interest rates and currency rates. Moreover, they are working to reduce their operation costs and risks which are their key objective and have priority over all others[422]. As a consequence, in an open competitive environment funds and information should flow readily into the various banking ends.

The government involvement in the industry has negatively affected it and caused the absence of several important institutions clear among which are a credit market, a foreign exchange market, a secondary market, a stock exchange market and, most importantly, a financial information centre. Hence, the Libyan commercial banks cannot gain entry into the open markets to raise funds: interest rates and currency exchange rates are determined by the CBL; the financial statements of the commercial banks in Libya are outdated; and there is no possibility to use financial criteria to evaluate bank performance. Moreover, there is no role to play in the Libyan economy for such economic factors as supply and demand.

The absence of these indicators and institutions has led stockholders to use the return on shares and the expenditure of the banks to determine the efficiency of the banks and their managements[423]. These factors have instigated much research, and hence this research, to use commercial banking sector indicators.

The aim of this chapter is to highlight important historical indicators in the Libyan commercial banking sector over the period 2000-2005. Trend and time-series will be used to examine itemization in the Libyan commercial banks. The chapter consists of five sections: the first presents the Libyan banks statistical base; the second, determines the period 2000-

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[421] Alexander, David. Britton, Anne, and Jorissen, Anne. *International Financial Reporting and Analysis*. London: Thomson Learning. 2003, p. 21.
[422] Stolowy, Herve, and Lebas, Michel J. *Corporate Financial Reporting*, p. 92.
[423] Because of the absence of these indicators, the researcher has decided to question shareholders on their ways of evaluating their banks efficiency.

2005 to be studied and explains the reason for the choice; the third, focuses on the itemization of assets and liabilities; the fourth presents the structure of the Libyan commercial banking sector's assets. It analyzes the sector's liquid assets, liquidity problem in the sector, investment, credit, commercial banks loan to various other sectors in the economy and non-performing loans. The change in these items during the period under review will be also discussed. The fifth section discusses the liabilities of the Libyan commercial banking sector and also analyse items such as capital and reserve accounts, deposits and inter bank borrowing. Moreover, the chapter discusses growth in branch networks during this period. The chapter concludes with a summary.

7.2 The Libyan Banking Statistical Base

The history of the Libyan banking sector goes back more than five decades. Prior to 1970, the Libyan banking sector was weak and consisted mainly of branches of foreign banks along with the National Bank, the Bank of Libya. Following the revolution in 1969, the state made several attempts to control the financial sector in general and commercial banking in particular. Accordingly, the banking sector fell under direct government control and regulation. This has given the state, in the form of the CBL, the upper hand over the reminder of the banking system. This governmental control has led to a number of problems, one of which is the obvious problem of the lack of a strong statistical base.

Consequently, a gloomy picture has emerged of the Libyan economic and banking sector's statistical base. According to many international financial organizations such as the World Bank and the IMF[424], the Libyan banking sector and economy suffers from important shortcomings which among others include quality, coverage, and a timeless and consistent

[424] Country Report by the IMF NO. 06/136 April 2006.

approach to data and statistics. All of these need to be addressed[425]. These shortcomings have hampered these organizations' ability to conduct relevant economic analysis and effective surveillance and made it difficult to determine economic rates and ratios such as inflation rates. The government, however, has expressed strong interest in having these organizations play a leading role in assisting and formulating strategies to reform the sector.

In turn, the World Bank and the IMF have continually recommended[426] the Libyan monetary authorities to increase their efforts to harmonise Libya's financial statistical data base with international standards[427]. These two organizations consider that the Libyan fiscal and financial information system is designed for administrative reporting and fulfilling the wishes of the government[428]. Therefore, they have advised the Libyan monetary authorities to start keeping accurate statistical information for planning and analysis. Moreover, they have encouraged the authorities on the one hand to establish a National Statistical Council that will ensure coordination among data-producing agencies, and enable discussion and verification of the national statistics and instigate a national statistical work program. On the other hand, they have asked also the Libyan monetary authorities to consider participating in the Fund's General Data Dissemination System (GDDS), as a useful framework for statistical development[429].

In 2003 the Libyan financial authorities agreed for the first time to publish the financial reports of international financial organizations such as the IMF and the World Bank[430]. In 2006, the CBL informed the IMF of its intention to participate in the GDDS to improve the standard of the Libyan national statistical system.

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[425] Inspection reports of the World Bank and the IMF are available in reports on Libya by the IMF No. 06/136 April 2006.
[426] IMF Country Report No.03/327 October 2003, pp. 24-25.
[427] Clear examples for this call can be found in reports No. 03/327, p. 24-25.
[428] IMF Country Report No.03/327 October 2003.
[429] IMF Country Report No.06/136, p. 15.
[430] IMF Country Report No 03/327 October 2003.

According to Alexander et al., economic and legal culture can be one of the most important causes of variation in a nation's accounting system. Culture has also an important influence on reporting and disclosing behavior with regard to financial information[431]. This seems to be the situation in the Libyan financial and banking sectors.

7.3 Financial Analysis

Financial analysis is a tool which can make the difference between the success and failure of banks, which enables to a large extent accurate interpretation of the banks' activities and a detailed examination of a business financial position and returns in relation to risk. Therefore, financial analysis can help in forecasting a business, or industry's future performance[432].

The process of financial analysis involves reclassification and summarization of financial data through the establishment of adequate accounting procedures. In the case of banks, financial statements are the source for securitising their financial data.

There are several techniques of financial analysis that the researchers may choose to use in this regard. The most well-known techniques are the horizontal (the trend and time-series analysis), and vertical financial analysis techniques[433].

Regarding the Libyan banking statistical base, this research attempts to use trend and time-series of a whole industry. In this way the researcher can compare the performance of the sector to its own history.

There are several reasons which have motivated the researcher to use this technique. The first reason is the lack of a competitive environment in the sector. The second is because the government has intervened in the sector besides owning a majority of the banks. The third reason is that the sector lacks data transparency and credibility. The fourth reason is that the

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[431] Alexander, David. Britton, Anne, and Jorissen, Anne. *International Financial and Analysis*, p. 26.
[432]Stolowy, Herve, and Lebas, Michel J. *Corporate Financial Reporting*, p. 574.
[433] Ibid, p. 573.

state-owned banks lack up-to-date published financial statements. Therefore, change in the sector is slow to be noticed. In this case, the researcher believes trend and time-series analysis is meaningful.

According to the literature[434] a five-year time frame is necessary. Longer periods of analysis, for example over a ten-year are also possible[435]. Consequently, the researcher has chosen the six years from 2000 to 2005 as the period of comparison. The year 2000 will be the base year of the comparison. Subsequently, computing a percentage change requires two steps; the first step involves computing the degree of change in the value of the dinar, the local currency, from the base year to 2005. The second step involves dividing the dinar's value to its base period value. The result of this calculation is an index, which enables to be examined the performance and trends of the Libyan commercial banking sector over the period.

7.4 The Period of Financial Analysis

As mentioned early in the history of the Libyan commercial banks' development, the government relied upon them to achieve its political goals. Accordingly, the commercial banks were distracted from their purposes of maximizing the value of the wealth invested in them, to satisfy the government elites. This has negatively affected the performance of the sector.

Several reasons motivated the researcher to choose the period 2000-2005 as the period for study. The first reason is that the Libyan commercial banking sector was subjected to intensive governmental regulation during the period. These new regulatory frameworks include, for instance, Law No. 1 of the year 2005 and the preceding Law No. 1 of the year 2003 regarding the regulation of the Libyan banks. These include Law No. 7 of 2003 and its implementation regulations which amended Law No. 5 of 1997, regarding the encouragement

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[434] Stolowy, Herve, and Lebas, Michel J. *Corporate Financial Reporting*, p. 574.
[435] Ibid.

of foreign capital. The second reason lies in the revival and proliferation of private commercial banks in the country during the period in question. The third reason stems from the rise in oil prices during this period, which increased state revenues and consequently government expenditure. The fourth reason was the lifting of UN and US sanctions in 2003 that had been imposed on the country in 1992. The lifting of these sanctions paved the way for fundamental reform policies not only in the banking sector, but in all spheres of the economy. These factors have generally contributed to the development of the Libyan commercial banking sector during period in question

7.5 The Assets and Liabilities Structure of the Libyan Commercial Banking Sector

From the historical point of view until 2003, the assets and liabilities structure of the Libyan commercial banking sector varied. Economic change and development as a whole affected the structure of the sector's assets and liabilities. They made it difficult to assess and compare ongoing processes in the economy. As the chapter analyses the composition of the assets and the liabilities of the Libyan commercial banks, itemization of the sector during 2004 and 2005 is used. This is to avoid any distortions that may occur from differences in the classification of financial items.

It is worth mentioning here that most of the items that the chapter discusses did appear on the Libyan commercial banks' financial statements, regardless of whether they were state-owned or private banks.

7.5.1 The Asset Structure of the Libyan Commercial Banking Sector

Assets can be defined as ''anything owned by a person or organization and having a monetary value, usually its cost or fair market value''[436]. Applied to the commercial banking sector, the

[436]Fitch, Thomas. *Dictionary of Banking Terms*. USA: Barron's Educational Series, Inc. 2006, p. 24.

term refers to the distribution of funds among cash, securities, investments, loans and other assets.

The assets of the Libyan commercial banking sector can be classified into eight categories: liquid assets including cash in vault in both local and foreign currencies; deposits with the CBL; deposits with domestic commercial banks both on demand and time deposits; deposits with foreign banks; investments; credits consisting of loans for economic activity; property loans; social loans and loans to the GMMR project; fixed and other assets; and finally contra accounts. Table 7.1 shows the Libyan commercial banks' assets structure for the period 2004-2005.

Assets	2004	2005	Growth of Assets	Growth %
Liquid assets	**6392.9**	**9083.5**	**2690.6**	**42.1**
Cash in vault	187.3	173.5	-13.8	-7.4
In local currency	165.2	151.7	-13.5	-8.2
In foreign currency	22.1	21.8	-0.3	-1.4
Deposits with the CBL of Libya	**6079.4**	**8874.9**	**2795.5**	**46**
Demand	1710.6	2747.8	764.2	44.7
Time	4368.8	6400.1	2031.3	46.5
Deposits with commercial banks	**126.2**	**35.1**	**-91.1**	**-72.2**
Demand deposits	45.7	35.1	-10.6	-23.2
Time deposits	80.5	0	-80.5	-100
Deposits with foreign banks	**1283.2**	**2017.7**	**734.5**	**57.2**
Investments	**119.3**	**131.3**	**12**	**10.1**
Credits	**6510.3**	**6166.6**	**-343.7**	**-5.3**
Loans for the economic activities	3192.7	2701.6	-491.1	-15.4
Property loans	1456.2	1426.3	-29.9	-2.1
Social loans	1488.4	1665.7	177.3	11.9
Loans to the GMMR project	373	373	0	0
Fixed and other assets	**1101.8**	**1125.7**	**23.9**	**2.2**
Contra accounts	**1891.5**	**3073.8**	**1182.3**	**62.5**
Total	**17299.0**	**21598.6**	**4299.6**	**24.9**

Table 7.1: Assets of the Libyan Commercial Banking Sector during 2004-2005 in Millions LD

Source: the CBL 49th Annual Report Fiscal Year 2005

As can be seen from Table 7.1, since the beginning of standardization in accounting in 2004, the liquid assets of the Libyan commercial sector increased by 42% from 2004 to 2005. This is indeed a remarkable development over one year, which indicates that the Libyan commercial sector has strengthened. This strong position is further evidenced with the developments in the deposits in the Central Bank of Libya, as the deposits increased by 46% from 2004 to 2005. However, during the same period, deposits with the commercial banks declined by 72%. In contrast with this, deposits with the foreign banks increased by 57%.

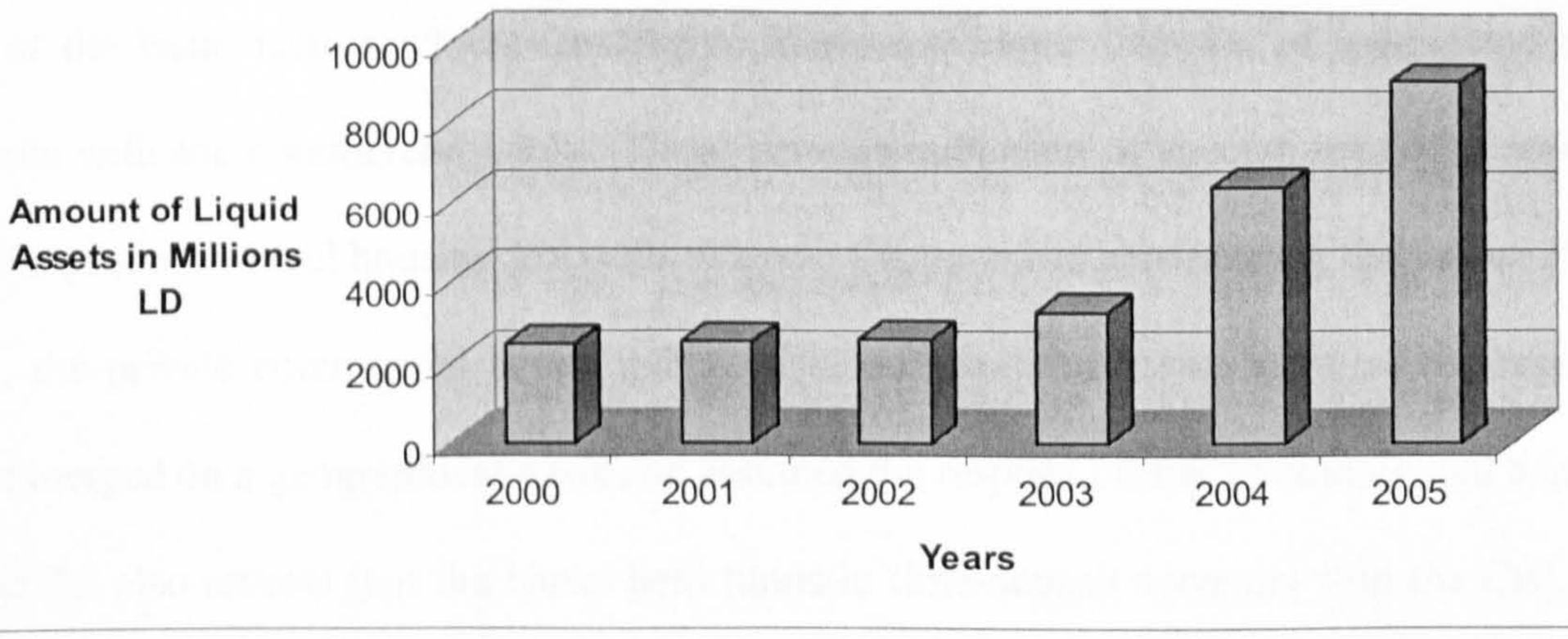
This indicates that there has been move from domestic commercial banks to foreign banks during the same period, which can be explained by the opening of the Libyan economy. As can also be seen from Table 7.1, during the same period, credits declined by about 5%.

7.5.1.1 Analysing Change of the Libyan Commercial Banks' Liquid Assets

Liquid assets have some features different from other kinds of assets. They can be sold rapidly, with minimum loss of value. However, the banks' liquid assets or liquidity is their ability to meet their obligations when they fall due without incurring unacceptable losses. Managing liquidity is a daily process requiring bankers to monitor and project cash flows to ensure adequate liquidity is maintained. The purpose of keeping liquidity is to meet a bank's short-term expenses and its reserve requirements.

The liquid assets portfolio of the Libyan commercial banks consists of cash in vault, deposits with the CBL and deposits with commercial banks. Figure 7.1 shows a trend and time-series analysis of the Libyan commercial banks' liquid assets LD in million during 2000-2005.

Figure 7.1: The Development of the Libyan Commercial Banks Liquid Assets during 2000-2005 in Millions LD.



Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports for the Fiscal Years 2000-2005.

The change in the Libyan commercial banks' liquid assets is shown in Table 7.2 which depicts impressive growth in many of their liquid assets. Particularly, deposits with the CBL recorded a handsome growth of 296% and the cash available at the banks increased by 27.70%. In contrast, recorded deposits with the commercial banks fell sharply by 29.30%.

Regarding cash in vault, Table 7.2 shows that the ratio of the cash in vault in local currency increased by 27.7%. The growth achieved can be attributed to three factors: meeting the short-term expenses of the banks, the absence of good investment opportunities and cash transactions in society. It seems the third factor is the usual plea of the bankers and monetary authorities to justify high levels of cash. However, holdings of foreign currency increased by 6.86 % following the sharp increase in oil prices. Table 7.2 shows the change in these items using the trend and time-series analysis.

The Libyan commercial banks are obligated, according to Article 57 of Banking Law No. 1 of 2005 to maintain with the CBL, without interest, monetary reserves corresponding to their deposit liabilities. Moreover, the commercial banks hold funds with other banks as a part of inter-bank funding to meet short-term liquidity requirements and their obligations with these banks.

Table 7.2 shows that deposits with the CBL increased by 145.9% and 469.3% respectively. One of the basic factors which caused this increase was the increase of specialized bank deposits with the commercial banks. These amounts allocated to specialized banks were to provide productive and housing loans for citizens. On the other hand, during the period 2000-2005, the private commercial banks increased in number. Moreover, many of the regional banks merged on a geographical basis and assumed the responsibilities of commercial banks.

Table 7.2 also reveals that the banks held funds in time-deposit accounts with the CBL and with other commercial banks as part of their loans portfolio diversification and as a means of profit generation. However, time-deposit accounts with the CBL witnessed a dramatic

increase of 469.3%. In sharp contrast, the time-deposits with other commercial banks recorded no increase at all. Table 7.2 summarizes the changes in the Libyan commercial banking sector's liquid assets, according to trend and time-series analysis.

Liquid assets	2000	2001	2002	2003	2004	2005	Growth of Liquid Assets	Growth %
Cash in vault	**135.9**	**234.4**	**124.7**	**187.3**	**187.3**	**173.5**	**37.6**	**27.70**
in local currency	115.5	113.0	103.0	165.2	165.2	165.2	36.2	**31.34**
in foreign currency	20.4	121.4	21.7	22.1	21.8	22.1	1.4	**6.86**
Deposits with the CBL	**2241.7**	**15732.8**	**2337.7**	**3089.1**	**6079.4**	**8874.9**	**6633.2**	**296**
Demand	1117.4	1500.0	1204.9	1207.8	1710.6	2747.8	1630.4	**145.9**
Time	1124.3	732.8	1132.8	1881.3	4368.8	6400.1	5275.8	**469.3**
Deposits with the commercial banks	**57.8**	**43.9**	**114.9**	**51.3**	**126.2**	**35.1**	**37.6**	**(39.30)**
Demand	13.0	9.9	14.9	21.3	45.7	35.1	36.2	**170**
Time	44.8	34.0	100	30	80.5	0	1.4	**—**
Total	**2435.4**	**2511.1**	**2601.1**	**3265.1**	**6392.9**	**9083.5**	**6648.1**	**273**

Table 7.2: Trend Analysis of Libyan Commercial Banking Liquid Assets during 2000-2005 in Million LD

Source: 48th, 49th and 50th Annual Reports of the CBL fiscal years 2004, 2005 and 2006, and the CBL quarterly economic bulletins 2000-2005.

7.5.1.1.1 The Problem of Libyan Commercial Banks' Liquidity

The commercial banking sector of Libya suffers from high liquidity. According to IMF reports, this is one of the basic features that has characterized the sector in addition to a high ratio of non-performing loans. In 1970 the CBL determined the ratio of liquidity at 15% of all liabilities after excluding four-month time-deposits and Jamahiriya Treasury Bills and Securities. The Libyan monetary authorities still use this ratio as the new banking law has not

been fully determined[437]. According to Alwaddan, in 2001 liquidity exceeded the reserve requirement by 144%[438]. On the other hand, based on preliminary data at the end of 2005, the banks' excess liquidity was equivalent to 34% of broad money[439]. Three factors have led to this situation: the first factor was the conservative defensive lending policies adopted by the banks' managers in holding substantial funds in liquid assets. The second factor, according to the IMF, was the monetary policy dominated by government credit and interest rate control. The third factor was the inefficient allocation of resources and the lack of suitable investment opportunities.

In May 2004, the government decided to revalue the foreign assets account at the CBL to buy back its own outstanding domestic debt and part of the public enterprise debt to commercial banks. Moreover, in 2005, the government had intended also to payback an additional amount of public enterprise debt to commercial banks. The government, however, considered this as a remarkable improvement in commercial bank loans[440]. In turn, the IMF recommended the monetary authorities to disregard this concern over liquidity. In addition, the IMF believed that government ownership of a majority of the commercial banks could have helped them to a large extent in recycling their liquidity. According to the IMF, at the end of December 2005, the amount of liquidity could be estimated at LD 6.8 billion (34% of broad money)[441].

7.5.2 The Investments

There is a high correlation between the level of investment and a country's economic development. The term investment appeared in the portfolios of the Libyan commercial

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[437] The CBL. Executive position of the monetary policy 2001-2006.

[438] Alwaddan, Abubakar. *Banking Reforms and Banking Efficiency in Libyan Commercial Banks*. Ph.D. thesis. Unversity of Northumbria, 2005, p. 130.

[439] IMF Country Report No.06/136 April 2006, p. 27.

[440] Executive position of the monetary policy during the period 2001-2005. [on line]. Available from: http://www.cbl.gov.ly/en/pf/print.php. [Accessed on 06/02/2007].

[441] IMF Country Report No. 05/83, p. 10.

banking assets and liabilities for the first time in 2004. Prior to this, the term Jamahiriya Treasury Bills and Securities appeared instead.

According to the interviewees, in 1974, Jamahiriya Treasury Bills and Securities were issued by the government. The main purpose for them was to assist the government in coping with its budget deficit and the economic sanctions that were imposed on the country later. From 1974 to 2003, this tool became the regular means by which the state raised funds. They were sold to the commercial banks and other state-owned organizations and the CBL obliged the commercial banks to buy them.

In 2003 the government liquidated Jamahiriya Treasury Bills and Securities, as their revenues were exempted from taxation. This had a severe impact on the commercial banks in general and state-owned banks in particular. The banks' profitability decreased by around 6%[442]. On the other hand, the IMF recommended the Libyan monetary authorities to create other market-based instruments, such as CBL certificates and treasury bills, to enhance the conduct of its monetary policy and create a suitable environment for investment[443].

According to the private banks' annual reports, one can extrapolate out that investment in the sector can be dividend into two categories: national investments which are long-term investments held in other national companies and international investments which are managed by the Foreign Arab Bank. Table 7.3 summarises the Libyan commercial banks' investment growth during 2000-2005 according to trend and time-series analysis.

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[442] Interviews.
[443] IMF October 2003. IMF Report NO. 03/327, p. 23.

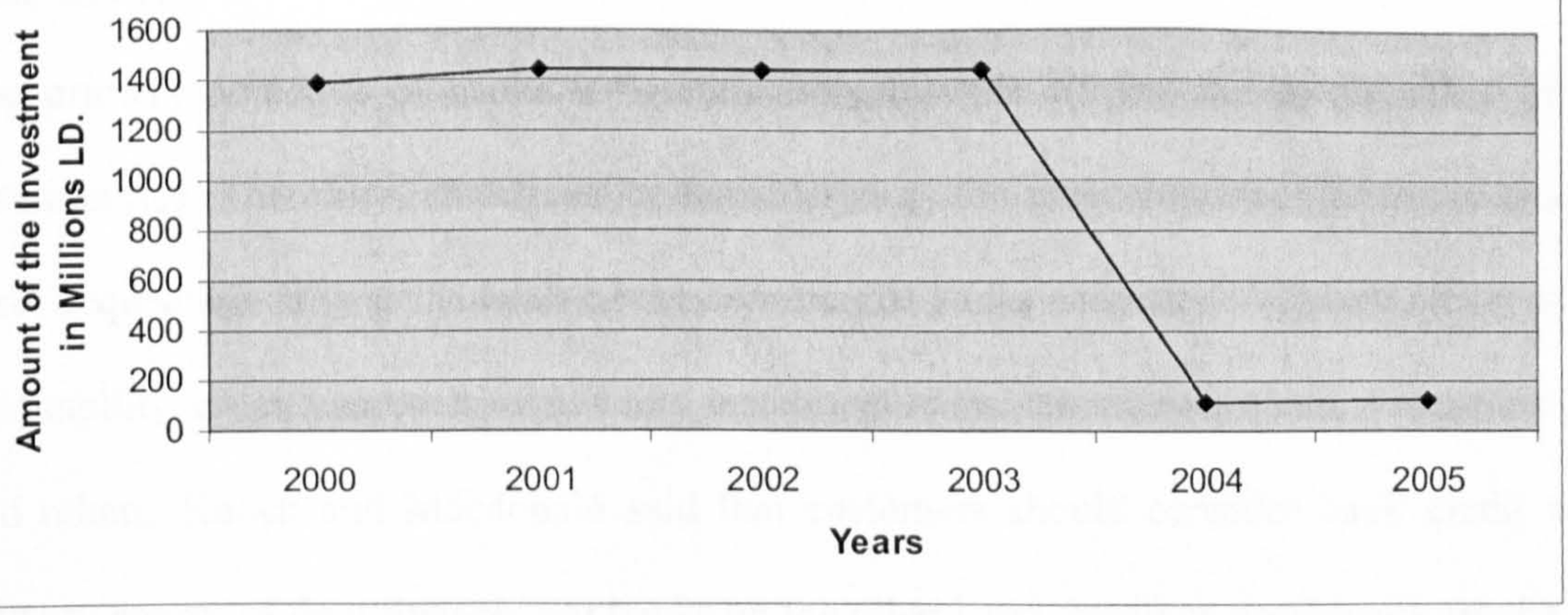
Years	2000	2001	2002	2003	2004	2005	Growth of Investments	Growth %
Investment in million LD	1392.5	1437.5	1437.5	1437.5	119.3	131.3	(1261.2)	**(90.6)**

Table 7.3: Trend Analysis of Libyan Commercial Investment during 2000-2005 in Million LD

Source: 48th, 49th, and 50th Annual Reports of the CBL Fiscal Years 2004, 2005, and 2006, and the CBL Quarterly Economic Bulletins (2000-2005).

The trend analysis of the Libyan commercial banks' investments between 2000- 2005 in Table 3 shows that the banks suffered sharp decline in their investments by 90.6%. The dramatic decline mentioned earlier can be attributed mainly to the liquidation of the Jamahiriya Treasury Bills and Securities. This can be traced back to the sharp increase in oil prices during the period, which led the government to enjoy a massive additional revenues windfall and remedy the previous budget deficits. Figure 7.2 summarizes the general trend of the Libyan commercial banks' investments during 2000-2005 in million LD.

Figure 7.2: The Development of the Libyan Commercial Banks Investment during 2000-2005 in Millions LD.



Source: 48th, 49th, and 50th Annual Reports of the CBL Fiscal Years 2004, 2005, and 2006, and the CBL Quarterly Economic Bulletins (2000-2005).

As can be seen from Figure 7.2 the investment account reached its maximum of LD1437.5 in 2001, owing to the government's increasing dependence on Jamahiriya Treasury Bills and

Securities. This was followed by constant levels in of investment in 2002 and 2003 respectively, as a result of the lifting of the economic sanctions and the rise in oil prices. However, subsequent to this period, there was a sharp decline in the investment account owning to the cancelling of the Jamahiriya Treasury Bills and Securities at the end of 2003.

On the other hand, the investments of the Libyan commercial banks witnessed a slight increase during 2004-2005 as a consequence of a series of factors. One of the main factors was the liberalization of frozen accounts. However, this slight increase in the investment level may be a good clue to proving the statements of the interviewees regarding the small amount of frozen accounts abroad. Moreover, as the private commercial banks did not generate any revenues from their investment in the stock companies in which they had invested, their managements followed conservative policies and did not invest in any of the companies on offer. Nevertheless, the fact that the banks increased their shares in the capital of these companies, which generate lucrative revenue, can be considered another factor which flowed from the previous situation.

7.5.3 Credits

The primary objective of banks is to earn income while serving the credit needs of their communities. Therefore, credit can be considered as the most important factor in enabling asset acquisition. It is at the heart of the commercial banks activities[444]. Based on its relative profitability, credit can be classified into instalment loans, commercial loans, real estate loans and others. Knock and Macdonald said that customers should consider bank credit as the primary source of debt finance. For banks on the other hand, credit or good loans are the most source of profitable assets[445].

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[444] IMF October 2003. IMF Report NO. 03/327, p. 23.
[445] Kock, Timothy, and MacDonald, Scott. *Bank Management*, p. 557.

Credit analysis is the tool that is used by the banks to determine the ability and willingness of borrowers to repay loans. In most banks, world wide, the work of credit analysis is basically similar. It includes collection of information, preparation and analysis of the information collected, and assembly and retention of information for the future. However, some bank loans are repaid according to a fixed schedule.

Recently, the CBL has extended its credit policy to incorporate other sectors in addition to foreign companies. According to the formal financial policy drawn up at CBL level, loans and overdrafts are the back-bone of the Libyan commercial banks' activities. Table 7.4 demonstrates the Libyan commercial banks' credits in million LD during the period 2000-2005.

According to which, total credits touched 10.43%, the result of an increase in social loans of 77.4%. The large increase in the wages bill of 21% reflected additional hiring of qualified people such as doctors and teachers and not to an increase in existing wage levels. This led to an increase in the demand for social loans of the commercial banks to meet such social expenditure as marriage and medical treatment abroad.

In 2004 the CBL lowered the interest rate on social loans from 7.5% to 6.5%. This can be considered as one of the factors associated with the increased demand for social loans. Moreover, the CBL increased the ceiling of social loans provided by the commercial banks to 30% of total liabilities.

Loans types	2000	2001	2002	2003	2004	2005	Growth of Credits	Growth %
Loans for economic activities	2802.9	3156.0	3269.8	3549.0	3192.7	2701.6	(101.3)	(3.61)
Property loans	1468.9	1436.9	1398.1	1472.1	1456.2	1426	(42.6)	(2.90)
Social loans	939.2	1091.7	1316.9	1381.0	1488.4	1665.7	726.5	77.4
Loans to the GMMR [446]	373	373	373	373	373	373	0	0
Total	5584.0	6057.6	6357.8	6775.1	6510.3	6166.6	582.6	10.43

Table 7.4: Trend Analysis of the Libyan Commercial Banks' Credits from 2000-2005 in Millions LD

Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

In 2005 the CBL considered that social loans, to a large extent shared in the non- performing loans problem[447]. Moreover, many of the bankers considered the recent financial circumstance of the Libyan citizens and asked the government to cancel this kind of loan or find another kind to deal with the situation[448].

Loans for both economic and property decreased dramatically by 3.61% and 2.90% respectively in 2005. Despite this the CBL permitted the commercial banks to grant loans and credits for existing foreign company projects in Libya. However, this phenomenon can also be attributed to provision by specialized banks of a substitute for financing debt with modest rate of interest, based on the government's LD 3 billion multi-year lending program. This led individuals to seek debt finance through these banks and abandoning the commercial banks. As a matter of fact, this diminished the demand for credit provision by the private commercial

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[446] **The GMMR is a project intended to transport water from southern Libyan aquifers to the northern coastal belt. However, the balance of the loans granted to the project of the GMMR remained, as it was, at LD 373.0 million. Therefore, the loan to the GMMR will not be considered in the horizontal analysis of this chapter.**

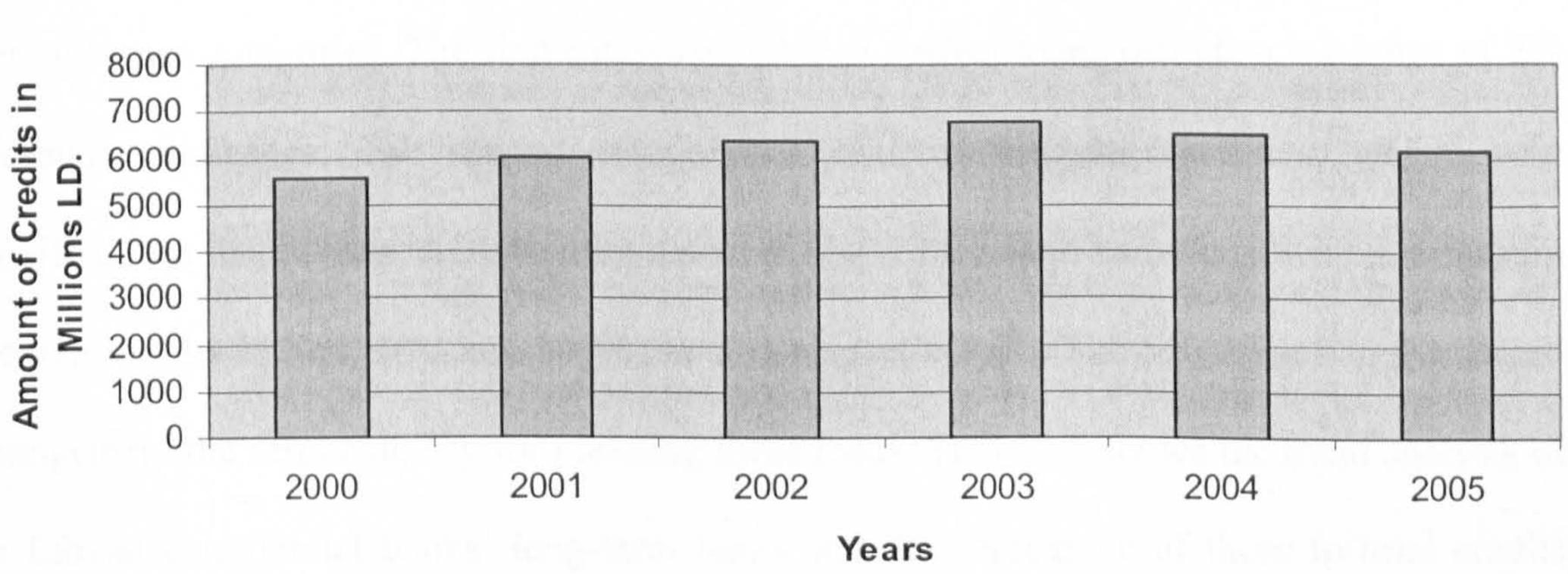
[447] The CBL. *Executive Position of Monetary Policy 2001-2006.*

[448] Interview.

banks. In 2004 the interest rate on this kind of loan by the CBL to facilitate the borrowing from the commercial banks, fell from 7% to 6%.

However, the IMF reiterated its recommendation for the Libyan monetary authorities to undertake this operation through the commercial banks and any interest rate subsidy should be granted through their budgets[449]. On the other hand, the CBL argued that this happened due to the lack of collateral and guarantees that the commercial banks would not be able to recover their investments[450]. This questioned the ability of specialised banks to guarantee these loans. However, Figure 7.3 pictures the development of the Libyan commercial banks credits during 2000-2005 in million LD.

Figure 7.3: The Development of the Libyan Commercial Banks Credits during 2000-2005 in Millions LD.



Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

7.5.3.1 Non-Performing Loans in the Libyan Commercial Banks

The history of the non-performing loans problem in the Libyan commercial banking sector goes back to the 1980s[451]. During the 1990s, the balance of non-performing loans in the

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[449] IMF Country Report NO.06/136. April 2006, p. 13.
[450] Ibid.
[451] Alwaddan, Abubakar. *Banking Reforms and Banking Efficiency in Libyan Commercial Banks*, p. 170.

commercial banking sector witnessed a dramatic growth that exceeded LD 880.5 billion[452]. Due to the severe impact of this problem, the CBL, for the first time, issued a circular concerning loan classification in 1995[453]. The circular classified loans into two categories: first, perfect loans with a 1% minimum ratio allowance; second, irregular loans. These were classified into three types: standard, doubtful and bad. The minimum allowance ratios for these were 10%, 30% and 60% per cent respectively[454]. In both cases, if the allowance ratios were not enough, the banks' General Assembly had the right to exceed these ratios[455].

Recently, and according to the CBL, the term bad loans', on the one hand refers to overdue short-term and medium-term loans, such as overdrafts and social loans. On the other hand, the bank amalgamated bad loans with their long-term loans. Therefore, short-term and medium-term overdue loans were be to transferred to the long-term loan accounts.

At the end of 2005, another amendment to loan classification was introduced. It reclassifies them into two categories. The first category included perfect loans include a tolerance of 2% minimum allowance. The second category consists of irregular facilities, which were classified into three types: sub-standard loans, doubtful loans and bad loans, with a minimum allowance ratio of 20%, 50% and 100% per cent respectively[456]. The circular left to the banks' management the responsibility for pursuing these loans. Table 7.5 shows the trend analysis of the Libyan commercial banks' long-term loans and the percentage of these to total credits during the period 2000-2005.

However, loans are considered as one of the most important assets for commercial banks, and the data in Table 7.5 demonstrates substantial growth was achieved in both total credits and long loans accounts. In particular, long loans increased by 14.80% comparing to 10.43% for total deposits.

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[452] Alwaddan, Abubakar. *Banking Reforms and Banking Efficiency in Libyan Commercial Banks*, p. 170.
[453] Ibid, p. 171.
[454] Ibid, p. 172.
[455] Ibid, p. 170.
[456] Circular no 48 of the year 2006 regarding the reclassification of credit.

According to Table 7.5, in 2004, the long-loan accounts recorded a handsome growth of 43.30%. In general, prior to 2005, the increase in long-loans can be related to several internal and external factors: first, the CBL as the representative of the state had to set up a specific loans policy. This policy could be defined as bank loans allocated for specific activities; second, a collateral policy that guaranteed banks' rights which had been considered to a large extent, and weak factors which hindered the banks from obtaining their rights. It seems that social factors and socialist political and economic attitudes played a major role in this concern.

Years	Total credits	Total long loans	Total long loans to total Loans %
2000	5584.0	2225.6	**39.90**
2001	6057.6	2222.0	**36.70**
2002	6357.8	2327.4	**36.60**
2003	6775.1	2380.6	**35.14**
2004	6510.3	2818.6	**43.30**
2005	6166.6	2554.9	**41.43**
Total	37451.4	14529.1	**38.80**
Change amount	582.6	**329.3**	**56.5**
Change in %	**10.43**	**14.80**	

Table7.5: Trend Analysis of the Libyan Commercial Banks

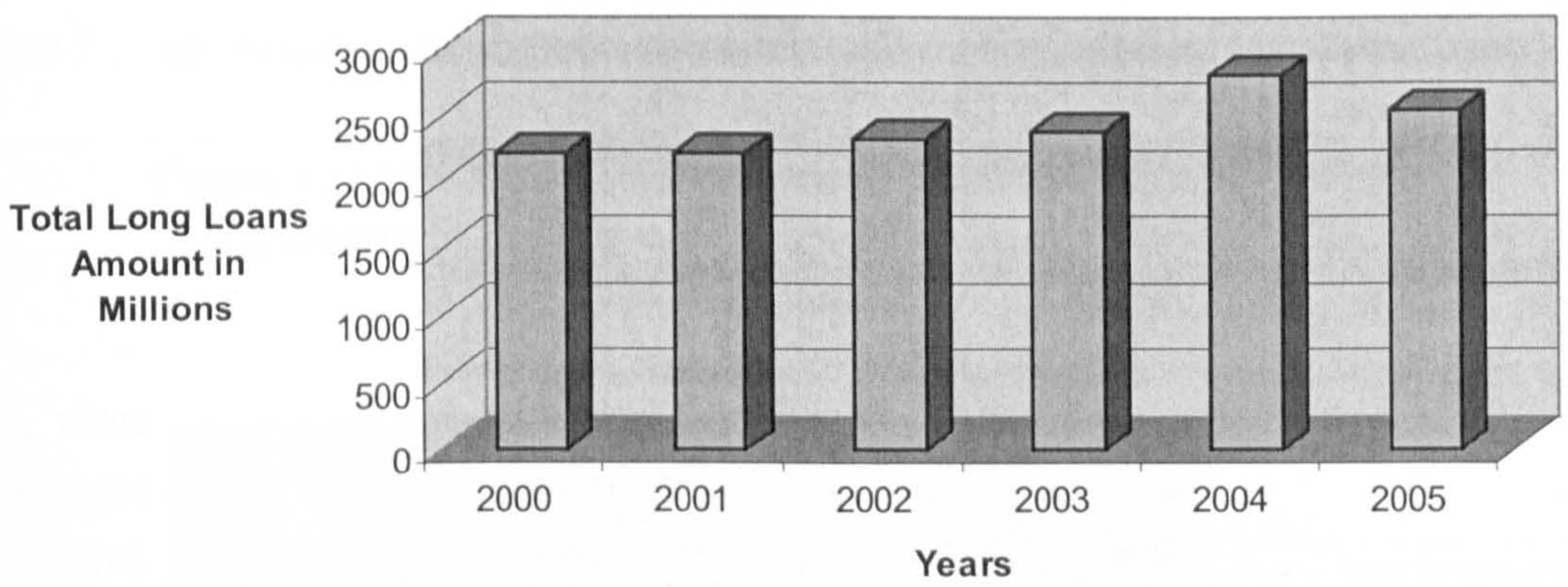
Total Long Loans during 2000-2005 in Millions LD

Source: Credit Policy and Banking Credit in Libya.

Prior to and during the period between 2000 and 2005, however, state intervention in all commercial banking activities was largely unsuccessful, creating a significant stock of non-performing loans. Clear examples for this severe impact were the loans given to companies

and governmental institutions, guaranteed by a treasury minister, who afterwards disavowed these committees and let these banks suffer the problems on their own. This was one result of the radical changes in political attitudes which led to the introduction of the new socialist regime. Figure 7.4 shows the development of the long-loan accounts during the period 2000-2005.

Figure 7.4: The Development of the Libyan Commercial Banks Total Loans during 2000-2005 in Millions LD.



Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

Beside the previous external factors that increased the number of bad loans, there are internal factors which have played important roles in this regard. Examples of these are: first, the nature of commercial bank ownership in the face of the state-owned majority of commercial banks; second, the lack of appropriate banking feasibility studies and the absence of appropriate banking principles with regard to credit and accounting matters. In general, all of these external and internal factors have led bank managements to pay little attention to evaluating and monitoring their clients' financial accounts, or keeping a watching brief on their banks' loans. The result has been an increase in non-performing loans, especially those provided by regional banks.

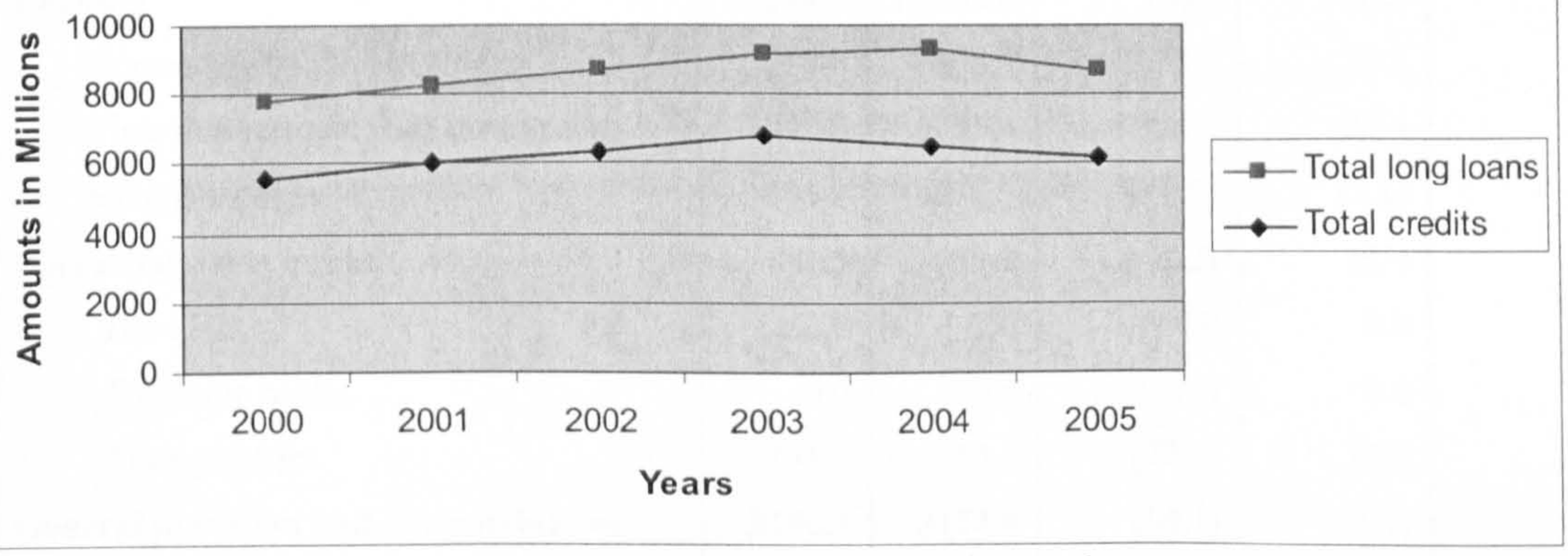
However, in 2005 long-loans accounts declined by 9.33% compared with the previous year. This was a consequence of: first, the conservative credit policy which was adopted by the

private commercial banks and their prosecution of bad loans; and second, the decrease in credits granted to the public sector as a result of the settlement of amounts due to the commercial banks from some public institutions.

The phenomenon of growth provision for non-performing loans has led the commercial banks to suffer from several problems. Examples of these are the exclusion of interest on loans, using the interest in suspense accounts and deductions in the annual provision for loans. These can be considered the main consequence of permitting the non-performing loans.

Figure 7.5 summarizes the correlation between total credits and total long-term loans.

Figure 7.5: The Correlation Between Total Credits and Total Long Loans of the Libyan Commercial Banks during 2000-2005 in Millions LD.



Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

7.6 The Structure Liabilities of the Libyan Commercial Banking Sector

The funds owed by banks, or their liabilities which include time deposits and demand deposits, are principally customer deposits. Moreover, these liabilities also are an obligation to transfer past transactions to future economic benefits[457]. Liabilities are categorized and grouped for presentation on the balance sheet according to who owns the debt, whether these

[457] Ittelson, Thomas. *Financial Statements: A Step by Step Guide to Understand and Creating Financial Reports*. USA: Career Press, 1998, p. 30.

debts are repayable within one year as current liabilities, or whether they are to be treated as long-term obligations[458].

With regard to the commercial banks in Libya, liabilities represent an important source of funds. The sector's liabilities portfolios consist of capital and reserves accounts, deposits, borrowings from banks, general provision and other liabilities and contra accounts. However, some of these items are divided into other sub-categories. Table 7.6 shows the structure of the Libyan commercial banks' liabilities according to their 2004-2005 classification.

Liabilities	2004	2005	Growth of Liabilities	Growth %
Capital and reserves	**806.8**	**1047.2**	**240.4**	**29.8**
Capital	222.4	573.2	350.8	157.7
Reserves	584.4	474	(110.4)	(18.9)
Deposits	**11278.7**	**14263.6**	**2984**	**26.5**
Demand and payment orders	7683.6	9856.9	2173.3	28.3
Time deposits and cash insurances	2909.2	3735.4	826.2	28.4
Saving deposits	685.9	671.3	(14.6)	(2.1)
Borrowing from banks	**131.5**	**59.2**	**(72.3)**	**(55)**
The CBL	0.0	0.0	0.0	0.0
Domestic banks	0.0	0.0	0.0	0.0
Foreign banks	131.5	59.2	(72.3)	(55)
General provision and other liabilities	**3190.5**	**3154.8**	**(35.7)**	**(1.1)**
Contra accounts	**1891.5**	**3073.8**	**1182.3**	**62.5**
Total	**17299**	**21598.8**	**4299.6**	**24.9**

Table 7.6: Trends Liabilities of Libyan Commercial Banking Sector during 2000-2005 in Millions LD

Source: the CBL 49th Annual Report Fiscal Year 2005.

[458] Ittelson, Thomas. *Financial Statements: A Step by Step Guide to Understand and Creating Financial Reports.* USA: Career Press, 1998, p. 30.

7.6.1 Capital and Reserves Accounts

According to Rose the "capital accounts on a bank's report of condition represent the owners' (stockholders') shares of the businesses"[459]. However, he also mentions that each new bank starts with a minimum amount of owners' capital after which it borrows funds from the public to "lever up" its operations[460]. Rose believes that banks are among the most heavily leveraged (debt-financed) of all businesses[461]. The banks' capital accounts normally represent less than 10% of the value of their total assets[462]. In addition to their capital, banks are required to maintain legal reserves for the protection of their depositors. The capital reserves represent unrealized profits and are not distributable to the banks' shareholders.

Regarding Libyan commercial banks their stockholder equity consists of the banks' capital and their legal reserves. The Law No 1 of 2005 determined the paid-up capital of the commercial banks of at least LD 10 million divided into shares[463]. According to the law each bank should fulfill its subscribed capital during a period not exceeding five years from the granting of its licence. Moreover, the law obliges the banks to reserve annually before declaring profits not less than 25% of their net profit to the legal reserve until they equal half of the paid capital[464]. Thereafter, 10% of the net profits until they equal the value of the paid up capital[465]. However, Table 7.7 shows the trend analysis of the capital and reserves of the commercial banking sector in Libya during 2000-2005.

Trend analysis of the Libyan commercial banks' capital and reserves between 2000 and 2005 (Table 7.7) shows that substantial growth was achieved in both capital and reserves. In particular, paid capital increased by 178%, while reserves increased by 32%. Consequently, the total of the capital and reserves had increased sharply by 86%.

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[459]Rose, Peter. *Commercial Bank Management*, p. 127.
[460] Ibid.
[461] Ibid.
[462] Ibid.
[463]Article No 67 of the Law No (1) of 2005.
[464] Law No (1) of 2005 Article No 73.
[465] Law No (1) of 2005Article No 57.

Capital and Reserves	2000	2001	2002	2003	2004	2005	Level of Growth	Growth %
Capital	206.0	206.0	206.0	206.0	222.4	573.2	367.2	**178.25**
Reserves	358.1	524.0	558.7	558.7	587.9	474	115.9	**32.37**
Total	**564.1**	**730**	**764.7**	**764.7**	**793.9**	**1047.0**	**483.1**	**85.64**

Table 7.7: Trend Analysis of the Libyan Commercial Banks Capital and Reserves during 2000-2005 in Million LD

Source: 48th, 49th, and 50th Annual Reports of the CBL Fiscal Years 2004, 2005, and 2006, and the CBL Quarterly Economic Bulletins (2000-2005).

Prior to 2005, the increase in total capital and reserves could be attributed to the legal or compulsory reserve, which had to be made in compliance with Law No 1 of 1993. This law made it an annual obligation that banks must retain, and not declare, not less than 50% of their profits until their reserves amounted half the paid-up capital. Thereafter, they had to retain not less than 25% of the profit until their reserves equaled the paid-up capital.

The same increase in total capital occurred in the year 2005. This was a consequence of three factors: first, a decrease in the legal reserves of the commercial banks according to Law No. 1 of 2005[466]; second, and most importantly, increases in the capital of all state-owned banks by more than LD 367.2 million due to the capitalization of the reserve of the commercial banks with the CBL to meet the requirements of the Basel Accords I[467]. This justified the fall in the legal reserves of 19.37% between 2004 and 2005; third, the number of the private commercial banks exceeded 5.

All of these factors caused the total capital and reserves of the commercial banks to rise by more than LD 483 million, *i.e.* by 85.62%, between 2000 and 2005. Figure 7.6 shows the

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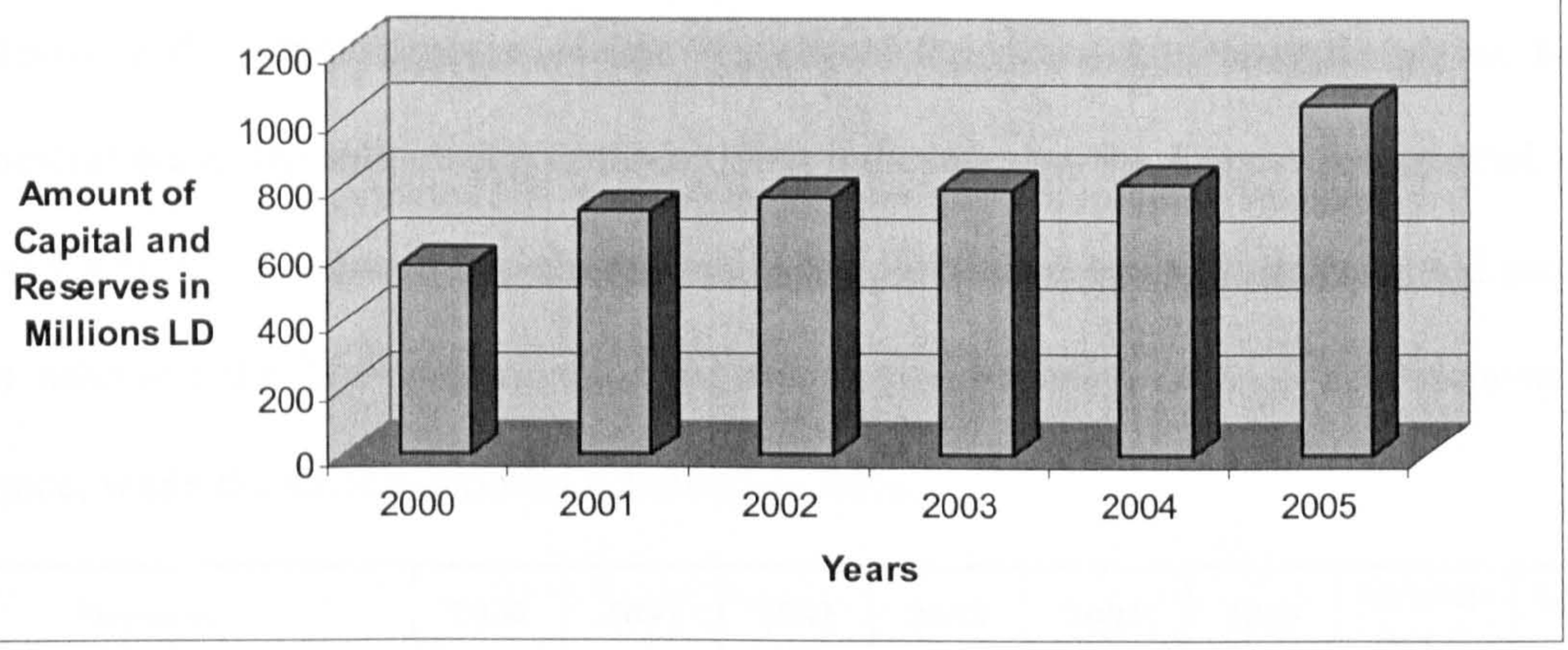
[466] Law No (1) of 2005Article No 73.
[467] Note: the CBL has yet to implement Basel I.

changes in the capital and reserves of the Libyan commercial banks during the period under review.

Figure 7.6: The Development of the Libyan Commercial Banks Capital and Reservers during 2000-2005 in Millions LD.



Source: 48th, 49th, and 50th Annual Reports of the CBL Fiscal Years 2004, 2005, and 2006, and the CBL Quarterly Economic Bulletins (2000-2005).

7.6.2 Deposits

Banks world-wide need steady and affordable sources of funds to earn profits. Their initial paid-up capital being restricted they need regular deposits to enable them to issue loans and made investments. It is clear that without deposit accounts, the banks, as institutions, would have very limited chances to make profitable investments and meet their other business expenses[468].

The term deposit refers to "funds placed with a bank in a savings account or in a demand account"[469]. Deposits can be considered as the major source of funds for bank lending them and represent claims by the banks' customers on their assets. Although the features of deposit accounts vary, four basic features characterize most deposit accounts: most of them earn

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[468] The Institute of Financial Education. *Retail Banking: Serving the Financial Needs of Consumers*. USA: The Institute of Financial Education, 1990, p. 53.
[469] Fitch, Thomas. *Dictionary of Banking Terms,* p. 117.

interest, set requirements for the initial deposit and maintaining a minimum balance, they are liquid accounts, and are protected by deposit insurance[470].

The Libyan commercial bank deposits can be divided into three categorizes: demand deposits and payment orders (in the case of Libya these are interest free), time deposits and cash insurances, and savings deposits. Table 7.8 shows the time-series analysis of the Libyan commercial bank deposits during 2000-2005. It indicates that the Libyan commercial banks achieved a steady growth in deposits during of 47.90%. The demand deposits and payment orders achieved the highest growth, 108.60%, comparing with 64% in time-deposits and insurance, while the saving deposits achieved 41.60%.

Deposits	2000	2001	2002	2003	2004	2005	Growth in LD	Growth %
Demand deposits and payment order	4745.4	5132.1	5801.8	6127.8	7683.6	9896.9	5151.5	108.60
Time deposits and cash insurances	2272.7	2747.6	2346.3	2823.7	2909.2	3735.4	1462.7	64.40
Saving deposits	416.0	506.5	559.7	615.7	685.91	671.3	255.3	41.60
Total	7434.1	8386.2	8707.8	9567.2	1278.7	1426.6	6829.5	47.90

Table 7.8: Trend Analysis in the Libyan Commercial Banks Deposit during 2000-2005 in Millions LD

Source: 48th, 49th, and 50th Annual Reports of the CBL Fiscal Years 2004, 2005, and 2006, and the CBL Quarterly Economic Bulletins (2000-2005).

As the first kind of deposit, demand deposits have increased remarkably. There are several factors which have caused this increase: first, the CBL placed on demand deposit specialized bank credits allocated for financing debt at modest rates of interest with commercial banks; second, the CBL closed many of the accounts of public companies and these companies, in turn, transferred these accounts to the commercial banks as demand deposits according to the CBL instructions; third, the open economy policy towards the world has increased the total

[470] The Institute of Financial Education. *Retail Banking: Serving the Financial Needs of Consumers*, p. 54.

amount of foreign capital in Libya. This has reflected positively on demand and payment orders and on total deposits in general. However, the main result of this huge increase of demand deposit accounts has been to increase the liquidity of the Libyan commercial banks.

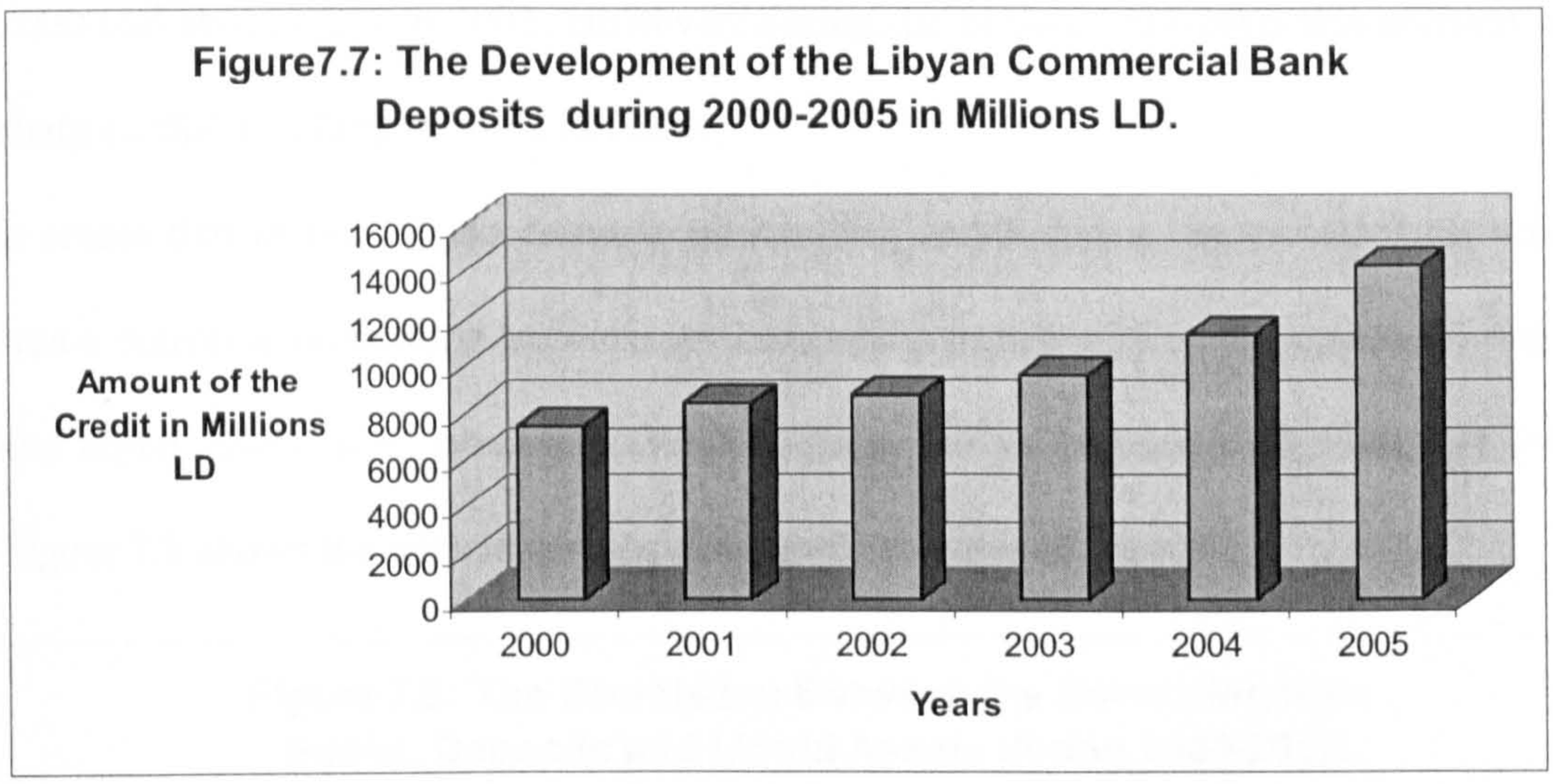
Time-deposits are second in terms of their importance and growth. In general, the accounts represent the deposits of the commercial banks with the CBL. During the period under review the accounts have shown significant development. They rose from LD 2272.7 in 2000, to LD 3735.4 in 2005. The initial increase can be related to the rise in total deposits by the government; second, the cancelling of the remaining sanctions that had been imposed by USA; third, the dramatic increase in the oil price.

In 2005, the CBL reduced its interest rate for commercial bank time deposits from 2.5% to 1.75%. The bank believed this would encourage the commercial banks to seek other domestic investment and finance areas to help in achieving the government's desired rate of economic growth. However, considering the contemporary economic circumstances, it could be assumed that this would also increase liquidity in the commercial banking sector as it could be assumed that the commercial banks would safeguard part of their profits as cash in vault.

The third type of banking deposit is the savings deposit. This account, according to the trend and time-series analysis, rose by 41.60% during the period under review. The increase prior to 2004 can be attributed to depositors' willingness to deposit money in these accounts and to obtain a profit from, in particular, the interest rate which varied between 5% and 6% in compliance with instructions from the CBL. In addition, the private commercial banks made an effort to encourage a wider sector of savers such as children and young people.

In 2004 the CBL harmonized the interest rate for individuals to a rate below a limit of 5% in accordance with the following classification: for the first LD 20.000 the rate was set at 5%; from LD 20.000 to LD 100.000 the rate was 4%; over LD 100.000 the rate was 0%. However,

Figure 7.7 summarizes the development of the Libyan commercial bank deposits during 2000-2005.



Source: 48th, 49th, and 50th Annual Reports of the CBL Fiscal years 2004, 2005, and 2006, and the CBL Quarterly Economic Bulletins (2000-2005).

7.6.2.3 The Borrowing Trend from Banks

The third source of funds for the Libyan commercial banks is borrowing from other banks. The banks in this case are the CBL and the domestic and foreign banks. However, these accounts constitute a very small portion of the commercial banks total liabilities. During the period 2000-2005 these deposits underwent a sharp decline, especially borrowing from the CBL and domestic banks. This can be attributed to the high level of liquidity. Table 7.9 gives a trend and time-series analysis of how borrowing from banks changed between 2000 and 2005

Bank Types	2000	2001	2002	2003	2004	2005	Growth amount	Growth %
CBL	119.1	90.2	61.3	32.4	0.0	0.0	(119)	(119)
Domestic banks	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign banks	29.0	57.2	93.5	131.5	59.2	30.2	30.2	104
Total	148.1	147.4	154.8	131.5	59.2	88.9	88.9	60.03

Table 7.9: Trend of Libyan Commercial Banks Borrowing from Other Banks in Millions LD during 2000-2005

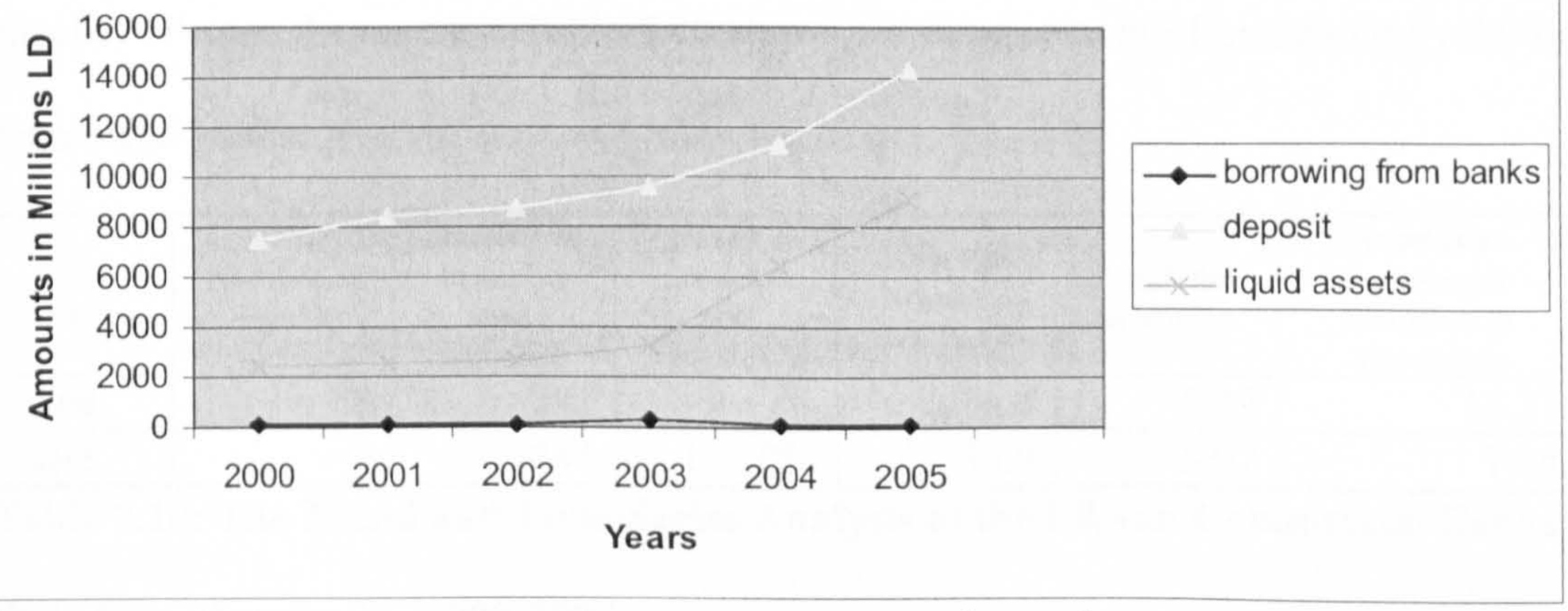
Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

Table 7.9 shows that borrowing from other bank accounts constitutes a very small segment of the total liabilities during the years under study. It represented 1.3% of the total liabilities in 2000 and about 2.2% in 2003. However, during the period 2004-2005 this account witnessed sharp declines, falling to .42% in 2005.

It seems that in the Libyan commercial banking sector during the period under study, there was a converse correlation between the borrowing from banks on the one hand, and deposits and liquid assets on the other hand. This could be due to the borrowing from banks declining.

Figure 7.8 shows the correlation between the three types of account.

Figure 7.8: The Correlation Between the Borrowing from Banks, Deposits and Liquid Assets during 2000-2005.



Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

7.7 The Growth of Banks Network: Branches

In the banking industry branching is the most important way to enter or open up a new market and gain valuable customers. Through their branches banks can offer most services that are available at the banks' head offices. According to Rose, branches are usually much cheaper to establish than a completely new bank[471]. Compared with establishing a new bank, branching

[471]Rose, Peter. *Commercial Bank Management*, p. 654.

needs less capital, less duplication of staff and far fewer administrative hurdles to clear than are required for obtaining a new bank charter[472].

However, there are still many factors to be considered in establishing new branches such as: location, design, customers' preferences and appointing managers and staff[473]. The decision of whether or not to establish a new branch is to a large extent budgeting decision which requires a large initial funds to purchase and lease the proposed site[474].

To promote the idea of banking amongst the people and boost savings in various productive sectors, however, the Libyan banks have not confined their activities only to the main cities. Widening participation in the economy's development has been the main objective of the sector. This has led the Libyan government to encourage its commercial banks to spread their branches all over the country. Table 7.10 shows the development of branching by the Libyan commercial banks.

Years	Number of Banks	Number of Branches and Agencies	Growth of Branches and Agencies %	Average Branches per Bank	Population in Million	Number of Persons per Branches in Thousands
2000	5	282	---	56.4	5.29	53.31
2005	9	444	17.70%	36.9	5.97	74.4

Table 7.10: The Trend and Time-Series Analysis of the Libyan Commercial Banks and their Branches during 2000-2005

Source: Annual Reports of the CBL, the CBL Economic Bulletins, and 48th and 49th Annual Reports Fiscal Years 2000-2005.

Table 7.10 shows that there was a remarkable growth in the number of bank branches during 2000-2005. In 2000 there were 282 branches owned by 5 banks. These banks were state-owned. However, by 2005 this number had risen to 444 branches owned by 9 banks, 4 of which were private commercial banks, in addition to the 5 state-owned banks. This increase in

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[472] Rose, Peter. *Commercial Bank Management*, p. 654.
[473] Ibid, p. 655.
[474] Ibid, p. 657.

the number of the banks can be attributed to Banking Low No 1 f 1993, which allowed the establishment of private banks in addition to the fast branching of the existing ones.

7.8 Summary

The Libyan commercial banking sector has witnessed a significant transformation during the period under review. Until 2005, the sector consisted of no more than nine banks. Nevertheless, there were 444 branches and agencies spread all over the country. Despite this growth, the entire commercial banking sector, both private and state-owned, is following the banking strategy drawn up by the CBL.

According to the IMF, these banks' statistical base, qualitatively and quantitatively, is still lagging behind those of other countries. Therefore, the figures shown on the balance sheets of these banks may not reflect their real potential.

The CBL has the formal power to control, regulate and supervise the commercial banks. On the one hand this produces rigid standards in such an area as liquidity. On the other hand, this close control and intervention has led to several severe problems such as: poor managerial autonomy and performance, a heavy legacy of non-performing loans and the failure of the commercial banks to attract deposits from individuals. Moreover, in these circumstances, banks have become less able to evaluate the credit conditions of their borrowers and therefore there are few risk management techniques being applied.

With regard to an open economic policy, the CBL has taken several important steps towards liberalizing the banking sector. One of these important steps was the partial liberalization of interest rates. However, the CBL in this connection needs to pay more attention to initiatives in other countries.

It is worth mentioning that despite new law regarding the entry of foreign banks into the country, as far as the domestic banking sector is concerned, no foreign bank has yet started up

in Libya. However, some foreign banks have set up representative offices to facilitate their needs.

Chapter Eight

Questionnaire Respondents Perceptions and Opinions on Financial Issues and the Potential for Islamic Banking in Libya

8.1 Introduction

The previous chapters attempted to present the research methodological framework and interview analysis alongside a financial analysis of the Libyan commercial banks. This chapter presents an analysis of the sample responses to the questionnaire administered in Benghazi, the second most important commercial city in Libya. As mentioned earlier a total of 713 questionnaires were randomly distributed to bank and non-clients. This procedure resulted in a sample of 140 completed questionnaires. The objective to this chapter is to present and discuss the overall responses of the questionnaire.

As this study is an exploratory study it was designed to make predictive statements. Moreover, the sample also has its special features. Therefore, any results or analysis should not be generalized at any level. This is because a set of determinant factors that have a significant role in the Libyan banking system may prove to be insignificant in another. In addition, there is no doubt that studies related to the banking industry in other countries have contributed substantially to banking literature, but their findings may not be applicable to Libya, due to differences in Libya's cultural, economic and legal environment. However, while there are many similarities in this study with others conducted in Libya, as we will see in the chapter context, there are also differences.

The analysis and discussion in this chapter are categorised into three sections which will be divided into a number of subsections. The first section provides profiles (demographic characteristics) of the respondents; the second section explores their banking background; the third section deals with their attitudes towards interest; and the fourth section surveys their attitudes towards Islamic banking. Finally, the chapter is summarised.

8.2 Respondents' Profiles

In order to carry out an analysis of the questionnaire findings, descriptive statistics were employed. The first part of the questionnaire dealt with the respondents' profiles and concerned various demographic factors such as age, occupation, level of education and marital status. Tables 1 to 6 present a comprehensive profile of the participants. It is worth mentioning that all respondents were bank clients.

8.2.1 Respondents' Ages

According to the Libyan Census of Population in 2006, the population is predominately young Almost 4% are over 65 of age, 61% between 15 and 64, and 35% between 0 and 14 [475] .This can be attributed to a high rate of population growth of about 3.3% during 1960-2003, which was higher than other North African and Middle East countries[476]. Recently, demographic growth in Libya has shown that the average population growth is 2%[477].

Regarding the demographic distribution of the respondents to the questionnaire, Table 1 shows that 6% of the sample were over 50 years of age, 16% were between 40 and 49 years, 33% were between 30 and 39 years old and 45% were between 20 and 29 years old. This distribution indicates that 78% of the sample was under 30. The results appear to be in line with the findings of M.J. Ali in 2005[478]. His study showed that Libyan banks need to provide modern banking services for this age group such as cash machines, bill payment technology.[479]

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[475] Source: Census and Statistics Department (estimated Census 2006).
[476] World Bank. *Report No. 30295-ly*. July 2006.
[477] Ibid.
[478] Jouada, Ali. *Level of Customers' Satisfaction About Banking Services Offered by Libyan Commercial Banks.* M.A. Thesis. University of Garyounis, 2005, p. 52.
[479] Ibid, p. 86.

Age	Freq	%
20-29	63	45
30-39	46	33
40-49	23	16
Over 50	8	6
Total	140	100

Table 8.1: Breakdown of the Respondents' Ages

8.2.2 The Respondents' Levels of Education

In Libya education is free to everyone from elementary school through to university and postgraduate education, whether studying within Libya or at a foreign institution. It is also compulsory between the ages of 6 and 15 at schools situated throughout the country. Furthermore, both males and females are admitted in all majors such as law, business, computer science, literature, security and engineering. It is worth mentioning that the most important influence for both sexes in choosing their subjects or fields of study are their personal interests[480]. However, the education system in Libya needs to take account of the future needs of the labour market, for this can help to a large extent in mitigating unemployment.

Table 8.2 shows that the respondents are distributed according to their level of education as follows: 79% of them hold at least a bachelor degree with a break down of 65% having a bachelor degree and 14% a postgraduate degree. 18% of the sample has a secondary school or comparable qualification while only 3% hold other qualifications (equal to secondary school). Record number of both boys and girls were enrolled in the education system during the 1970s and 1980s. It is true that the majority of Libyan families believe that education is an

[480] [On Line]. Available from: http://www.higheredu.gov.ly/. [Accessed on 12th December 2007].

investment for the future. To evidence this, according to UIS statistics data, in 2005, 84.2% of adults and 98% of youth in Libya were literate[481].

The results indicate that the utilization of banking services in Libya is predominantly the habit of well-educated people, and appears to be in accord with the findings of Jouada who reported that more than 57% of his sample held a bachelor degree or higher. According to his research recommendations, more sophisticated banking products and services should be offered as they can be easily handled by these well-educated people. Moreover, banks should inform and prepare less-educated people to accept these products and services.

Level of Education	Freq	%
University	90	65
Postgraduates	19	14
Secondary school or equal	26	18
Other qualification (equal to secondary school)	4	3
Total	139	100

Table 8.2: The Respondents' Level of Education

8.2.3 Respondents' Occupations

Table 8.3 shows that 68% of the respondents were paid employees of either the state, commercial or social organizations. 13% were self-employed and 19% were academicians. However, in 2004, 59% of the Libyan labour force was in the services sector[482]. A detailed

[481] UIS Statistics Data. [On line]. Available from: http://stats.uis.unesco.org/unesco/tabeViewer/document.aspx?ReportId=121&IF_languge=eng&BR_Country=4340. [Accessed on 20th September2007].

[482] The World Fact Book. [On line]. Available from: http://www.cia.gov/library/publications/the-world-factbook/goes/ly.html. [Accessed on 30th September 2007].

study showed that 62% of the sample was employed in the services sector[483]. This is because in Libya work in the public sector in general is more secure and provides greater social opportunities though it is not more financially rewarding.

Occupations	Freq	%
Paid employment		
a) For a state-government institution	80	59
b) For a state or self-government company	4	3
c) For a commercial company	6	5
d) For a social organisation or association	1	1
Self-employment	18	13
Academician	26	19
Total	135	100

Table 8.3: Breakdown of the Respondents' Occupations

8.2.4 Respondents' Gender

In Libyan society, women are permitted to hold bank accounts. However, it is their relatives: their husbands, brothers and fathers who usually visit the banks. Nevertheless, there are many Libyan women employees in the banking sector. The findings of an earlier study reported that 69% of Libyan banks' regular customers were males[484]. In general, the status of women in Libya is better than in many other countries, but women still face social hurdles[485]. Table 4 shows almost 70% of the respondents were males, while females accounted for about 30%.

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[483] Jouada, Ali. *Level of Customers Satisfaction about Banking Services Offered by Libyan Commercial Banks*, p. 52.
[484] Ibid, p. 52.
[485] Freedom House. [On line]. Available from: http://www.freedomhouse.org/modules/mod_call_dsp_country-fiw.cfm?year=2006&country=7002. [Accessed on 30th October 2007].

Gender	Freq	%
Male	96	69
Female	44	31
Total	140	100

Table 8.4: Breakdown of the Respondents' Gender

8.2.5 Respondents' Marital Status

Table 8.5 reveals that majority of the respondents in the sample, 57% were single, while 43% was married.

Marital Status	Freq	%
Married	60	43
Single	80	57
Total	140	100

Table 8.5: Respondents' Marital Status

The percentages of married and single respondents were not equal. Although, Libyan culture favours early marriage, recent circumstances are moving against it. There could be five reasons for this: first, the high rate of unemployment which was estimated in 2004 at 30%[486]; second, the new attitudes of many Libyan families in refusing their children approval to marry until they have finished their university degrees; third, in the present economic situation in Libya, income is not sufficient to run a home, hence young people must hope to marry a well-educated person in employment; fourth, many young people of both sexes have taken jobs or study in other Libyan cities or abroad. Hence, a culture of living on their own is developing; fifth, the majority of respondents are between 20 and 29 years of age.

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[486]The World Fact Book. [On line]. Available from: http://www.cia.gov/library/publications/the-world-factbook/goes/ly.html. [Accessed on 30th September 2007].

8.3 Respondents' Banking Backgrounds

In order to investigate the respondents' banking background, it was important to explore their monthly income; their monthly savings; where they hold their bank accounts; the types of account held; how long they had held their accounts ; how often and for what purpose they visited/ used the bank and their satisfaction with the services offered.

8.3.1 Respondents' Monthly Income

As table 8.6 depicts a significant majority of the respondents, 70%, earned between LD 200 to LD 300 a month; about 13% of them earned between LD 300 and LD 700; 10% earned between LD 900 and 1000; and only 5% earned more than LD 1000. So 83% of the sample earned between LD 200 and LD 700. This reflects the data behind Law No. 15 of 1981 regarding wages and salaries in Libya. However, only 68% of the sample was subject to this law (paid employments[487] and academicians). It needs to be emphasised that some respondents hesitated to answer this question and considered it too personal a matter. Table 8.6 shows the distribution of the respondents according to their monthly income.

[487] Someone who is paid to work for a person, organization, company or state.

Monthly Income	Freq	%
Less than 200	36	30
201- 300	50	40
301-400	4	3
401-500	4	3
501-600	2	2
601-700	6	5
701-800	0	-
801-900	0	-
901-1000	12	10
Over 1000	8	7
Total	122	100

Table 8.6: Breakdown of the Respondents' Monthly Income

8.3.2 Respondents' Bank Types

The respondents were asked whether they had their bank accounts with a state-owned or private bank or a state-owned and private bank. Table 8.7 reveals that state-owned banks supplied services to 86% of the survey respondents. A further 9% held their accounts with private banks. Only 5% of the sample indicated that they held their accounts with state-owned and private banks. Indeed, this segment used to hold their accounts with a state-owned bank prior to switching to the private banks. There are two possibilities why these respondents hold second accounts with a private bank: they were not satisfied with the services offered by the stated-owned bank or they use the state-owned bank to cash their salaries, wages and complete transactions, as a matter of necessity. One other reason might be the fact that service charges in the state-owned banks are lower. However, holding accounts in both private as well as state-owned bank enables respondents to make a useful comparison,

while evaluating service quality. Table 8.7 shows the distribution of the respondents according to their bank types.

Bank Type	%
Commercial state-owned bank only	86
Commercial private bank only	9
Commercial state-owned and private banks	5

Table 8.7: The Respondents' Breakdown According to their Banks

8.3.3 Respondents' Incentives to Open Bank Accounts

The respondents were asked what had motivated them to deal with their banks. Certain incentives motivated respondents to choose a specific bank: such as reputation, advice from friends and family members and advertising through the media. In his study regarding customer satisfaction and banking services in Libyan commercial banks, Jouada found that the requirement from the customer's employer the most important incentive to motivate a customers to open bank an account, followed by the bank's location, personal relationships and advice from relatives and friends[488].

Table 8.8 indicates that 44% of the respondents had opened their bank accounts on the instructions of their employers. This is because many organizations have entered into agreement with specific commercial banks to deal with their salaries and wages portfolios. 20% of respondents were attracted by the bank's reputation to open an account and 14% were motivated by advice from friends. However, advice from relatives, bank confidentiality and media advertising were less important in motivating the respondents. They counted for 7%, 4% and 1% respectively. Details of the respondents' incentives to their account with their banks are reported in Table 8.8.

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[488]Jouda, Ali. *Level of Customers Satisfaction about Banking Services Offered by Libyan Commercial Bank,* p .54.

Incentives to Deal with the Bank	%
Organization instructions	44
Reputation of the bank	20
Bank confidentiality	4
Advice from friend	14
Advice from relatives	7
Advertising through the media	1
No answer	7

Table 8.8: The Respondents' Incentives to Open Bank Accounts with Their Banks

8.3.4 Length of Time Accounts Hold

It was important to find how long and where respondents held their accounts in order to investigate their level of satisfaction with their banks. Table 8.9 shows that a high proportion of the respondents, 51%, had held an account with their banks between 6 and 9 years. Of the rest, 30% had held their account between 3 and 6 years, 10% for less than 3 years and 9% between 9 and 12 years. The results are similar to the findings of Jouada's study where 52% of his respondents had dealt with their bank for less than 10 years[489].

[489] Jaouda, Ali. *Level of Customers Satisfaction about Banking Services Offered by Libyan Commercial Banks,* p .56.

Banking Duration	%
Less than 3 years	10
3 to 6 years	30
6 to 9 years	51
9 to 12 years	9
More than 12 years	0

Table 8.9: How Long Respondents Have Held Bank Account

8.3.5 Respondents' Frequency of Visiting Banks

To explore the respondents' purpose for visiting their banks, it was important to investigate the frequency of their visits to their banks. Details of the respondents' frequency of visits to their banks are reported in Table 8.10.

Frequent Visit	%
Less than 1	17
1 to 3 times	77
3 to 6 times	4
Over 6 times	3
No answer	9

Table 8.10: Average Frequency of Visits to Bank per Month

Table 8.10 shows that a high proportion of the respondents, 77%, visited their banks 1 to 3 times per month, 38% of whom were women. However, on average, 17% of the respondents visited their bank less than once of whom 43% were women. Moreover, 7% of the sample visited their banks more than 3 times per month.

8.3.6 Respondents' Main Reasons for Visiting Their Bank

Banks are financial institutions that offer a wide range of financial services. They are the principal provider of such financial services as credit and payments for the purchase of goods and services. Moreover, banks are also sources for obtaining financial information and financial planning advice.

In the absence of advanced technology for delivering banking services in Libya's commercial banking sector, there are other reasons that lead respondents to visit their banks, such as making a deposit, inquiring about their balance and withdrawing cash (see Table 8.11).

Main Reasons to Visit Banks	%
To make a deposit	6
To get investment advice	1
To inquire about a balance	7
To withdraw cash	79
No answer	7

Table 8.11: The Respondents' Main Reasons to Visit their Banks

Table 8.11 shows that 4 out of 5 respondents visit their bank to withdraw cash. All of the respondents in this category were in the paid employment of either the state, commercial companies, social institutions or academies. This implies that Libyans still see banks as the normal place for making withdrawals from their monthly wages and salaries. However, 7% of the respondents visited their bank to inquire about their balance, 6% to make deposits and only 1% to obtain advice on investments.

8.3.7 Types of Account

According to Article 65 of Banking Law No.1 of 2005, Libyan commercial banks are companies that ordinarily accept deposits in current demand accounts or time deposits, grant loans and credit facilities, and engage in other banking activities.

Jaouda claimed that most commercial banks in Libya still provide traditional banking services such as current accounts and saving accounts. He stated that 97% of the people in his study sample held current accounts. He went on to say that current accounts were the bedrock of banking activity in Libya's commercial banks[490].

However, it was thought relevant to carry out a survey of the types of accounts held by the respondents in the present study to check for any possible changes which may have taken place since Jouda's study. Table 8.9 indicates 84% of respondents hold a current account, 10% have both a current account and a saving accounts, and only 3% hold a saving accounts. It is clear that only a small number of respondents use a saving account compared with a current account. This offers clear evidence of the limitation of service provision by the Libyan commercial banks. In addition, there is a lack of trust in the banking sector because of previous experiences of alterations to the currency and limitations on withdrawals, along with low rates of interest on personal saving accounts arising out of high levels of liquidity and a lack of appropriate investment opportunities, (as mentioned earlier). Table 8.12 illustrates the various types of account held.

Accounts Held	%
Current account only	84
Saving account only	3
Current and saving accounts	10
No answer	3

Table 8.12: Types of Accounts

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[490] Jaouada, Ali. *Level of Customers Satisfaction about Banking Services Offered by Libyan Commercial Banks,* p. 55.

8.3.8 Other Services Which Respondents Make Use of At Libyan Banks

The Libyan banks offer other traditional banking services besides saving accounts and current accounts, such as over draft, money transfers, personal loans, letters of credit and travellers cheques. How frequently these services are used is depicted in Table 8.13.

The Services	Yes %	No %
Internet banking	3	97
Self-service machines	3	97
Credit cards	1	99
Debit cards	1	99
Monthly bank statements	39	61
Telephone banking	4	96
Standard cheque-banking	51	49
Money transfers	7	93
Personal loans	10	90
Travellers cheques	4	96
Overdrafts	0	0
Letters of credit	0	0
L G	0	0

Table 8.13: Other Banking Services Used

Table 8.10 indicates that cheque usage stands at 51%. In additions, 39% of the respondents use their monthly bank statement. Other services, such as personal loans, money transfers, telephone banking and travellers cheques are little used at 10%, 7%, 4% and 4% respectively. It is also obvious that only a small number of respondents use letters of credit, internet banking, self-service machines and credit and debt cards. This is understandable because

some of these services, such as internet banking, self-service machines, telephone banking and credit and debit cards, are not generally made available by the banks. Partly this can be related to the generally undeveloped infrastructure in the banking industry. In addition, it could be that other parties in society provide some of these services more cheaply, e.g., money transfers and personal loans. This offers evidence of parallel financial systems.

However, because the majority of the respondents are in paid employment, none of them use services such as overdrafts, letters of credit and letters of guarantee. In a previous study concerning the level of customer satisfaction with banking services offered by the Libyan commercial banks, 37% of the sample population were self-employed and none of them used these services[491]. This might be because these banks impose conditions that are too arduous to make them attractive.

However, Jouada found that most of the respondents in his study stated that several of these banking services were very important and should be provided by all banks all over the country. According to Jouada's, priority was given to self-service machines, credit and debit cards and bill payments facilities[492].

8.3.9 Respondents' Monthly Savings

Personal saving is the proportion of a person's wealth that is not spent on current consumption[493]. The purpose of saving is to have resources available for an emergency and the purchase of new items. Respondents were asked about their monthly savings or deposits in their saving accounts. Table 8.14 summarizes the responses.

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[491] Jaouada, Ali. *Level of Customers Satisfaction About Banking Services Offered by Libyan Commercial Banks*, p. 57.
[492] Ibid, p. 59.
[493] Pass, Christopher and Lowes, Bryan. *Dictionary of Economics*. Glasgow: International Book Manufacturing Ltd. 1993, p. 484.

Monthly Saving	%
Imprecise percentages	42
Not applicable	51
No answer	7

Table 8.14: Respondents' Monthly Savings

Table 8.14 shows that 51% of the respondents were not making regular monthly savings, because they considered their monthly incomes was insufficient to save. 42% were unable to quantify the amount they saved each month It is worth mentioning here that all the respondents who said they were unable to save were in paid employment. This can be related to four factors: a) salary and wage constraint over a long period of time; b) a lack of accommodation between salaries, wages and prices; c) stereotyped Libyan consumption life styles; and d) the spread of *Takaful,* a form of joint saving between social groups such as friends and relatives. It is kind of "*musharaka* savings account"[494], where each member of a group is expected to deposit a certain amount of money every month for a specific period of time. It is the leader's duty to collect member contributions at the end of the month. At the beginning of every month, the leader hands the entire sum of cash to the group member agreed upon by the others as in the greatest need. Interestingly, in many cases the group's members do not know each other. Moreover, many people do not consider *takaful* as a kind of saving. There are different motives behind saving in this way: e.g., for matrimonial, religious or cultural ceremonies, and for buying gold, cars, land, and sometimes houses. However, 42% were able to make savings out of their monthly income even if the amount varied.

[494]It is worth mentioning that similar savings practices occur in other Muslim countries such as Egypt, and Bangladesh. See: Mohammed, A. A. Institutionalization and Promotion of Saving Habits Through *Bai-Muajjal* Mode of Financing. *Managerial Finance*. 29(2/3).2003, p .10.

8.3.10 Secured Loans from Banks

The previous part aimed at eliciting information on the respondents' monthly incomes and their monthly savings. This part deals with the respondents borrowing money from their banks.

The Statement of Respondents	%
Secured loans	20
Had not secured loans	73
No answer	7

Table 8.15: Secured Loans from Banks

Table 8.15 indicates that 20% of the sample had secured loans from their banks while 73% had not. It seems that respondents have other sources for borrowing when they are in need such as from family members and friends. In addition, they may have collateral in the form of valuable personal possessions to use in negotiations for cash with goldsmiths. This indicates that financing is still conducted the traditional manner in Libya.

8.3.11 Success in Securing Loans According to Ages

Table 8.13 shows that there are significant differences in the respondents' ability to secure loans from their bank. The ages of the respondents are very important in determining their future choices in this regard. Table 8.16 shows respondents secured loans according to age as follow: 47% of respondents between 30 and 39 years old did not, nor did 31% between 20 and 29 years old, nor 22% between 40 and 49 years old and no respondents over 50 secured any loan. Table 8.16 also indicates that 78% of the respondents who did not secured loans were under 40.

Age Groups	Secured Loans	Did Not Secure Loans
20-29	23	31
30-39	31	47
40-49	8	22
50 and over	38	0

Table 8.16: Acquisition of Loans According to Ages

Regarding the respondents who secured loans, Table 8.16 shows that 38% of them were over 50, 31% were between 30 and 39 years old, 23% were between 20 and 29 years old and only 85% were between 40 and 49. In the other words 54% were less than 40 years old. However, 46% of them were more than 40. This may reflect the influence of the commercial banking system on a society which is now more accustomed to life in an environment dominated by the system. And the domination of young age group in the sample is noteworthy.

8.3.12 The Purposes for Securing Loans

Investigating the purposes for securing these loans was also investigated. 31% were for house purchase, 31% for car purchase, 23% were secured for medical treatment abroad and 15% was for other reasons. However, in the absence of a cheap and effective public transport system or the desire to buy property, it can be assumed that the loans were secured out of personal necessity. Moreover, the respondents were aware that bank borrowing may lead to involvement with *fatwas* issued by certain scholars and, although dealing in interest may be permissible in cases of extreme necessity, which allows a person to act in a manner that would otherwise be forbidden[495]. According to these *fatwa,* once a person finds himself in a situation of necessity, he is obliged to do everything in his power to move away from the

[495] Interviews.

situation. He is not allowed to persist in the situation for ever. Table 8.17 shows a breakdown of respondents according to their reasons for securing a

Purposes	%
For house purchase	31
For car purchase	31
For medical treatment abroad	23
Combination of purposes	15

Table 8.17: Purpose for Securing a Loan

8.3.13 Respondents' Opinions on Service Quality between Private and State-Owned Banks

The banking sector in Libya has become relatively competitive in recent years. This is because the government has started gradually to move the industry from state-ownership towards privatization. In addition, a liberalization policy has been followed by a government aim of encouraging international players to engage in the sector.

In general, banks in Libya all deliver the same products and services. There is usually only a minimal variation in interest rates charged or the range of banking products available to customers. Thus, bank managements tend to differentiate themselves from their competitors through service quality. In order to investigate for any significant difference in banking service quality, respondents were asked which banks (state-owned or private banks) they considered provide the better services. Interestingly, everyone answered this question. The findings show in Table 8.18.

Respondents Statements	%
State-owned banks	31
Private banks	69
Total	100

Table 8.18: Bank Preference Based on Quality of Service

The findings indicate that most respondents, 69%, believe that private banks provide better service. Even though, 50% of them hold their accounts with state-owned banks. Nevertheless, while 31% believe that state-owned banks provide better services, only 24% of respondents hold their bank accounts with state-owned banks. This may indicate that the performance of state-owned banks in Libya does not enjoy general approval. There may be two reasons for this: low service quality and physically unattractive environment. Such dissatisfaction influences their customers' expectations and evaluation of their services.

The private banks spend millions of Dinars on prestigious head officers and modernising their branch networks and focus on providing high quality services in terms of fast delivery, an attractive physical environment, the appearance of their staff and the other gifts which the banks offer seem to have been well spent. This has led their customers, especially the young people, to engage in positive word-of-mouth advertising on behalf of their banks. It seems this positive word-of-mouth advertising is particularly effective in a collective Eastern culture like that of Libyan where social life is structured in a way to improve social relationships between the community and the individual.

8.4 Marketing

Marketing is considered as the essence of success in today's highly competitive world of banking and one of the main ways to promote customers' satisfaction. Banking services are often characterized by intangibility, perishability, and easy emulation. Output is variable with

high customer contact and a tendency to decentralisation. These characteristics have a considerable impact on the way bank customers perceive and evaluate the quality of bank services. Therefore, marketing research is increasingly focused on the commercial banks as more banks and financial companies strive for quality in their financial service provision. This section deals with the role in Libyan commercial banks: how it provides explanations and dispenses information, leaflets and advice concerning their present situation and their historical origin.

8.4.1 Opening an Account

Banks are institutions which deal with a broad range of financial products and services. As part of their commitment to transparency and accountability to their customers, banks provide them with sufficient information to choose the right services. This information usually comes in the shape of leaflets or consumer publications in addition to face-to-face information provided by bank staff. Leaflets and other bank publications allow customers to read and keep all the information they need on the bank's key commitments and responsibilities to its customers. The banks usually make sure that customers are given clear information about their products and services. However, basic details are also provided in their banks' publications. These publication explain: why the bank was founded; how customers can choose the right services and what choices are open to them; how to open bank accounts; what their terms and conditions are; their interest rates and charges, their systems of payment; how their customers will be told about any changes to services; how they deal with financial difficulties and complaints and, most importantly, the value they place on confidentiality and reliability in dealing with personal information. In words these publications and leaflets aim to give customers all the details they need to help them to reach a decision. However, to investigate the marketing role of Libyan banks, the respondents were asked if they had

received any leaflets or explanations about the services offered by bank and accounts when they started dealing with their bank. The findings are shown in Table 8.19.

Information Received	%
Received information	12
Did not receive any information	84
No answer	4

Table 8.19: Provision of Information to Prospective Clients

According to Table 8.19, 84% of the respondents did not receive any information or leaflets regarding their bank's activities. 88% of this group hold their accounts with state-owned banks. This means that only 1 in 8 respondents received any information about their chosen bank's activities. Moreover, usually, this information was verbal only.

8.4.2 Receiving Explanation as a Client during Banking Experience

Today in banking as in other service industries, customers must remain alert to constant environmental changes. This is another basic function of marketing in which the banks send their customers information related to changes in interest rates, terms, conditions and advertise their new services and products. Moreover, the banks train their staff to effect these changes and convince the customers. When the respondents were asked about receiving any information regarding changes in their dealing with their or new baking products, 89% of them said that they did not receive such information. Only 6% stated that they received their information either monthly when drawing their wages and salaries or on request. 4% gave no answer. Jouada's similarly found that 85% of those in his study stated that they did not received any information relating to changes in services, products or charges, while 15% only

received such information on request[496]. Table 8.20 details findings of the information respondents received from their bank.

Information Received	%
Yes	6
No	89
No answer	4

Table 8.20: Notification of Changes to Customers by Banks

Table 8.20 indicates the insignificant role that marketing plays in Libyan commercial banking. This can be related to three factors: first, the absence of specialist departments devoted to marketing as mentioned earlier; second, the failure of management to understand the benefit that good marketing can bring to their banks. El Sheref discovered that Libyan managers neither understand nor try to understand the nature or importance of marketing[497]; third; the absence of basic infrastructures such as post codes and mail services that can facilitate the delivery of these services.

8.4.3 Satisfaction Levels

Customer satisfaction is a significant issue for banks as customers are becoming increasingly sophisticated as they gain access to the latest forms of information technology, such as the internet. Consequently, many commercial banks are increasing their focus on customer satisfaction and customer retention by trying to improve their range and quality of their

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[496] Jaouda, Ali. *Level of Customers Satisfaction About Banking Services Offered by Libyan Commercial Banks,* p. 63.

[497] El Sheref, Ahmed. *Perception of Banks' Managers to Bank Marketing Concept and Its Application to Libyan Commercial Banks: A Field Study M.A.* Thesis. University of Garyounis. 1998, p. 69.

service provision. The respondents were asked to express their satisfaction towards their banks' services. Table 8.21 shows their responses.

Respondents' Satisfaction Degree	%
Strongly satisfied	4
Satisfied	41
Undecided	10
Dissatisfied	28
Strongly dissatisfied	10
No answer	7

Table 8.21: Level of Respondents' Satisfaction

According to Table 8.21, almost 45% of the respondents were satisfied with their banks services, while dissatisfied respondents accounted for 38%. 10% of the respondents were not decided on their banking satisfaction. A contemporary study on banking regarding customers' satisfaction found that 56% of them were satisfied with Libyan commercial banks services. However, customers were found to be most satisfied with the products or services they use most[498].

8.4.4 Respondents' Preferred Banking Criteria

In planning an appropriate marketing strategy for attracting more customers, banks need to identify the criteria by which potential customers choose a bank[499]. According to Chen, in 1979, the concept of Critical Success Factors (CSF) was defined for the first time[500]. CSF can

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[498] Al-Tamim, Hassan, and Al-Amin, Abdulla. Analyzing Service Quality in the UAE Islamic Banks. 8 (2). *Journal of Financial Services Marketing*. 2000, p. 122.
[499] Almossary, Mohammed. Bank Selection Criteria Employed by Students in Bahrain: An Empirical Analysis. *International Journal Bank Marketing*. 19(3), p. 115.
[500] Chen, Tser-Yeth. Critical Success Factors for Various Strategies in the Banking Industry. *International Journal of Bank*. 17(2). 1999, p. 83.

be defined as "the limited number of areas in which results, if they are satisfactory, will ensure successful competition performance for the organisation". CSF can be a useful tool to help management focus attention on areas that can bring success to their organisations[501]. In general, there are two attempts to identify CSF: a) identified them as a number of factors; b) rank them according to their relative importance.

In the banking industry, researchers suggest three critical aspects in a competitive market: a good reputation, width and depth of products and services, and low operating costs[502]. To discover what constitutes a good bank in the eyes of the respondents in this study, the following points were included in the questionnaire: a) a wide branch network and the proximity of the nearest bank; b) new products and services; c) privacy and data protection; d) a management team with a great deal of experience and a high degree of competence; e) low service charges.

In order to determine the relative attractiveness of these factors, the respondents were asked to rank them from 1 to 5, using 1 to indicate the most important and 5 to indicate the least important option for them.

Table 8.22 indicates that 43% of respondents ranked privacy and data protection first. 33% of the respondents' ranked a wide branch network fourth; and 38% ranked low service charges as the fifth most important factor.

This shows that respondents have realized the importance of personal information and fear misuse. Privacy and data protection at present are crucial for building confidence in a bank. It is worth mentioning that, presently, there are no comprehensive laws regulating the use of data in Libya. Instead, there are Articles in banking law which deal with narrow concerns and have limited value. Most of the privacy Articles on banking law in Libya are directed at how

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[501] Chen, Tser-Yeth. Critical Success Factors for Various Strategies in the Banking Industry. *International Journal of Bank*, p. 83.
[502] Ibid, p. 84.

the CBL deals with information not with the industry[503] and particularly with the increasing use of computers within the banking sector[504]. Solutions to this problem lie jointly between government, the CBL, the banks and their customers. These parties should work together to develop law concerning the use of private information with in the banking sector.

The second most important factor for bank success selected by the respondents was management experience and a high degree of competence. 33% ranked this factor first. Only 3% of the respondents ranked this factor fifth, 19% and 14% of the respondents ranked management experience and a high degree of professionalism third and fourth respectively.

The third, most important factor for the respondents was the new customer's services: 27%. Only 15% of the sample ranked it fifth; 21%, 19% and 18% of the respondents ranked this factor first, second and fourth in that order. One can conclude that in future these customers may seek a new service provider out of feelings of neglect or a lack of appreciation for their patronage by their current banks.

The fourth most important factor given by the respondents 33% was a wide branch network and the convenience of proximity to their bank. This means that wider branch networks may the increase of a bank's customers. 29% of the respondents ranked this factor first. However, low service charges were the least important factor for of the respondents 38%.

According to the respondents, a bank's success depends mainly on five factors: privacy and data protection, management experience and a competence of professionalism, new products and services, a wide branch network, and low service charges. The results are shown in Table 8.22.

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[503] See Articles No 61 and 62 of the Libyan Banking Law No. (1) of 2005.

[504] El-Shukri, Aisha. *The possibility of determining the cost of major services in the Libyan commercial banks.* MA thesis. University of Garyounis. 1998, p. 154.

Factors	First Rank	Second Rank	Third Rank	Fourth Rank	Fifth Rank
A) A wide branch network	29	15	11	33	12
B) New products and services	21	19	27	18	15
C) Privacy and data protection	43	25	18	14	0
D) Management experience and competence.	33	31	19	14	3
E) Low service charges	20	9	13	20	38

Table 8.22: Evaluation of Desirable Characteristics in Libyan Banks

8.5 Respondents' Attitudes Towards *Riba* or Interest

Among the most important teachings of Islam for eliminating exploitation and establishing justice in business transaction is the prohibition of *riba* or interest. Islam does not consider money as a commodity but a medium of exchange and a store of value. Therefore, *riba* or interest is completely prohibited under Islamic law. This leaves no room for arguing that *riba* refers to usury and not interest. Indeed, most prohibitions in Islam are easy to understand. In moral terms, a society which encourages interest for instance on lending will require needy people to pay back more than they borrowed, which quite often is a huge burden. This section, hence, deals with respondents' attitudes towards *riba* or interest.

8.5.1 *Riba* and Profit

Recently, the prohibition of interest or *riba* has been one of the most discussed issues between Libyans. This is because they want their financial dealings to be lawful and according to Islamic doctrines. The aim here is to investigate the impact of interest on respondents' lives. Therefore, the respondents were asked if they had ever received interest from their banks deposits. Table 8.23 shows that 99% of the sample had not. It can be seen from Table 8.23

that the respondents, regardless of age, gender, income, education or occupation, expressed a high degree of awareness of the Islamic prohibition of riba or interest.

Respondents Statements	%
Against profit from interest	99
For profit from interest	1

Table 8.23: Respondents Attitudes to Profit from Interest

8.5.2 Influence of Age on Attitudes to *Riba*

The age of respondents is a very important factor in choosing a bank as well as determining the bank's ability to provide them with a full range of Islamic banking services. Regarding the respondents who had not profited from bank interest 99% as depicted in Table 8.23, only 3% of them were over 50 years old, 14% were between 40 and 49, 38% were between 30 and 39 years old, and 45% were between 20 and 29. In other words, one can conclude that 83% were under 40. This suggests enormous opportunities for Islamic banking in Libya. Only one in six were over 40 years old. This is justifiable because the respondents believe that interest is against their religion, so they refuse to entertain it in their lives. This means that the consistent refusal to be involved in interest is governed by behaviour not by attitudes.

Age Groups	%
20-29	31
30-39	26
40-49	10
Over 50	2

Table 8.24: Abstainers from *Riba* According to Age

8.5.3 Willingness to Grant Loans with Interest

Islam offers a complete explanation of what constitutes *riba,* and its consequences on humanity. This clear and comprehensive understanding allows Muslims to discern what is

lawful and what is forbidden. This is crucial to overcoming confusion and following Islamic ways for conducting business. In order to gauge their determination to shun interest, the respondents were asked if there were any incentives that would make them grant loans with interest. The answers for this question are displayed in Table 8.25.

Respondents	%
Willing	20
Not willing	80

Table 8.25: Respondents' the Possible Incentives to Grant Loans with Interest

It is clear that 80% of the respondents stated that there were no incentives that could force them to grant loans with interest. In contrast 20% said that they would grant loans with interest but only in case of necessity. These findings are in line with the statistics showing some interest-bearing loans were offered and accepted out of necessity. However, 80% of those who had secured loans felt guilty on religious grounds, in comparison to the 2% who felt normal about borrowing money. A further 8% and 10% felt their loans were too expensive and that they had been exploited. The results are shown in Table 8.26.

Respondents' Feeling	%
Felt normal	2
Felt loans were too expensive	8
Felt exploited	10
Felt guilty on religions grounds.	80

Table 8.26: Respondents' Feeling towards Securing Loans

8.5.4 Bank Interest and *Riba* in Respondents' Views

Islam permits increases in wealth through economic and financial activities, while it prohibits unlawful increases, such as through interest regardless of whether the rates are low or high. Unfortunately, in the Libyan banking sector, the transactions can involve interest. Thus it is becoming increasingly difficult for the majority of the citizens to abstain from dealings which involve interest. However, in order to investigate respondents' views regarding a possible correlation between *riba* and interest, the respondents were asked if they believe that bank interest and *riba* are one and the same. Interestingly, every respondent agreed that bank interest and *riba* are the same. The results are shown in Table 8.27.

Respondents Statements	%
Interest and *riba* are the same.	100
Interest and *riba* are not the same.	0

Table 8.27: Bank Interest and *Riba* in Respondents Views

8.5.5 Respondents' Views on Bank Transactions with Other Organisations involving Interest

According to the findings to the previous question, respondents believe that interest without any doubt is *riba* and it is unlawful. This encouraged the researcher to examine the respondents' deeper understanding of interest as *riba*. Therefore, they were invited to express their opinions regarding bank transactions with other banks and organisations involving interest. Table 8.28 indicates that 81% of the respondents believe that banks should not be allowed to deal with other banks and organisations whose loans may be interest-based. On the other hand 19% of them believed that banks should be allowed to deal with other banks and organisations on an interest basis. However, the opinions of this particular group of respondents reveal that they misunderstand the dynamics of *riba*. For them understanding *riba* is not a cognitive opinion, but rather a dogmatic one that is conventionally accepted

without doubts. Therefore, they find it is difficult to arrive at the right judgement. This misunderstanding is not just a miscalculation; it is the result of a lack of understanding of key terms in *fiqh* jurisprudence as related to transactions in Islam.

Respondents Statements	%
For	19
Against	81

Table 8.28: Respondents Approval of Interest Based Banks Transactions with Other Organisations

8.6 Respondents' Attitudes towards Islamic Banks

Banking is the most developed part of the Islamic financial system. Although the principles of Islamic banking differ from those of conventional banks, both serve as financial intermediaries and act as links between savers and investors, and undertake the financing of economic and social development activities for the benefit of the people. However, the rapid development of Islamic banking has led conventional banks to seriously consider its growth. This situation calls upon to develop cooperation between one another. However, the aim here is to the explore respondents' attitudes towards Islamic banking.

8.6.1 Respondents' Understanding of Islamic Banking

The contrast between the conventional and Islamic banks is understandable. Recent developments have resulted in an increasing number of Islamic banking studies. These studies have aimed at developing a deeper understanding of the subject but also gauging people's knowledge regarding Islamic banking. The respondents in this study also were questioned on their knowledge of differences between conventional and Islamic banks. Table 8.27 shows that 24% of respondents said they believed there are differences between Islamic and

conventional banks but they cannot cite any. Table 8.29 also shows that 76% of the respondents can think of no difference between Islamic banks and conventional banks.

This may sound contradictory to the findings presented in the previous section regarding people's attitude towards *riba* in which a large majority said they were against riba. The reasons for this apparent contradiction are related to people's construction and definition as individual and as members of an institution. Owing to the political revolution in the economic sphere during the 1970s and 1980s, and to salary and wage constraint over a long period, a people's justification for dealing in interest with institutions, in particular with public institutions, has emerged. However, they are adamantly against involving interest between individuals. This can explain the differences in the opinions of the participants in providing apparently contradictory answers to the concept of *riba* and its institutional expression in a banking context.

Respondents Statements	%
Believe	24
Disbelieve	76

Table 8.29: Percentages of Respondents Believing There Are Difference Between Islamic Banks and Conventional Banks

Table 8.28 shows 76% of the sample have no knowledge of differences between Islamic and commercial banks. However, while the number of publications concerning Islamic banking principles and their application in the international sphere has grown rapidly, these particular of respondents show that in Libya little of this has been disseminated and followed. It could be that this gap in Islamic banking knowledge is temporary for there are now various Muslim bodies emerging which can provide a general explanation of Islamic banking principles. This would certainly make Libyan society more familiar with the general principles and culture of

Islamic banking practices which, in turn could be expected to increase familiarity with Islamic banking within the society and facilitate its introduction nationwide. As a consequence, Libyans may respond positively and participate in Islamic banking operations. In this event it is likely that the Libyan government would follow suit.

According to Haron and others, a decade after an Islamic bank was first established in Malaysia, only about 63% of the country's Muslims have understood either partly or completely the difference between the Islamic and conventional banks[505]. However, only 24% of the respondents in this Libyan study knew the difference between Islamic and conventional banks.

8.6.2 Source of Knowledge on Islamic Banks

As shown in Table 8.28, 24% of the sample do have knowledge of differences between Islamic and the commercial Libyan banks and all of them hold at least bachelor degrees. However, the sources of their knowledge come mainly from television and radio, 58%, 21% from friends and family members, 12% through visits abroad and only 9% through newspapers and magazines. The results can be seen in Table 8.30.

Sources of Knowledge	%
Newspapers and magazines	9
Television and Radio	58
Friends and family members	21
Visits abroad	12

Table 8.30: Sources of Knowledge on Islamic Banking

[505] Haron, Sudin. Ahmad, Norafifah, and Planisek, Sandra, L. P. Bank Patronage of Muslim and Non-Muslim Customers. *International Journal of Banking Marketing*. 1994, 12(1), p. 38.

8.6.3 Islamic Bank Utilisation by the Respondents

In Libya people used to deal with chartered banks controlled by the state. They did not follow or were unable to obtain banking products or services governed by Islamic doctrine. These banks received demand deposits and time deposits, made loans, invested in securities, and paid and received interest on these services. Therefore, the respondents were asked whether they agreed that if interest-free banks opened up throughout country, people would use them. As the results in Table 8.30 indicate, 58% of the respondents strongly agreed, 29% of the sample agreed. Interestingly, no respondents disagreed or disagreed strongly. Only 9% stated they did not know and 4% gave no answer. One can conclude that 87% of the respondents agree that should interest-free banks open up in the country Libyans will use them.

Respondents Statements	%
Strongly agree	58
Agree	29
Disagree	0
Strongly disagree	0
Do not know	9
No answer	4

Table 8.31: Respondents and Islamic Banks Utilisation

8.6.4 Willingness to Transfer Accounts to Interest-Free Banks

The respondents were asked if banks which did not charge interest on loans were to open would they transfer all their bank accounts to them. Table 8.32 shows that 93% of the respondents stated that they would transfer all their bank accounts and transactions to the interest-free banks, while only 7% declined. The results of this part may sound contradictory with the result established in the previous section that people do not see any difference between conventional and Islamic banks. Yes, the results in this section demonstrate that

might well transfer their accounts to Islamic banks if there was an opportunity. This contradiction could again be explained because of people's as a result of political revolution and the suppression of wages and salaries. In other words, people may have fixed opinions regarding riba and its implication, but voicing their concern in the public sphere is another matter. Thus, they would consider transferring their belief in the tenets of Islam.

Responses	%
Willing	93
Unwilling	7

Table 8.32: Willingness to Transfer Accounts to Interest-Free Banks

8.6.5 Reasons why Respondents Would Transfer their Accounts to Interest-Free Banks

The respondents were asked what would motivate them to transfer their accounts to interest-free banks. In the case of conventional banks, it is assumed clients transfer their accounts to other banks because of higher (rates of interest) profits, a wider range of services and better access to finance and competitive services. In the case of interest-free banks other factors of an ethical or religious nature may be involved. Table 8.33 indicates that 60% of respondents see religion as the only reason to transfer their accounts and transactions to interest-free banks. 3% cited ethics as the sole reason and another 3% indicated social reasons. 29% of respondents said that a combination of the previous reasons would be sufficient reason for them to transfer their accounts and conduct their transactions in interest-free banks. However, religion was the most important reason for the respondents to transfer their bank accounts.

Reasons	%
Religious	60
Ethical	3
Social	3
Combination of the above reasons	29
No answer	5

Table 8.33: Reasons for Transferring Accounts to Islamic Banks

8.6.6 Islamic Bank Patronage

Table 8.32 indicates that 93% of respondents would transfer their accounts and transactions to Islamic banks if they had the option. Table 8.33 reveals that 60% of the respondents would transfer their accounts for religious reasons. However, to examine the respondents' levels of commitment to Islamic banks, they were asked if they would transfer their deposits to an interest-free bank even it is announced that it had no profit to distribute on its accounts at the end of the year. 39% of the respondents indicated that they would keep their deposits with the bank, 27% answered that they would retain their deposit at the interest-free bank because it could distribute good profits in subsequent years. 9% said they would consult relatives and friends then decide what to do and only 1% indicated they would withdraw their total deposits at once and transfer them to a commercial bank, while 7% gave no answer. One can assume that roughly 75% of the sample have positive attitudes towards Islamic banks. The results are shown in Table 8.34.

Respondents Statements	%
Keep the deposit with the same bank	39
Retain a deposit with the banks because it of high future profits	27
Consult relatives and neighbour	9
Withdraw all deposits and switch them to commercial banks	1
I do not know	17
No answer	7

Table 8.34: Ongoing Patronage of Islamic Bank with No Profit-Sharing

8.6.7 Islamic Banking Provision

In 1974, the first private sector Islamic bank was established in Dubai. The pioneering effort soon led to more Islamic banks in the Middle East and other parts of the world. The substantial and unexpected growth of Islamic banking has led many governments to modify their banking laws to permit Islamic banking and its attendant services. Therefore, the respondents were asked that if interest-free banking were to be provided in the country, who would they like to provide the services. Table 8.35 confirms that 63% of the respondents preferred such a service to be provided by the state. This could be related to three factors: first, the Libyan monetary authorities have imposed firmer and tighter control on the private banks compared with the state-owned banks and they provide less support to them. This could limit the expansion and success of these banks. Second, the private sector had a rather bad economic experience as a result of the revolution (change in the national economic system) during the 1970s and 1980s in terms of nationalisation and hence the termination of the private sector. Third, the political attitudes towards Islamic banking in general are favourable. However, 13% see the private sector as a suitable provider of services. Only 3% see the foreign banks as suitable providers for Islamic banking services while 4% proposed the

commercial banks as the Islamic banking provider and 7% gave no answer. Table 8.35 shows the respondents attitudes.

Respondents Statements	%
The state	63
Commercial banks	4
Private banks	13
Foreign banks	3
No answer	7

Table 8.35: Respondents' Attitude to Islamic Banking Provision

8.6.8 An Islamic Banking Address

Nowadays, there are hundreds of Islamic banks operating all over the world, from Africa and Europe to Asia and America. Moreover, all major conventional banks in many western as well as eastern countries have opened windows under the name of Islamic banking windows or *sharia* windows once they realised the huge benefits of an Islamic banking system on their profits. Furthermore, as the system is based on the prohibition of levying and paying interest, it is commonly called interest-free banking. The respondents, therefore, were also asked if interest-free banking were to be provided, how would they prefer it to be called, addressed, or referred to.

Table 8.36 indicates that 45% of the sample preferred the service to be called Interest Free Banking Services, 28% preferred it to be called Muslim Commercial Banking, 18% saw it as *Sharia* Compliant Banking, 6% and 3% preferred it to be called Social Banking and Ethical Banking respectively. Most importantly nobody wanted the service to be called Islamic Banking Services. This can be interpreted as clear evidence of political attitudes and an association of Islamic banking with terror and providing corridors for circulation of funds

among terrorists. According to Zamir, "Terrorists have no religion. They can have accounts in any bank"[506]. However, with the opening up of the economy to the world, the Libyan government should regard Islamic banking as part of mainstream banking. Thus, Islamic banking could operate under the supervision of the Central Bank, receiving clients' deposits and investing them. Therefore, the government and regulatory body should cooperate and gradually remove barriers and make Islamic banking a viable and approved part of Libya's banking industry

Respondents Statements	%
Islamic banking services	0
Interest-free banking services	45
Muslim commercial banking	28
Sharia compliant banking	18
Social banking	6
Ethical banking	3

Table 8.36: Islamic Banking Service Addresses

8.7 Summary

In this chapter, different opinions of Libyan respondents have been presented in relation to conventional financial and banking matters but their opinions and preferences are also revealed on Islamic financial and banking services. The objective of this chapter was to provide a description of the respondents' views in order to enable the reader to understand their nature and attitudes better.

The majority of the respondents were aged between 20 and 39 years, indicating that most of them were of the younger generation. This has the advantage of allowing the financial

[506] Zamir, Zahid. Why this Hullabaloo over Islamic Banking ?. *The Daily Star*. 5(754). July 21 2006.

authorities to study and consider the needs of this generation when designing and introducing new banking services and products.

The educational level of the sample was very high, with most of them holding university degrees or higher qualifications. This finding provides bank managements with a powerful incentive for providing more sophisticated products and services which they are fully capable of handling. Moreover, the banks should take the opportunity to prepare less-educated clients to use them also.

The majority of respondents visit their banks between 1 and 3 times per month. The main reason for this visit is to withdraw money. A high proportion of the respondents have held their accounts with their banks for between 3 and 9 years and most hold their accounts in state-owned banks in accordance with their employer's instructions.

Current accounts are the services used most provided by the Libyan commercial banks, and many respondents have confined themselves to using this service only. This is not because they are unaware of other services, but because they either do not require them or are unable to fulfil the required conditions for these services.

Despite the absence of a marketing function in the Libyan commercial banking sector, in general, the results show that the respondents are satisfied with the range of the products and services provided by their banks. Moreover, the respondents see that private banks are now providing better and more competitive services than the state-owned banks.

Regarding Islamic banking and other finance matters, Islam, as a religion in Libya, was found to be the main factor influencing the respondents' attitudes towards interest and secured loans. Thus, they are evidently cautious about profiting from interest either through lending or saving and consider this as *riba*. For this reason, the respondents showed positive attitudes, and are happy to support and patronise Islamic banking establishments in Libya. This can explain the growing demand for introducing Islamic banking services into the country, despite

the general population having little understanding of its principles and its differences from conventional banks. Finally, most of the respondents consider the state as the most provider for such a service under the address of interest-free banking rather than Islamic banking. It maybe possible to this in relation to political positioning in the country.

Chapter Nine

Interviewee Perceptions and Opinions on the Provision of Islamic Banking Services in Libya

9.1 Introduction

This study, as mentioned previously, aims at exploring the potential for Islamic banking in Libya. For this reason, in addition to the questionnaire, interviews were conducted to gather primary data on the perceptions and opinions of the participants. Thus, the aim of this chapter is to discuss the interviewees' perceptions on various matters related to the potentional provision of Islamic banking in Libya.

The sample of the interviews consisted of ten individuals ranging from two chairmen of boards, one general manager, one department manager, two jurists and four scholars. It is important to note that these interviewees have a close attachment to the banking sector, and in some cases, they combine two positions at the same time, such as members of the general assembly and jurists. Moreover, they are well-informed about Islamic finance and Islamic banking.

In this chapter, the first section reveals the criteria for the interviewees' sample. The second section considers their perceptions on the Libyan Islamic banking establishment, such as the role of the *sharia* institutions and scholars in Libyan society, and the possibility of establishing Islamic banking as an appropriate regulatory system in Libya. The third section considers *sharia* supervision such as whether *sharia* can be applied, whether there are enough people suitably qualified in *Fiqh almua'mat* in Libya, how sharia supervision could be implemented, and who would appoint and approve *sharia* board members. The fourth section outlines channels for providing Islamic banking in Libya.

It is worth mentioning here that in some areas there was a measure of agreement between interviewees. However, we can assume that nearly all the interviewees had the same attitude

and vision regarding the establishment of Islamic banking in Libya. Table 9.1 reveals the occupations of the interviewees.

Interviewees	First Position	Second Position	Third Position
A	Chairman of Board Directors	----------	----------
B	Chairman of Board Directors	----------	----------
C	General Manager	----------	----------
D	Department Manager	----------	----------
E	Jurist	Academia	Member Board Directors
F	Jurist	Scholar	General Assembly member
G	Scholar	Academia	----------
H	Scholar	Academia	----------
I	Scholar	Academia	----------
J	Scholar	Academia	----------

Table 9.1: The Interviewees' Positions

9.2 The Criteria of Interviewees' Sample

As already mentioned, the total number of interviewees was 10. Specifically, 4 interviewees held only one occupation; they worked in the Libyan commercial banking system over a long period of time. 4 other interviewees hold two occupations, all of whom have a close attachment to the Islamic economy through their specialist field of *fiqh al mumalat*. They have also published articles and books in this field. In addition, they are members of the *fatwa* board of the General Endowments Board and *Zakah*. Moreover, 2 interviewees, who also have close links with the banking sector through their investments, represent their banks in

legal matters and are members of their banks' boards of directors, as can been seen in Table 9.1. However, only 60% of the sample are scholars, jurists, and bankers who practice social *Urf* (social custom) in society.

It should be noted that the interviewees in the sample are well-informed people on the subject of Islamic finance and banking, compared with the other interviewees in the main sample. As far as these interviewees are concerned, their knowledge was gained either during their studies or from attending courses related to the subject, which was very rare in the sector, or from their experiences working with international banks.

9.3 Analysis of the Interviewees' Perceptions on the Libyan Islamic Banking Establishment

The open-ended question was the main tool used in the interviews. These questions related to the role of the Islamic institutions and scholars in Libyan society, to the structure of sharia boards, the availability of the *sharia* board members, and to the regulation of Islamic banks or windows whenever they exist. Therefore, the main aim of the following paragraphs is to pursue the perceptions on these subjects.

9.3.1 The Role of *Sharia* Institutions and Scholars in Libyan Society

In contemporary Libyan society, religion is of the greatest importance to the members of the traditional units of the family, the clan and the tribes. Religion dominates the structures, values and attitudes of society.

However, the main aim of the first question is to assess the importance of the Islamic institutions and the scholars' role in Libyan society. This was to help interviewees become familiar with the interview topics. The first question was:

In your experience how do you see the role of the sharia institutions and scholars in Libyan Society?

The findings reveal that all interviewees agreed on the important role that *sharia* institutions and scholars have been playing in the society. In this respect interviewee H stressed the important role that the religious institutions, their educational institutions, the mosques and their leaders have played in the social, political, educational and financial life of the Libyan people. He went on to emphasize that as a result of religion's powerful role, Libya's Islamic society has developed its own special features and overcome all attempts to change its identity as a Muslim society. He summarized these features by saying it is *Sunni Muslim* society, with the *Maliki school* being the predominated *madahab*.

According to scholar interviewee I, the role was extended to cover the international sphere. As a result, many of the Muslims leaders in Africa, Europe and other Islamic countries, had been students enrolled in institutions. He mentioned the role of Al-Jaghbub University (south east Libya) in spreading Islam in Africa in ancient times. According to I it was one of the oldest Islamic Universities in the world and he believes its may be older than Al-Azahr University in Egypt[507]. He mentioned also the role that the Islamic University in Bayda[508] has played in teaching and training Muslim intellectual leaders from all over the Islamic world. Moreover, he further described the significant role which the Islamic Mission Society has played in Africa and poor Muslim countries. In addition, interviewees I and H mentioned the extremely poor role played by the organisation within Libyan cities apart from Tripoli. Both of them believe this could be one of the main reasons in the failure to understand the conceptions and practices of Islamic finance and banking. Interviewee H related this situation to the isolation of the religious education establishments for more than thirty-six years and the

[507] Small city south-east Libya.
[508] Also small city north east Libya.

scarcity of publications in this field. In addition, interviewees I and H emphasized the closure of the Islamic University in 1978, in compounding the scarcity of publications in this field which has affected negatively relations between the banking sector, the other economic sectors in general and the religious institutions and scholars.

During the interviews the researcher noticed that both sides, bankers and scholars, complained of their mutual ignorance of each other's views and practices and each believes this to be the reason behind the creation of the gap between them.

9.3.2 The Possibility of Establishing Islamic Banking in Libya

As the interviewees are in close contact with Libyan society, the following question was asked to gauge if Libyan society is ready to accept an Islamic banking system. Accordingly the interviewees were asked the following question:

According to your opinion and in the light of recent circumstances, do you think that Libyan society ready to accept Islamic banking?

All the interviewees said they believed that Libyan society is ready to accept Islamic banking. However, 60% of the interviewees mentioned that, from a legal and social point of view, there could be no objection to the formation of Islamic banks. On the other hand, 40% of the interviewees indicated that, in Libya, it would be political attitudes that have a clear hand in the development and decision-making in any Libyan banking system. Thus, the implementation of Islamic banking could not succeed unless the state was ready to put its full weight behind it.

Moreover, interviewee B explained the situation simply by saying that it would be the concept not the practicality of an Islamic banking system which would be forbidden, face constraints

and an unfriendly reception should it be discussed. He added that the contemporary financial authority, for no understandable reason, is striving hard to hinder the inception of an Islamic banking in Libya. He went on to state that the authority has hesitated and is irresolute in asserting reasons for its attitude behind such a block. According to interviewee A (long experience in the Libyan banking sector), the first proposal for Islamic banking was submitted to the Libyan Central Bank in 1978, and since that time, there has been a strong and continuous demand for Islamic banking in Libya. Supporting this statement, the Libyan Prime Minster Ghanem in 2005 stated that, "There is no objection, and I think that some proposals were presented to the Central Bank of Libya, and they are under review"[509].

Reasons for Not Implementing Islamic Banking	%
There is no objection to implement Islamic banking.	60
The implementation of Islamic banking in Libya needs state support.	40

Table 9.2: The Interviewees' Opinions Towards Reasons for Not Implementing Islamic Banking

On the other hand, 50% of the interviewees (mainly bankers) believe that the presence of the Islamic banks could constitute a threat against the commercial banks be they private or state-owned. They think that the Islamic banks will attract most of the commercial banks' clients. They consider this as the real reason for deferring the implementation of Islamic banking.

Worldwide, there has been much discussion on Islamic banks successfully achieving their target. To consider the possibility of Islamic banking succeeding in Libya, the following question was asked of the interviewees:

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[509] Ghanem Interview. [On line]. Available from: http://en.ljbc.net/online/subject_details.php?sub_id=78&cat_id=2 . [Accessed on 21st October 2005].

To what extent do you think that the Islamic banks could succeed in achieving their targets, if they were permitted?

All the interviewees agreed that Islamic banking is receiving increasing global recognition and attention from the banking industry. Moreover, interviewees C and B believe to a large extent that strong growth and significant international development, has established Islamic banking as a major international banking system. This is contrary to the situation in Libya, where Islamic banking is still negligible and under-developed. On the other hand, all the interviewees consider Libya to be an Islamic country; consequently there are no conditions which need to be fulfilled, or cautions considered, in establishing Islamic banking in the country. Moreover, they emphasised that well-established, carefully-positioned, and supportive Islamic banks in Libya could help in enhancing, promoting and improving many aspects of the Libyan banking system in general and of the national economy.

60% of the interviewees (bankers and jurists) mentioned that before introducing new banking services there had to be some hope it could succeed in Libya. First the monetary authorities need to ascertain that their plans for banking development and growth have realistic goals. Introducing idealistic banking regulations alone would not be enough. Interviewee D said that the Libyan monetary authorities should consider the experience of the other countries in this regard.

In this context, however, scholars H and J believe that the presence of the scholars in financial organizations would raise moral standards and minimise corruption problems in the financial sector, by enhancing and wakening religious and moral deterrents. In his opinion, this would happen by the interaction between scholars and employees in these financial institutions.

Moreover, interviewees A, B, and C (bankers) said that Islamic banking would attract deposits from large segments of Libyan citizens who have customarily avoided commercial banks. The Islamic banks, on the one hand, could help to create competition between the

various banks whether state-owned, or private. On the other hand, competition could help these funds to find their way into the banking system, to circulate around the economy and into investors' hands. Three interviewees, however, gave examples from their relatives and friends: how they hoard money in their homes to avoid dealing with banks and the interest that they charge or pay. However, they could see that the introduction of Islamic banking in the near future would allow the banks' clients the choice of banking either with a conventional or an Islamic bank.

Taking into account the religions features of Libyan society, interviewees assumed that the future for Islamic banking in Libya will be bright, stable and capable of rapid development. This may be because the sector will need to form a uniform council representing the different Islamic schools, because it will not face the dilemma of differences of interpretation of Islamic principles arising from the positions adopted by the different schools. This may mean that identical instruments will not be rejected by one board and accepted by another. For this reason, the source of *fatwas* will be one and every *fatwa* will originate from this source and be subject also to the same rules. This is one of the main strengths, according to the interviewees. It shows that Islamic banking is clearly tangible, feasible and capable of operating in Libya successfully.

9.3.3 The Regulation of Islamic Banking in Libya

Islamic banking is distinguished from conventional system, by being based on profit and loss sharing and the elimination of interest. As conventional banking, Islamic banking is also in need of effective, prudential supervision and regulation.

There are two ways to supervise Islamic banks. First, there needs to be specific, separate legislation and banking regulations which exist and are parallel to the conventional banking

system. Second, an entire financial system should be restructured in accordance with Islamic concepts. Consideration of these two provisions led the researcher to the following question:

In your opinion and in the light of banking law, do you think that the recent Libyan banking legislation is able to supervise Islamic banks, or is there a need for separate legislation and regulation?

First of all, all the interviewees agreed that Libya does not require its banking system to be fully compatible with Islamic law. As in other Muslim countries, Islamic banking can exist alongside conventional banking. This is because Islamic banking has an organizational setup similar to that of conventional banks. On the subject of Islamic banking regulations, the interviewees' answers were unpredictable, and three different attitude patterns were revealed.

30% of the sample believes that recent banking law may help to a large extent in establishing Islamic banking in Libya. They argue that the CBL as the formal authority that supervises and regulates the Libyan banking system can take the necessary steps to grant permission to the banks which wish to engage in Islamic banking. According to interviewee F (jurist) there are several ways to achieve this target because, as the existing law is flexible and able to observe Islamic banking, new law can be introduced without fundamental changes being necessary in the existing one. One of the other interviewees, A, had mentioned that the CBL can also help the Islamic banking institutions find ways of using existing regulations to ease their business.

Contrary to this, 3 of the group believe that the recent law does need to be amended so that it can supervise the Islamic banks effectively. These participants argue that in the light of international standards, the existing banking legislation in Libya enables supervision of any banking system not only an Islamic one.

In sharp contrast to this answer, the four scholars believe that as Islamic banking differs from conventional banking in several aspects, new law should be issued to supervise Islamic banks in the event that they are allowed to operate in the country. Table 9.3 summarizes the earlier discussion.

Interviewees' Opinions and Attitudes	%
New law should be issued.	40
The recent banking law is able to supervise Islamic banks.	30
The recent banking law needs to be amended, so that it can supervise effectively.	30

Table 9.3: The Interviewees' Attitudes towards Islamic Banking Regulation

Administratively, the bankers' interviewees have revealed that the CBL can establish an independent department to carry out the task of control and inspection of Islamic banking activities, just as it supervises the other banks. This department could be called the Islamic Banking Services and Supervision Department, similar to the other units and departments within the CBL.

9.3.4 *Sharia* Supervision

Sharia supervision is an integral and important part of the Islamic banking industry. The role of *sharia* supervision should go hand in hand with that of the Islamic banks themselves. Delorenzo defines *sharia* supervision as "the process of ensuring that a financial product or service complies with Islamic legal precepts or the service complies with Islamic legal precepts and principles either by its conforming (to one degree or another) to a recognized

Islamic norm or by its not violating the same"[510]. It involves continued supervision and permanent checking of contracts, transactions and procedures. Consequently, it should be independent and free to give declarations on proposed contracts and transactions[511]. This, however, has made Islamic banks structures quite different from conventional banks, and subject to an additional layer of governance, to comply with Islamic law.

9.3.4.1 The Availability of the *Sharia* Board Members in the Libyan Society

Sharia advisory roles are vital in Islamic banks. The *sharia* supervision on the bank's *sharia* board should be formed from the moment the bank is incorporated. It should consist of trustworthy scholars who are highly qualified to issue *fatwa* on financial transactions and activities[512].

However, the credibility of Islamic banks' activities is highly dependent on the credibility of its *sharia* scholars. In other words, for recent circumstances, the banks have to appoint scholars with a specialization in the field of *fiqh-almua'mat*, and knowledge of financial markets and practices[513]. Delorenzo has mentioned that recently the number of people who are qualified to serve as *sharia* board members is quite limited[514].

However, the intention of the researcher in this context is to investigate the availability of Libyan scholars, who are qualified to issue *fatwa* on financial transactions and activities. With this purpose in mind, the following question was asked.

Do you think that Libyan society suffers from a lack of scholars in fiqh-almua'mat, and knowledge of contemporary financial market and practices?

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[510] Delorenzo,Yusuf, T. Shari'a Supervision in Modern Islamic Finance. [On line]. Available from: http://www.guidancefinancial.com/pdf/shari'a_Supervision_in_Modern_Islamic_Finace.pdf. [Accessed on 20th July 2007], p. 1.
[511] Ibid, p. 2.
[512]Delorenzo,Yusuf, T. Shari'a Supervision in Modern Islamic Finance., p. 3.
[513] Ibid, p. 2.
[514] Ibid, p. 3.

The interviewees insisted that before they answered, they wanted to mention that Libya has many scholars who are open-minded, modernists, and not extremists. Moreover, interviewees 'G', 'H', and 'I' mentioned that the recent attitudes of many Libyan contemporary scholars, in terms of issuing fatwa, is to use appropriate opinions regardless of the *madahabs* or schools. Interviewee 'I' has emphasised that the scholars do not undermine the opinions of other jurisprudences either Sunni or Shiite, as both of them are dependent on each other. Therefore, they believe this will help the Libyan scholars in the future have trust in potential depositors, borrowers and customers who wish to conduct their affairs in an Islamic bank.

Interviewees G, H, and J argued that in modern Libyan society it is not rare to find scholars who are qualified in business or economics and the *sharia* at the same time. They related this to the active role that mosques and the previous religious educational institutions have played in teaching Quranic and Islamic doctrines such as *fiqh-almua'mat* in Libyan society.

As a result of these responses, the researcher decided to ask the following question to obtain the interviewees attitudes towards the approaches that can be used to overcome the scarcity of specialized scholars:

If Libyan society is suffering from a scarcity of scholars, in your opinion what approaches can be adopted by the Libyan Islamic banks to overcome this problem?

The majority of interviewees mentioned that the *sharia* boards should shoulder the major responsibilities towards God, society and their bank's clients. They believe that to exercise their responsibility, the *sharia* boards will need to hold regular meetings to inspect the banks' books, its operations, and examine their investments and transactions; to conduct an annual review, report to the shareholders, and discus all enquiries received; to prepare draft opinions

and deliver them to all those concerned and involved in designing or finding new Islamic banking services or products.

Interviewees G, H, and J argued that although they could understand the important role of *sharia* supervision in the sector, they saw ambiguity and misunderstanding in how these responsibilities could be carried out in practice.

Broadly speaking, the interviewees suggested two ways to overcome this obstacle. First, in the near future, 8 of the interviewees think the best way is for the state to cooperate with other countries that practise Islamic banking. This could happen by sending qualified people to held degrees in Islamic banking and finance and to attend seminars, training courses, and conferences on technical know-how, issues and developments pertaining to the practice of Islamic banking and finance. Second, 20% of the sample took a contrary view. They believe that the state could invite experts from other countries to help in establishing an Islamic banking industry in Libya. In their opinion, this will allow a considerable number of bankers, jurists, economists, and scholars to benefit from the experiences of others in the industry (see Table 9.4)

Interviewees' Opinions and Attitudes	%
Sending qualified people to attend seminars, training courses, and conferences on technical know-how.	80
Invite experts from other countries to help in establishing Islamic banking industry in Libya.	20

Table 9.4: The Interviewees' Perceptions on Overcoming the Lack of *Sharia* Scholars in Islamic Banking Practice

As they are in close contact with other academic professionals, 40% of the sample (see Table 9.1) considered the future and stated that the state should introduce Islamic banking and finance an education strategy to enable bankers, economists and *sharia* scholars to work

together for the benefit of the industry. According to them, the state should consider introducing in the first instance, formal education programmes such as Certificates, Diplomas, Degrees and Postgraduate course in Islamic banking and finance. In the second phase, specialist colleges known as colleges of Islamic banking and finance should be established. However, interviewee H was optimistic about the newly created *sharia* departments in some Faculties of Arts such as that at the University of Garyounis. In the third instance, a public resource centre based on corporate or individual membership should be established. It should also encourage the writing of books and other materials on Islamic banking and finance.

9.3.4.2 The Possible Form of *Sharia* Supervision in Libya

Sharia supervision must be the back-bone of Islamic banks. This will boast the confidence of shareholders and the public that all the banks' activities are in compliance with *sharia.* Compliance and legitimacy with *sharia* principles will be achieved by having a proper governance framework. *Sharia* supervision can be performed either by individual or by a board of supervisors. Whether each bank has a board, or a national *sharia* board supervises the whole sector, is not important. In general, the choice will be governed by several considerations. Thus the researcher considered that it was important to pursue the interviewees' perceptions regarding the form of *sharia* supervision in Libya. The following question, therefore, was asked:

In general, there are two possible forms of sharia board practice for Islamic banking. First, a national sharia board, second, individual sharia boards for every Islamic bank and window. In your opinion, which form do you consider the more suitable for Islamic Libyan banks?

80% of interviewees believe that a national *sharia* board would be the suitable form. Interviewee G considered that, according to Libyan society, it will be better for the country to have one main *sharia* board. In the first place this would avoid the obstacles that are facing the Islamic banking industry in other countries; second it would help in building the country's credibility as a centre of Islamic banking in the future.

Moreover, interviewee J (economist and jurist scholar) argued that neither the size of the Libyan banking market, nor the economic situation will bear more than one board. Interviewee H in turn revealed that the character of the Libyan people will not tolerate diverse declarations easily from a range of different sources.

However, because of his academic background, interviewee H also asserted that the existence of a national *sharia* board could provide many advantages to Libyan Islamic banking. First, Islamic bank trend to use different names for their products and this has caused several difficulties and misunderstanding for their clients. Thus many of them find it is too difficult to remember these names and terminologies. H believes that having the national *sharia* board as the sole religious authority will help in standardizing vocabulary and terminology in the world of Islamic banking and finance. This would ease communication among *sharia* board members, customers and bankers. On the other hand it may help in the preparation of relevant training courses on Islamic banking and finance. He went on to state that the *fatwas'* that will be issued by this board and their subsequent development could be documented. Therefore, in the future, these *fatwa* resolutions would become rules which could be used by those on the front desk for the efficient working of the Islamic banking system. In legal matters, appropriate documentation may be the first step in the founding of Islamic banking regulations. According to H this will help to a large extent in the promotion of Islamic banking and finance in academic and professional circles. It needs to be mentioned here that

the national *sharia* board is succeeding in Malaysia, a multicultural country with more than 30 ethnic and religious groups and subgroups.

However, 20% of the sample were against the idea of having a national *sharia* board. They believe that every Islamic bank or windows should have separate *sharia* board. According to interviewee F this will give the banks more space to diversity their Islamic banking activities and may alleviate the tied control of the central bank. Interviewee A mentioned that in the light of the scarcity of qualified scholars, the appointment of members from various related backgrounds such as *sharia* scholarship, the law, economics, and finance, will allow for more innovation and fresh brains to enter the banking sector. Table 9.5 summarizes the opinions and attitudes of the sample.

Interviewees Opinions and Attitudes	**%**
Strongly prefer national *sharia* board.	80
Support separate *sharia* boards for every bank and window.	20

Table 9.5: The Interviewee Perceptions and Attitudes towards the Form of *Sharia* Supervision in Libya.

9.3.4.3 Appointment and Approval of *Sharia* Board Members

There are several ways to appoint and approve *sharia* scholar boards' members and determine their remuneration. For instance, in the case of a bank's *sharia* board, the *sharia* board members are appointed by the bank's board of directors. Their remuneration is proposed by the bank's management and approved by the board. However, in the case of a national *sharia* board, a national registration process might be established along the lines of the certification of *sharia* advisors implemented by the central bank. This has led the researcher to investigate the participants' opinions on the suitable authority to appoint and approve *sharia* board members. The following question was asked:

Who do you think should have the right to appoint and approve the sharia board members in the case of Islamic banking implementation in Libya?

This issue concerning which authority should have the right to appoint and approve *sharia* board members was controversial. Different opinions and attitudes were obtained. 30% of the sample believed that the CBL should be the suitable authority to appoint and approve *sharia* board members.

20% of the interviewees believed that the state representatives in the CBL, or the Treasury Minister, or the General Endowment Board and *Zakah*, or even the Universities could be empowered to nominate sharia board members and determine their remunerations. They believe this will help to avoid any hassle with the state authority.

20% of the interviewees also thought that because of its functions and contributions to society, the General Endowment Board and *Zakah* could be considered the only source for qualified scholars in terms of *fatwas* being issued. They think it is the right authority in terms of appointing and approving *sharia* board members. Moreover, one interviewee saw the Universities as suitable sources for appointing *sharia* board members. This would leave them as the sole authority that can appoint and approve the *sharia* boards' members. However, the interviewees who hold these opinions insisted that Libya does not lack honest people to confirm or appoint scholars to the *sharia* boards.

Conversely, 30% of the sample believed that there is no authority they would count on to form the *sharia* board. They justify their opinions in the light of the present situation and circumstances in Libyan society. Table 9.5 summarizes the different opinions of the sample.

With respect to remuneration, the interviewees showed their willing to accept no pay or low pay for their services in order to reduce overhead expenses of the banks, especially, when the

industry is in its infancy and the funds under management are still few. They believe this will enable them to meet their responsibilities towards God and their fellow Muslims. Moreover, they believe that the authority which has the right to appoint *sharia* board scholars, should also determine remunerations.

It needs to be mentioned here that all the interviewees insisted that the *sharia* board should contain moderate *sharia* scholars, men and women, who have no extremist political affiliation or aspiration and regard Islam as a way of life and suitable for all ages. In the interviewees' opinions board members should be picked to form homogeneous groups. This would give the banks' clients guarantees that the sector would not be involved in political activities, or amenable to political pressures. Most importantly in their view, these scholars should be acceptable and trustworthy to both government and society.

Interviewees Opinions and Attitudes	**%**
Believe that the CBL is the suitable authority to appoint and approve sharia boards' members.	40
Believe that there is no suitable authority to count on to form sharia board.	30
Believe that the state representatives, the CBL, or the Treasury Minister, or the General Endowment and *Zakah*, or universities can be the suitable authorities to appoint and approve sharia board members.	20

Table 9.6: Interviewee Opinions and Attitudes Regarding the Suitable Authority to Appoint and Approve *Sharia* Boards Members.

9.4 Channels of Providing Islamic Banking in Libya

The Islamic banking sector is governed by quite different principles from the conventional sector. First, and most important, it serves God through serving human needs and developing

a distinctive Islamic corporate culture. This will lead it to meet the expectations of Muslims and non-Muslims, and share with them in profits and losses.

However, no one can ignore those Islamic banks, similar to other financial institutions, seek to make profits which are essential to their business. Islamic banking can be practised in two different ways: one, by providing windows of Islamic banking in the commercial banks; two, by providing specialized *Sharia*-compliant banks. These two modes of providing Islamic banking can be practiced by states, the private sector, or partnership between the state and the private sector, or with foreign investors. However, all these considerations led the researcher to the following controversial question:

Who do you think has the right to provide Islamic banking services in Libya and in which form should they be provided?

It is interesting to note, that most of the interviewees, including scholars, jurists, and bankers, said that Islamic banking services should be provided either by the private sector, or by the private sector in partnership with foreign investors. 50% of the sample believes that the role of the state should be solely to supervise and to regulate the industry. However, the bankers, as they are self-evidently in closer touch with the banking sector, believe that government interference will lead the industry to face the same problems that are new facing the commercial banks in the country. Interviewee A said that Islamic banking can be easily introduced in the country. It requires no change in either the laws of the country or current commercial banking practices. The system primarily can be practised even in separate departments in one or two private banks. He believes that Islamic banking, on an experimental basis, will not cause any disruption to other banking practices. He added in the future the industry can be supplemented by specialized Islamic banks. However, the steps for introducing Islamic banking should be fully considered and well-planned to avoid possible

disappointment the potential clients. Interviewee A emphasised that staff working on Islamic banking in its early stage can be recruited from other Islamic banks abroad.

On the introduction of Islamic banking in Libya, interviewee B considered that this is the right time to work towards its introduction. According to him, the problem with our regulations and the state agencies is that they are not concerned about having one foot in the *haram* and one in the *halal*.

9.5 Islamic Banking Activities and Mode of Finance

Islamic banks function as financial intermediaries between savers and the ultimate investors and users. In addition, Islamic banking is providing more basic retail and consumer products. These products help in financing personal needs, such as automobiles, home purchase and home improvement. Thus, during the 1980s, the attitudes of Islamic economists changed from considerations of the possibility of Islamic banking, to evaluations of their performance and achievements[515]. Moreover, all Islamic banks agree on the basic principles with slight differences in practice. The following paragraphs consider the interviewees' perceptions on Islamic banking products, its principles and modes of finance. Therefore the following question was asked:

In a society used to a banking sector which allows interest-based credit, what do you think oft the key principles behind Islamic banking products and modes of finance?

The interviewees' answers revealed a deep lack of understanding regarding the range of the Islamic baking products, but not of the principles that should govern them. This situation can be related to the lack of appropriate conferences to attend and to inadequate integration with the international research sphere and academia. The interviewees hope that regulatory change

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[515]Abul Gafoor, A.L.M.. *Interest- Commercial Banking*. The Netherlands: Apptec Publications. 2000, p. 40

will pave the way for a clearer understanding of Islamic banking products. However, the interviewees, especially the scholars pointed out that the basic principle of Islamic banking products is that all forms of interest are forbidden. In addition, the clients and the Islamic banks should work on the basis of risk and profit-sharing. However, interviewee F (jurist and scholar) believes that as the banks generate profits from their business, there is no harm for clients to receive interest. He went on to say that donations can be made to channel this additional money, to charity originations people in need.

Regardless of the view of interviewee F, interviewee 'I' stated that the banks and their clients should share the investment risks and divide any profits or losses between them. In addition, the banks should only support practices that are not forbidden. Consequently trade in alcohol, betting and pornography is not allowed. Moreover, Islamic banks, as institutions, are not permitted to lend to other banks or institutions at interest. He also declared that the principles of Islamic finance are aimed at a compromise between the interests of the individual and the interests of society. As a scholar with long experience in teaching *fiqh-almua'mat* and an author of several books in this field, interviewee G stated that, in addition to the previous considerations, Islam has also recognised private ownership. Moreover, the Islamic financial system has placed particular emphasis on markets and competition and the additional benefits that the community can gain from them. He emphasized that Islam in general it is very flexible and allows many activities. According to him, the flexibility of Islamic finance provides an array of investment opportunities for investors who are looking for a broad range of products that address their needs and are in accordance with Islamic doctrines.

Concerning the Islamic modes of finance, interviewees G and I believe that the Libyan people are already practising many of the Islamic banking modes such as *murabaha* in gold transactions. They believe that there is no doubt that the Libyan people do practice and accept

many modes of Islamic banking and finance. Both G and I see and commend *mudaraba (qared)* as a contract in profit sharing, with one party providing funds and the other his management expertise. Profits are shared between both parties in proportions agreed in advance. Losses, if any, are the liability of the funds provider, and the second party loses the benefit from his efforts

However, G believes that *mudaraba* is best suited for project and trade financing. According to him, in this mode of finance, the bank uses its clients' funds, or its own funds but not both together. He related this view to the concept of money in Islam. He briefly summarized money as a medium of exchange, not as a commodity. Therefore, it can play the role of a unit of account and also a store of value. He asserted that it is not legitimate for money to generate profit, unless it is joined in partnership with work (human effort), regardless of whether the result is profit or loss. It is interesting to speculate on what G has mentioned. He strongly believes that because the Libyans are deeply religious they will want to follow the lead of the scholars regardless of the *madahab* or school they support, concerning Islamic banking features and practices. In his opinion these features, on the one hand, can build up hopes of Islamic banking and devise new Islamic banking products which can enrich the variety of Islamic modes of finance. On the other hand, they also can help resolve some of the most serious problems facing Islamic banking; indeed not only resolve these obstacles, but hopefully devise alternative models which will be distinguished by their risk-sharing element. H is confident that Libyan Islamic society with its scholars, bankers, merchants and business people can be a wealthy source for Islamic banking innovations.

9.6 Summary

As the analysis of the interviews in the previous sections demonstrates, the interviewees strongly believe that there is a world-wide race to take part in the Islamic banking industry. However, Libya is amongst the countries that need to reconsider its attitudes towards and understanding of Islamic banking. According to the interviewees, it seems reasonable to assume that the country actually needs to completely rethink its approach to banking, and seek wider opportunities to allow more of the general public to participate.

The interviewees said that Libya, like other countries can have a dual banking system where Islamic banks exist alongside conventional ones. They think that Islamic banking in Libya can be provided through two channels. In the beginning it can be provided by windows in the private commercial banks. Later a service could be made available in the established Islamic banks. However, in both cases, the group insists that the role of the state should be supervision and regulation of the industry. Indeed, according to them the implementation of Islamic banking cannot succeed in Libya unless the state is ready to support it.

The interviewees believe that the operation of Islamic banking in Libya should be based on principles such *mudaraba* and other modes of Islamic finance for which there are no corresponding principles in conventional banking operations.

The interviewees also strongly believe that the features of the Libyan society will provide an appropriate milieu for Islamic banking development and innovation. However, they consider the experiences of other countries in this regard can serve as good examples of what Islamic banking can provide in Libya.

Moreover, the interviewees assume that the future of Islamic banking in Libya will be bright, stable, and capable of rapid development. Finally, in their opinion, the challenge is to identify how the contemporary Libyan monetary authority discusses and handles the introduction of Islamic banking.

Chapter Ten

Conclusion and Recommendations

10.1 Introduction

This chapter further interprets and analyses the responses from the questionnaire and the interviews in demonstrating the perceptions and attitudes of the participants for the empirical part of this work. It is worth mentioning here that it has been conceded that in some areas, there was agreement between interviewees and respondents and in others areas there was disagreement.

The aim of this concluding chapter is to set out the main findings of the study, particularly those that have emerged from the previous chapters. This chapter also makes recommendations to enhance the performance of the Libyan banking industry; and also offers some solutions to the problems, which reflect negatively on the performance and reform of the Libyan commercial banking sector.

10.2 Major Findings

The major findings from the questionnaire and the interviews are summarized below.

10.2.1 Interviewees and Respondents' Profiles

The results of the study show that the majority of the respondents are well educated with 65% holding a bachelor degree and 14% having a postgraduate degree. With regard to the interviewees, experience was a major feature in determining the participants. This was because some highly experienced interviewees had considerably less education than others. The length of the interviewees' experiences in their field varied from 15 to 45 years. However, the illogical and discouraging conditions for selecting higher banking executives constitute obstacles in the way of the banks' development, reforms and privatisation. A clear

example is that because it is now necessary for members of a bank's board of directors to hold a graduate degree, many people with long experience of banking matters as well as financers feel deterred from investing in the banks. Consequently, the banks are overstaffed by educated employees lacked banking management skill and flexibility, and good command of a foreign language. Indeed, the basic reasons behind this phenomenon are the isolation of education institutions and of their mostly outdated curriculum in terms of finance and banking studies compared with the rest of the other world. These curricula do not qualify them for a banking profession that requires capability of intellectual judgment, evaluation and analysis of banking and economic facts, and good communication skills. Moreover, overstaffing in addition to a high level of bad loans deters foreign banks from becoming involved in the sector either through privatisation or directly by setting up branches.

The questionnaire revealed that 78% of the respondents were from the younger generation and under 30 years, and 45% of them were aged between 20 and 29. The younger generation in this case constitutes an attractive segment of customers for banks in Libya. This is because of three reasons: a) they enjoy a high level of education and have more progressive careers (so their income will generally be higher than that of non-graduates of the same age); b) they can be considered as more financially sophisticated and will expect a wider range of financial services as they progress through their careers; c) most importantly, they are tomorrow's as well as today's customers. Therefore, for Libyan bankers, age is a very important element in determining their marketing mix, priorities and customer targeting. On other hand, all the interviewees were over 50 years of age. As for gender distribution, all of them were males. However, while 69% of the respondents were male, 31% were females. Islam gives a woman the same rights as a man, so long as her important role as a mother and a wife is not neglected. History is witness to Muslim women's contribution to civilisation in various professions such as teaching, trade and other fields. This indicates that more studies are

needed to diagnose the main obstacles and prospects that prevent Libyan women's participation in the banking sector, and help in developing the policies which can facilitate their involvement in the banking sector, and enable them to contribute in the building of the sector.

The research showed that the majority of the respondents were in paid employment. They worked either for the state, or for commercial or social organisations. A significant majority, 83%, were earning between LD 200 and LD 700. The reason behind these low levels of income is the domination of Law No.15 of 1981 regarding wages and salaries which affects negatively the living standard of Libyans and their purchasing power. Thus, reform of this law needs serious consideration. Moreover, as there are few problems in the availability of funds, more research based on a scientific study that matches country's economic needs is needed to encourage young Libyans to start-up their own enterprises, in addition to establishing credit bureaux to solve the information gap problem and to show people who guaranteeing loans and others. All of these could help in: a) alleviating the level of fraud and theft that makes banks cautious in granting loans; b) enabling Libyans to become small investors with shares in the banks through privatisation processed, and to enhance the establishment of a financial market; c) granting subsidiary loans to small and medium-sized enterprises.

However, the interviewees were closely connected to the banking sector and Islamic finance. Among them were *sharia* scholars, jurists, branch managers, head of departments and chairmen of boards. Nevertheless, as mentioned earlier, the prevailing political and financial culture does not recognize Islamic banking and links it to terrorism. As these interviewees are Libyan intellectuals they should take the initiative and clarify the ideas underpinning Islamic banking and finance so they become accepted and implemented in Libya. This is because Muslims should practise everything according to Islam doctrines and Islamic banking can help in this regard.

10.2.1.1 Banking Background

10.2.1.1 Bank Types and Incentives for Dealing with Banks

An examination of the kind of bank used by the respondents revealed that 86% of them dealt with state-owned banks, 9% with private banks and 5% had at least one account with both a private and a state-owned bank. The reasons for dealing with both, were either that the respondents were not satisfied with the products and services offered by the state-owned banks or because their wages are paid into state-owned banks. Thus they are dependent on these banks for withdrawing cash. However, most of the respondents believe that private banks provide better services. This is a most serious consequence of the long history of state owned-banks failing to fulfil the hopes and expectations of Libyans. Therefore, they find it difficult to trust state-owned banks. Without a doubt, this distrust in the state-owned banks should require the banks to review their policies in dealing with their customers and adopt new ones based on market-oriented approaches which will accord with Libyan society's circumstances and Islamic doctrines. Furthermore, these new policies should reduce the degree of control of the CBL over the operations of the commercial banks in general and the state-owned banks in particular.

Indeed, it was found that 45% of the respondents had opened their bank accounts in accordance with instructions from their employers, 20% because of the bank's reputation and 21% following advice from friends and relatives. This shows the domination of the public sector institutions over their employees' banking preferences. This situation constitutes a monopoly by the state-owned banks and is one of the main obstacles in the development of the private banking, and the spread of a banking culture. Therefore, real consideration should be given to the public sector employees over their banking preferences.

10.2.1.1.2 Banking Duration

Regarding the length of time that respondent have held their, it was found that 81% of them had held their accounts for between 3 and 9 years, and 30% between 3 and 6 years. This can be attributed to the domination of the young age groups in the research sample and in the Libyan population as a whole. As mentioned before this segment of the population constitutes the banks' future customers. Therefore, modern and advanced services such as internet banking and ATMs machines should be provided by the banks to meet their expectations and needs, and more research is urgently required.

10.2.1.1.3 Respondents Saving and Securing Loans

The powerful influence of Law No. 15 of 1981 regarding the wages and salaries in Libya is such that it has kept wages and salaries in check while allowing prices to rise. Together with the stereotyped behaviour of the typical Libyan consumer, it has brought about a situation where, by their own admission, 51% of the respondents have been unable to save. In contrast, 42% of the respondents have been able to save. However, this group was unable to give a precise figure about their rate of saving. This is because the banks are not conceived to serve the social aims such as those of educated people for whom the benefits of saving and investing are important. Moreover, the vast majority of payment transactions are still carried out in cash, as the self-services machines and credit and debt cards are not generally available. Consequently, wages and salaries are withdrawn at once which leads people to adopt consumer behaviour.

The demand for loans was found to be low. Indeed 73% of the respondents had not secured any loan from their bank. Of these 78% were aged less than 40. It was also found that most loans had been secured to pay for highly priced goods and services such as cars, houses or medical treatment abroad. This is because the banks neither provide these banking services

nor participate in projects provided these kinds of needs or support projects can provide services and goods based on settlements. Moreover, the lack of bank marketing studies and the absence of legislation encourage it, disable bank managements from considering diversifying their banking services and speeding up their provision to meet their customers' needs and expectations,

10.2.1.1.4 Bank Accounts, Services and Banking Service Satisfaction

The commercial banks in Libya still provide traditional banking services and accounts. The main types of account provided by the banks are generally limited to: current accounts, saving accounts and fixed-period deposits. It was found that demand, 84%, is high for current accounts with 84%, but only 3% certainly of this group of respondents, has saving account. It is noted that the a rising apprehension of risk among Libyans over fraud and theft, the underdevelopment of banking infrastructure, the absence of a banking and saving culture, and worries about the provision and costs of new services is holding back the provision of new services. Therefore, serious development of baking's infrastructure and more legislation are needed to overcome the limitation of banking services.

In Libya people still see banks as windows for withdrawing monthly wages and salaries. Indeed it came as no surprise that 79% of the respondents visit their banks for this purpose only. Only 7% of them visit their banks in person to deposit money. However, 77% of the sample visit their banks between 1 and 3 times per month and only 7% visit their banks between 3 or more times per month. It is clear that bank visits were low, therefore, the Libyan banks appear not to be serving the desire of the majority of their users. This has clear implications for bank managements who not only which to retain existing customers but also to attracting new ones. It also indicates the low financial awareness in Libyan society.

Other banking services such as internet banking, credit card facilities and telephone banking are provided exclusively, and to a very limited extent only, by private banks. In addition, customers often have difficulties in meeting banks' (especially state-owned) conditions relating to some of these services. The results show in general that the usage of these other services is quite low. The exception is the relatively high usage (51%) for standard cheque book accounts. This is because the majority of the respondents are in paid employment and like to have the use of a cheque-book as well being able to visit their banks to withdraw money and 31% of the respondents are provided with a monthly bank statement. It is clear that banks in Libya need to be in line with global trends in providing their services in terms of quality, speed and channels of delivery. This is because customers can only be retained and attracted when banks have a sound understanding of their customers' need. However, it was found that 56% of the respondents are satisfied with the services provided by their banks. This is in fact quite a surprise in the light of their limited services. This can be however linked to the absence of other financial institutions which could provide banking services and personal communication networks within their banks to facilitate their needs. Although, the survey provides evidence that respondents are satisfied with their overall banking relationship, problems still exist and more research may suggest positive ways in which both customers and banks can further improve and cultivate their relationships. It is clear from various researches conducted in other countries that service management has a direct impact on attracting customers, which in turn impacts on the financial performance of the banks.

A comparison of the respondents' levels of education with the banks' differing ways of delivering their services appears to show a widening gap between the industry's rate of technological development and the ability of their customers to adopt new services. Moreover, the results indicate that bank staffs have a poor knowledge of their employers'

customs and of how to build a rapport with their bank's clients. Not only that but the majority of bank employees are unable to communicate in a foreign language.

10.2.2 The Banking Sector and the Basel Committees

Libya is in process of restructuring its banking sector under the guidance of the Basel Committees. The process is geared towards strengthening the sector and attracting foreign investors. The interviews show that reform and rehabilitation of Libyan banking is losing momentum having been constrained by a series of severe reversals. The interviews showed the interviewees lack an understanding of the Basel Committees' concepts and principles. This is a clear indication that the CBL is making little effort in this regard. According to some who have considerable understanding of the Basel committees, Libyan banks at present are finding it hard at present to meet the committees' standards.

10.2.3 Marketing

The findings of this part of the study have revealed the present insignificant role that marketing plays in the Libyan commercial banking sector. This is because no marketing departments yet exist in either the private or state-owned banks. In addition, Libyan Banking Law No. 1 of 2005 does not refer to any regulation process for this function. Therefore, few respondents received any information or leaflets regarding their banks' activities when opening their accounts; only 12% stated that they received verbal information. Moreover, it was also found that 89% of the respondents did not receive any information regarding any change in their banks' activities and only 6% stated that they received such information when they requested it.

To understand this and other failures, it is useful at this point to analyse the salient features of the Libyan commercial banking sector: 1) Libya's banking system was wholly state-owned

through the 1980s and 1990s until the first privately-owned bank opened in Benghazi in 1996; 2) the sector has been under the tight control of the CBL which for long time owned most of the commercial banks. This has led the sector to serve the government and support the political attitudes; 3) planning and decision-making has been centralised under the authority of the CBL's board of directors; 4) the sector is administered by highly educated people (academia) who have less experience in banking activities and protocol; 5) the sector is local in scope. This because of the existence of the Libyan Foreign Bank which acts as the foreign agent for the government and Libyans banks. Moreover, foreign banks are coming to Libya. None yet has begun operating in Libya. Therefore, the sector is lacking the considerable benefits of the direct involvement of foreign banks such activities as integrating with the international banking sector and creating a competitive market; 6) the Libyan banks follow a tight lending policy despite having substantial available liquidity; 7) for reasons that remain in dispute, the sector does not provide many banking services; 8) accessing some banking services is very time consuming and bureaucratic; 9) there is a lack of real competition between the banks as the CBL tightly control all operations carried out by the banks; 10) many of the new Articles of Law No 1 of 2005 are unrealistic or incompatible with a more developed banking sector and society, and, believed make things more complicated. In addition, many banking activities such as marketing are not covered by the Law. It seems that the preparation of the Law was over-dependent on one person's or one group's skills and contacts. It is also important to state that the elitist nature of banking does not welcome everyone into its fold. This again relates to service quality management in the banking sector, which has not been fully implemented in Libya as in most of the developing countries.

10.2.3.1 Banks' Preferred Criteria

Considering, the insignificant role that marketing plays in the sector, it is easy to claim that the Libyan commercial banks do not make sure that their customers are given clear information. The results indicate that there is little focus on services for the client as an individual. Banks seem neither to know nor care what is important to their clients and so the provision of value-adding services is generally weak. Therefore, respondents rank privacy and data protection as top of their list of criteria, followed by managerial experience and a high degree of professionalism, new customer services, wide branch networks, the bank's proximity to work or home, and low services charges. According to the results respondents showed increased understanding of the privacy issue and feel that banks are not adept at managing privacy issues. However, maintaining customers' trust has never been harder and banks worldwide have succeeded in continually valuing their customers and protecting their data thereby earning their customers' confidence. However, there are two reasons behind the lack of confidence in banks regarding personal data protection: the lack or shortage of staff trained to deal with personal data, and no government strategy, policy or guidance.

10.2.4 Attitudes towards *Riba* or Interest

In Libya, the Islamic religious tradition shapes the meanings and purposes of human perspectives and the meaning of modernity. This has linked society and the economy with religion. These results show that religion is the main factor influencing the decisions of respondents when dealing with interest and banks. Consequently, all respondents agreed that bank interest and *riba* are the same. For this reason, 81% of them stated that banks should not charge firms and organisations interest. It is useful at this point to mention here the powerful role which mosques play in teaching people the key terms of Islam to substitute the deficit of formal education system in this regard. As mentioned earlier, this has led religion to dominate

the structure values attitudes and thinking of Libyans. This mind-set of thinking has created a growing trend, particularly among younger people to shun business and transactions incongruent with Islamic doctrines. This is called by some a religious awakening. The shunning of such dealings is conservatively and unquestioningly accepted. For this reason, not only interest or *riba* is not accepted but also gambling and so on. Therefore, it came as no surprise that the research showed that almost all the respondents received no interest on their account holdings. It is however important also to state that role of imams and their teaching is mostly limited to worship and other acts of religious performance, and therefore their contribution on *fiqh mumalat* or financial and economic transaction has been limited.

It was also clear that, regardless of their gender, age, income, education or occupation, the respondents showed a high level of awareness of dealing with interest. However, 83% of the group are all under 40 years of age. Moreover, 80% of the group stated that there is no incentive to force them to impose interest charges when they grant loans. This again shows that attitudes to riba are based on religious sentiment only.

10.2.5 Islamic Banking

Since the mid-1970s Islamic banking has become a widely known term in international banking. Islamic banks have been established not only in countries where Muslims are in the majority but in countries where Muslim are in a minority. Accordingly, many Islamic and non-Islamic countries worldwide now practise some form of Islamic banking. This innovation took two forms. The first form involved an attempt to restructure the whole banking sector in accordance with Islamic concepts. This also took two directions: a) the entire banking system is transformed to accord with *sharia*; b) the transformation process is allowed to proceed gradually. The second direction represents an attempt to establish Islamic banks and windows alongside conventional banks in what can be called a dual banking system. These banks and

entities compete with conventional banks to attract deposits. The majority of these institutions were established through the private sector. In both cases, however, the banking operations of Islamic banks are subject to the regulations that apply to all banking systems. The purpose of this part of the chapter is to summarise respondents' and interviewees' attitudes towards an Islamic banking concept: its form, regulations, channels and provision of services throughout the country.

10.2.5.1 Islamic Banking Knowledge

In this study, which is based on primary data gathered through a questionnaire and interviews, it was found that there is a lack of knowledge as well as an absence of understanding of Islamic banking among the interviewees and respondents. Despite this the interviewees and respondents have recognised the flourishing development, growth and promotion of Islamic banking. Much of the interviewees' knowledge was obtained while they were studying abroad or during work experience with international banks. The respondents' knowledge was acquired mainly through television and radio. The interviewees attributed this situation to the closure of Islamic education institutions and the scarcity of relevant Islamic publications. Again the results reveal the role that scholars as Libyan intellectuals need to play in educating people on the principles of the Islamic financial and economic transactions which are the basis of Islamic banking.

10.2.5.2 The Possibility of Implementation of Islamic Banking in Libya

In Libya people are used to dealing with banks which do not provide products or services which accord with Islamic doctrines. One of the main concerns of this study is to examine the ability of Libyan society to recognize, accept and utilise Islamic banking products and services.

It was found that the interviewees believe that from a legal and social point of view, there is no objection to the implementation of Islamic banking in Libya. They consider this as the right time to introduce it. However, the interviewees thought that the presence of Islamic banks could constitute a threat to the Libyan commercial banking sector. They went on to state that, in their view, Islamic banks will attract most of the commercial banks' clients. In support, 87% of the respondents said they would use the services and products provided by Islamic banks. Moreover, 93% of them said that they would transfer all their bank accounts and transactions to the interest-free banks once they had opened up in the country. It was also found that the main reason to transfer their bank accounts was religion. Once again this shows that religion is the primary and most significant factor in the choice of Libyans, and their desire to emphasize the Islamic identity of the society. This implies that Libyans "conformity" to Islam and scholars' fatwas is absolute, but the absence of a network of Islamic bank forces them to accept conventional banking for their daily business.

10.2.5.3 Islamic Banking Support and Commitments

The research revealed that the vast majority of both respondents and interviewees have highly positive attitudes towards Islamic banking. It was found that 77% of the respondents were ready to accept any return or no return so long as the banks observe Islamic principles and deal with their money accordance with *sharia* principles. In addition, the interviewees stated that when the industry was in its infancy or where the management had small funds, they would accept no pay or low pay for their services. This is because they consider that their contribution would enable Islamic banks to develop the economy in general, a banking system, and a social welfare framework that would be effective and conform to Islamic teachings. From this, it is possible to claim that both respondents and interviewees are willing to take a risk with Islamic banks. This point emphasizes the justification and explanation

provided in the previous section regarding attitudes towards *riḅa* or interest and the implementation of Islamic banking.

10.2.5.4 The Regulation of Islamic Banking

According to the research findings, some interviewees believe Islamic banking is the business of religion and thus it should confirm with Islamic doctrines. Some, however, totally ignore the differences between Islamic and conventional banks. They assume that the recent Libyan banking law (Law No. 1 of 2005) is able to supervise Islamic banking. They cite two reasons: a) Islamic banks have an organisational set-up similar to that of the conventional banks; b) the present banking law is flexible and structured according to international standards and thus is able to supervise any kind of banking industry. For these reasons, Islamic banking can exist alongside conventional banking and offer a dual banking system. However, in sharp contrast, the scholars who were interviewed believe that Islamic banking differs from conventional in many aspects; therefore, new law should be issued to accommodate Islamic banking. Considering the Libyan banking system's present circumstances and regulation, one can claim that regulation and supervision of Islamic banking in Libya do need to be at the same level of development. However, to safeguarding the interests of depositors and not to lose confidence in the stability of Islamic banking and the banking system as a whole, the financial authorities can be called into play as they can affect the degree of success with which Islamic banking is introduced into the general banking system. It is likely that in the initial stages of the Islamic banking process, some of its transactions will fall into legal voids and thus may not be permitted by the existing legal framework. Therefore, under a pilot program private banks can provide Islamic windows under certain restrictions by relying on their branch networks. After a certain period of operating and accumulating a sufficient critical mass of customers windows can convert to banks, and new separate Islamic banking law could be issued. At this

stage other Islamic financial institutions could be introduced. Malaysia constitutes a good model in this regard.

10.2.5.5 The Possible Form of *Sharia* Supervision of Islamic Banking

The role of *sharia* board supervision is one of the distinguishing features of an Islamic banking system. The emergence of this role constitutes one of the most important developments in contemporary Muslim banking. This is because the non-existence of a *sharia*-compliant element negatively affects public confidence in Islamic banking. *Sharia* supervision may be performed at two levels: a) each bank has a *sharia* board; b) a national *sharia* board supervises the whole sector.

It was found that 80% of the interviewees preferred a national *sharia* board as the more suitable form of supervision. According to the interviewees the choice for Libya is informed by several considerations such as: the size of the banking market and the health of the economy, the scarcity of scholars who are qualified in business and *fiqh al-mumalat* and the place of religion in Libyan society. All of these considerations made them assume that a national *sharia* board is the more suitable form. Admittedly, since expertise in *fiqh al-mumalat* is relatively scarce in Libya, institutions involved in Islamic banking in the case of a national sharia board would not be in need of assistances to interpret Islamic transactions. This has the beneficial side-effect that it would promote consistency across the services and products offered by Islamic financial institutions. Most importantly in future a national sharia board would provide stability to the Islamic banking in Libya through: first; better understanding of Islamic finance and banking by the monetary authorities and Libyans which would lead to closer cooperation between them and Islamic financial institutions. Second, standardize Islamic banking products which are presently lack in many countries and

constitute a source of confusion. Third, helping to establish rating agencies especially ones which could rate products as well as institutions on the ground of their *sharia* compliance.

10.2.5.6 Islamic Banking Provision

The private sector has pioneered Islamic banking globally. The rapid expansion of Islamic banking has encouraged many states to claim that they want to follow the example and offer Islamic banking as an integral part of their banking sector and acts as the hub for the banking industry.

It was found that all interviewees believe that to avoid problems that are facing the Libyan commercial banks, the role of state should be to supervise and to regulate the industry. All interviewees believe that Islamic banking services should be provided either by the private sector or in partnership with foreign investors. According to the interviewees, one experiment which could be devised would allow for the provision of windows in one or two private banks. This would not cause any general disruption to the Libyan commercial banking sector. In contrast, it was found that 73% of the respondents preferred the services to be provided by the government. They claimed this might avoid the tight and firm control that the state imposed on the private sector and the previous unhappy experiences of the private sector with the state during the 1970s and 1980s. Considering the circumstances of the Libyan baking sector in terms of reform and privatisation, it seems that the private sector in partnership with foreign banks under the supervision of the CBL would be a suitable provider of Islamic banking. This in fact would provide enormous advantages to banking sector reform and privatisation.

10.2.5.7 An Islamic Banking Address

Islamic banking is becoming popular among both Muslim and non-Muslim populations. According to Farook, "Islamic banks are neither charities nor terror facades; they are banks operating under a central bank and their funds have been subject to regular supervision and auditing"[516]. Despite the fact that the respondents were attracted to Islamic banking purely for religious principles and showed their willingness to give their funds and saving for the purpose, it was found that no respondents wanted the services to be called Islamic Banking. 54% of them wanted the service to be called Interest Free-Banking or Social Banking or Ethical Banking. It appears that both the respondents and the interviewees feel that it is time for Libyans to have their own Islamic banks regardless to the service address. They are in need of Islamic banks which can act as safe keepers for their Dinar and Dirham and help them to develop themselves financially according to *sharia*. Their desire is clear through their choice for the service to be known as interest-free banking or social banking and be in accordance with the prevalent political ideology. Therefore, the banks as financial institutions can operate under the supervision of the financial authorities, and have little trouble in providing their services.

10.3 Recommendations

From the interviews and the questionnaire, contemporary Libyan circumstances and in the light of the theoretical concepts considered in this study, it is now possible to make some recommendations and suggestions, which could help in the development of the Libyan commercial banking sector and introduce Islamic banking to Libya. However, this part of the study will be divided into two sections: a) recommendations regarding the Libyan commercial banking sector; b) recommendations regarding Islamic banking implementation.

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[516] Farook, Latheef. *Islamic Banking in the Aftermath of 9/11*. South Asia News Agency. [On line]. Available from: http://www.sanagency.com/18jun06.htm. [Accessed on 10th December 2007].

10.3.1 The Libyan Commercial Banking Sector[517]

Libyan society is part of an emerging economy, which is also experiencing rapid economic and social change as it opens its doors to the outside world. The future will be a challenging experience for the banking sector in Libya, as the foreign banks will be able to operate in the country. This will increase competition between banks and thus customers will be the centre of attention. On the other hand, for the customers, competition will result in easier access to services, a wider choice of products and services, and competitive pricing. For this reason it is highly recommended that Libyan commercial banks grasp the opportunity, and:

1) Adopt market-oriented approaches to improve banking services and thereby improve their own position, accrue clients and improve the reputation of banking. This is because in today's increasingly competitive environment, customer satisfaction and retention are important elements in banking strategies.

2) Improve the tangible environment must be one of the priorities of the Libyan commercial banks, such as up-rating the quality of the basic infrastructure, the decoration and the furniture in banks. This would do much to convey an atmosphere of enthusiasm and contentment among their clients and staff.

3) Most importantly, issue new legislation to organise and encourage Libyan banks to have marketing departments. Moreover, the monetary authorities should encourage initiative in the banking sector and promote the creation of much needed new departments and services.

4) In line with present stage of development, co-operate with the state, the other banks, and the CBL and work together as a cohesive team to raise citizens' awareness of the importance of an efficient and effective banking system. This could be a good opportunity for bank managements to show that they care for their individual clients. They could, and should, make the effort to supply their customers with banking activities, products and new saving,

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[517] It is worth mentioning here that most recommendations regarding the Libyan commercial banking sector were discussed with the interviewees.

investment and credit schemes. These could be communicated through brochures handed out to clients. The banks could also cooperate with the media and Education Ministry in informing the public about the importance, services and products of the banking sector. This could be used strategically to affect the prevailing negative attitudes towards banking, raise levels of awareness and educate people about their rights in regard to the banking sector.

5) Establish a higher council in the banking sector, due to the new economic and financial changes that will have taken place in the economy in general and in the banking sector in particular. It should seek to create a balance between practice and a theoretical frame-work. It is highly recommended that banks should encourage highly experienced employees to work on after retirement and help create such a council to help in overcoming the present problems. In addition, this council could cooperate with other banking experts worldwide to facilitate the transformation stages of the banking sector.

6) Recruit and then device policies to enable banks to retain qualified managers, regardless of their level of education and nationality, who are able to prepare and develop training programmes, draw up principles for delivering services and set self-development plans for employees and managers. Such measures in addition to a Higher Council for banking could help to largely overcome the present poor quality of performance, reduce role ambiguity and role conflict, and facilitate life for management and clients.

7) Delegation and empowerment are other crucial factor in employee training and team-work enhancement. In addition, staffs need to be involved in setting goals and then implementing the process in a participatory working environment. On the one hand this would help to improve the second tier banking managers. On the other, it would help build staff self-confidence to deal with any difficulties that may arise while delivering services to clients. Most importantly is the need to develop an efficient reward system which would offer powerful motivation for staff to achieve these goals and targets.

8) Improve their services by introducing new services and using new technologies in delivering their services. Undoubtedly the first, and relatively easy to accomplish, innovation should be installation of Auto Teller Machines (ATM). These should be introduced in every commercial bank branch, agency and headquarters. As "holes in wall", they guarantee safety for transactions and help clients and customers to deal with them. Thus, there could be more than 444[518] ATM machines available for clients all day long, 7 days a week, all year to facilitate their clients' transactions. Regardless, of the suitability of the banks' general infrastructure, this would help to a large extent in transforming Libya from a cash-based to a card-based society and decreasing the need for cash outside the banking system. Moreover, the machine could undertake an educational role by spreading saving awareness among Libyans, and helping them to rationalise their expenditure. These commercial banks must also upgrade and diversify their banking services and accounts. New types of accounts such as money market deposit accounts and long term deposit accounts are needed.

9) The role of the CBL needs to be redefined and another body should be established to carry some of the bank's duties and responsibilities such as the Financial Services Authority in the UK. Thus, for example, financial jurisdiction and daily supervision could be separated out between the body responsible for regulation and that for supervision[519]. The CBL, for instance, could be responsible for the overall stability of the financial system, for monitoring the monetary system and for such infrastructure as the payment system. On the other hand, the new entity could be responsible for supervising the day-to-day financial activities of the banking sector[520]. This would help to a large extent to: a) build a banking sector data base; b) alleviate the massive government interference; c) provide and build specific measures to improve the internal system; d) encourage the private sector with various subsidiary policies to take central role in the banking sector development; e) most importantly help in

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[518] Approximate number of the commercial banks branches and agencies in Libya.
[519] Many of the interviewees were in favour of this.
[520] Many countries practise this kind of financial system such as Japan, UK and USA

establishing a safe and sound banking sector basis which has both credibility and transparency and complies with international financial standards.

10) New legislations should be enacted to encourage Libyan banks to become involved in community banking and to develop plans to adopt community development projects in future. This could include tax relief as the Libyan banks are the only institutions which generate profits.

11) The CBL should provide training courses and workshops for bank staffs to overcome ambiguities regarding the Basel Committees. However, it could be claimed that the Libyan commercial banks need time to be ready to implement Basel Committees procedures.

12) Bank officials at branch level should be given full freedom for making routine banking decisions in the light of existing banking law.

13) The CBL and the monetary authorities should be determined to seriously cooperate with the IMF and the World Bank.

10.3.2 Islamic Banking

In a contemporary world that is marked with a rapidly changing socio-economic environment, Libya has been gone through a long period of economic isolation. Therefore, the country needs to act now, as banking diversification is an essential goal for its economic development. For instance, the Libyan monetary authorities still do not recognize what Islamic banking can provide for the Libyan people, its banking sector and the economy in general.

10.3.2.1 On the Economy Level

Libya, strategically located in North Africa is a safe and stable country with a small population, a large land area and a long coast. This has opportunities for Libya and Islamic banks.

1) Libya's geographic location and proximity to EU countries makes the country more qualified than other Northern African countries in the region, to play the central role as Africa's financial and banking centre. Moreover, its Mediterranean location could help it develop into an international banking centre and financial focal point between the Arab world, Africa and Europe.

2) Islamic banking would help consolidate these roles and make the country, on the one hand, one of the main Islamic international financial centres and a gateway for Africa for Islamic banking, while on the other hand supporting the new political role that Libya is seeking in Africa.

3) Islamic banking would give Libya a wealth of opportunities in helping reconstruction and modernization of its housing sector, infrastructure, agriculture and tourism. Moreover, Islamic banking can participate in financing huge projects such as building modern airports and factories, which will need massive amounts of capital, similar to the other countries that are practising Islamic banking such as the UAE and Bahrain.

4) Islamic banking can considered as fundamental strategy in the diversification of the Libyan economy, as the country's wealth still emanates from oil which at present remains nearly the only source of income at the national level. In addition, it will contribute to the formation of a financial base of country, which can be utilised for the economic growth of the country.

10.3.2.2 On the Banking Sector Level

1) The emphasis of Islamic banking on ethical, moral, social and religious values can help the Libyan banking sector to remedy its chronic problems, such as fraud, corruption, lack of transparency and credibility, and moral hazard. Such chronic problems can be overcome by using international Islamic standards, such as the Accounting and Auditing Organization for Islamic Institutions Standards as a guide, in conjunction with a *sharia* supervisory board.

2) State support for establishing any new banking structure is very important and cannot be overemphasized. The findings of this research indicate that in order for Islamic banking to participate in the development of the Libyan economy, changes must happen in the state's attitudes regarding the industry. The state should take the initiative of institutionalizing Islamic banking and execute it seriously.

3) It is important to establish a fair and reasonable regulatory framework for Islamic banking in Libya for both economic and social reasons. This entails treating the banking industry operating in Libya on the same basis as all of the banks contribute to the national economy. However, the special position of a *sharia* supervisory board within Islamic banks and the principles of the industry reveal that Islamic banking will be more comfortable with specialized regulations that recognize their particular input. However, in the early stages of implementing Islamic banking in Libya, the recent banking law should be amended so that supervision of the Islamic banks can be accomplished. It is important to realise that future performance and achievement by the industry will be inevitably affected by the industry's legislative framework.

4) Many central banks worldwide have established a main *sharia* board to take over the job of supervising all Islamic banks and institutions. This central board is normally the only source of *fatwas*. The Libyan board will have an executive office and will meet regularly to set up *fatwas*. The board would also maintain contact with the managements of the banking and financial institutions to review their operational reports and to gauge the *Sharia* compliancy of the products. It seems this will be the most suitable form of *sharia* board for implementing Islamic banking in Libya.

5) Islamic banking can help the Libyan banking sector to go global and integrate with the international financial markets. It can help Libyan banks to gain the technical ability to invest efficiently; it can help build a basic banking infrastructure that meets international standards;

it can also act as a magnet in attracting foreign banks to become involved in Libya's banking development. Moreover, local branches of the Islamic banks will be able to access financial and managerial support from their parent bank or group.

6) As the public sector in Libya has failed to carry out the necessary development projects to satisfy people's wishes for a more advanced banking system[521], the suggestion of the interviewees that the most suitable providers for Islamic banking would be the private banks through a system of windows, at least in the experimental stages, is both natural and understandable. Thereafter, foreign investors in partnership with private sector can provide the services. The role of the state in both cases should be to supervise the industry and establish a department in the CBL for the purpose.

7) With regard to privatization, it seems unlikely that the state could find buyers for the banks as presently constituted, so it seems better to market banking services. In Libya's case, marketing banking service offers the best potential for attracting foreign investors to engage in the Libyan banking sector. Therefore, foreign Islamic banks may well be the most suitable investors for establishing partnerships, and providing branch banking services over the Middle East, because they are better able to work in the Libyan business environment. Because they are used to working in the informal financial markets of several countries (although in countries such as the UK it was not easy for Islamic banking to function directly as Islamic banks even though they used to make huge efforts to conduct their activities to meet the demand of their clients), they are already operating in complicated business environments with weak infrastructure, in underdeveloped countries such as Bangladesh and Sudan. These banks have their origins in private capital and have created a wide international network of branches and subsidiaries. On the one hand, they can help in the development and

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[521] Al-Qathafi Warns Corrupt Officials. [On line]. Available from: http://www.tripolipost.com/ [Accessed on 25th November 2006].

the promotion of the Libyan private banking sector nationally, and on the other hand, they can help direct the Libyan private sector towards the global financial market.

8) Marketing Islamic banking services may be also the best strategy for attracting the participation of the main international non-Islamic commercial banks if the regulatory climate can be improved. Most importantly this could greatly reduce the need of the Libyan monetary authorities to find a partner in improving the banking system, and help in accelerating reform of the Libyan banks' infrastructure.

9) Islamic banks can issue *sukuk* or Islamic bonds which can contribute to promoting and strengthening Libya's emerging financial market. The experience of the Dubai Islamic Bank is a good example in this regard. Between 2004 and 2006 the figures for sukuk board operations totalled almost 70% of the whole capital market in the UAE[522].

However, it is clear that Islamic banks' ways of doing business are flexible and clearly feasible for operating in Libya too. This is based on their willingness to seize an opportunity, the urgency with which they act, their appetite for risk and their belief in their own ability to work in a mixed environment.

10.3.2.3 On the Level of Social Environment

Islamic banks are financial institutions based on the intermediation of deposits and involving a variety of financial instruments. Thus, they offer a full range of Islamic deposit and credit products. Their banking instruments such as leasing and advance purchase are similar to those used by other financial institutions, but which are not provided by Libyan commercial banks. The substantial difference lies in sharing responsibility, risk and the prohibition of interest. Moreover, these banks have explicit social goals in addition to profit maximization and conformity with Islamic principles. They make a point of helping a client choose the right

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[522] Dubai Islamic Bank. [On line] . Available from: http://www.cpifinancial.net/cpifn/award/1_bib/Dubai_Islamic_Bank.pdf. [Accessed on 16 January 2008].

finance product. They see this as one of the most important services for a client when they are engage with the banking sector. To this end, Islamic banks provide their clients with effective and innovative *sharia* compliant solutions to their financial needs and are committed to transparency and fairness in their dealings.

According to the research findings, Libyans believe that commercial banking interest in its modern form is prohibited. This may explain why they have so far largely rejected dealing with commercial banks. These results show that Libyans have a considerable but as yet unmet demand for Islamic banking. This is because at present the commercial banks in Libya do not follow Islamic principles in providing financial products and services. These commercial banks make their profit from the margin between the borrowing and lending rates of interest. Moreover, the findings show that Libyans secured loans for non-productive activities and mainly out of human necessity. Thus Islamic banks are ideally geared towards social responsibility programs in Libya for the following reasons:

1) They will invest in academic exchange programs between Libyan universities and other foreign universities, especially on Islamic finance and banking. This will also help in reducing the shortage of skilled employees by people who know the workings of Islamic banking.

2) As the results in this research indicate, these banks will develop rapidly and gain the enthusiastic support of young people and intellectuals. This will open the door to devising new modes of finance based on interest-free products, which can be used for different purposes such as trade, housing and industry whereby a society oriented financial engineering can also be developed.

3) These Islamic banks can help the society to overcome people's negative attitudes towards financial habits for they are in a good position to educate and encourage people as people have trust in Islamic institutions. It is to be recommended that Libyans need to develop a better understanding of savings and investment. These initiatives and praction undoubtedly

help Libyans to save to buy a car, a home, educate their children, perform the Hajj, and prepare for their children's weddings, for their retirement and simply to save.

4) The issue of interest is one of the basic barriers that prevents people from putting their money into savings and investment vehicles. Islamic banks, as interest-free institutions, can thus provide financial services to large segments of people, many of whom have never been served before by commercial banks as a result of their rejection of *riba*. Therefore, with an Islamic bank they can safeguard their money, withdraw it at any time and permit their banks to use their deposits in productive ways. Their deposits can go into a pool which is then invested by the banks in *sharia* compliant investment. Thus, Islamic banks can overcome financial exclusion due to religious preferences.

5) Islamic banks, by mobilizing the considerable holdings which will accrue to the banking sector, will be able to exert a huge effect on the nations' ability to finance domestic investment and, in turn, maximize interaction between the banks and the people.

6) Subsequent to the previous point, Islamic banks have several different methods of using and encouraging saving. It has been proven that their methods do encourage people to save, even though the return to depositors is not fixed in advance but rather based on profit-loss sharing principles. Banks can treat deposits as *quarad Elhasan* from depositors to the bank, or deposits can also be accepted on the *al-wadiah* principle. In both cases, the banks guarantee to return the original amount (value) of the deposit. However, holders of savings in Islamic banks can be given either pecuniary or non-pecuniary benefits[523]. To encourage saving habits, Islamic banks can request depositors to grant the bank permission to employ their funds at its own risk. This will make the depositors consider themselves as shareholders and encourage them to deposit more. However, the banks may use deposits in various other ways such as for

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[523] Islamic banks used this way see: Lewis, Mervyn, and Algaoud, Latifa. *Islamic Banking*. Cheltenham: Edward Elgar, 2001, p. 128.

investment accounts in which profits can be shared in a prior agreed manner on the basis of *mudaraba* and *musharaka.*

7) Islamic banks can go beyond purely financing activities by serving people's basic needs. There is an appetite that needs satisfying at the grassroots for cars, home and electrical goods on a *murabaha* basis. These banks can also use the *istisna* mode of finance to fulfil their clients' requirements in relation to property and buildings[524].

8) Islamic banks can establish trading companies that can finance the credit purchase of commodities as well as assets: a) these companies would buy commodities and assets and sell them back to their clients on the basis of deferred payment which involves equity participation or by using *murabaha*; b) *Ijara wa iktina* is another flexible mode of *sharia* finance for buying properties or vehicles[525]. In this mode of finance, loans may be fully repaid at any time without penalty and the client owns the asset at the end of the contract. None of these modes of finance nor those previously mentioned are at present provided by the Libyan commercial banks.

9) Islam does not deny that capital, as a factor of production, deserves reward. Accordingly, Islamic banks can use several modes of finance to encourage investment in addition to savings; and they can also help in job creation by using for example: a) the *Istisna sharia* mode of finance which can be used by the banks to finance huge projects for manufacturing equipment, vehicles, construction and housing and other related products; b) the two-tier *mudaraba* mode of finance can be used to help in achieving this target. Here the banks act as the *mudarib* on the saving side and as the investor when providing funds to clients ; c) *Takaful* as mode of finance can be used also by Islamic banks to achieve lawful saving and fulfil a range of financial needs of Libyans. The banks can provide several investment strategies from which clients can choose. Moreover, the clients may choose to place their

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[524] This mode of finance was used by the Libyan Land Bank during 1970s to finance housing.
[525] Good example of this mode of finance provider is First Leasing Bank.(See bank website at: http://www.1stleasingbank.com/index.htm)

deposits in *murabaha*. The funds in both cases will be managed by the banks or well-respected investment managers on behalf of the client investor. These modes of finance make Islamic banks work as intermediaries between depositors and investors to provide funds for small and medium-sized enterprises. These kinds of enterprise which will help in job creation and economic development are not presently supported by the Libyan commercial banks. Moreover, the banks can also participate in funding public enterprises which are frequently mega-projects.

10) The *Mudaraba* special investment account is a mode of investment for investors who look for more substantial profits. These special investment accounts are related to specific projects and investors have the opportunity to invest directly in preferred projects carried out by the banks. Moreover, the profit ratio is negotiable as work is based on profit and loss sharing and accords with *sharia* requirements[526]. This mode of finance is in addition to the previous one and can also help in enabling much needed projects in manufacturing and construction industries, and also for creating job opportunities. Such projects plays a vital part in alleviating the negative damaging impact of unemployment which is such a scourge on societies, like Libya, where the size of the active labour force in particular among the youth, due to almost non-existent job opportunities is low.

11) In addition to savings and investments, Islamic banks can provide Islamic insurance by establishing companies based on *takaful* or mutual funds. These companies can offer the full range of *sharia*-compliant *takaful* products and services to the Libyan market similar to those available in other Muslim countries such as Saudi Arabia (*takaful ta'awuni*) and Bahrain (Solidarity *Takaful* Company). However, *takaful* is not a new concept Libyan society in particularly among tribal members does still practise it despite the lack of institutions. Each member of the tribe pools resources in the effort to support the needy within the tribe. These

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[526] See: http://www.rhbbank.com.my/islamic/fd/m_sia.shtm.

people believe that all human beings will invariably be exposed to the possibility of meeting catastrophes and disasters, and that Islam requires that they must find ways and means to respond to such catastrophes and disasters. More importantly, providing this service will do much to help Libyans to overcome their doubts regarding conventional insurance. This is due to the involvement of interest, gambling and uncertainty. Therefore, *takaful* can be seen as an alternative to conventional insurance because it is based on the concepts of social solidarity and cooperation. According to Ayub, the *takaful* business has proved its viability in a period of only twenty years. The industry has been growing at a rate of 10% to 20% annually compared to a global average growth of 5%[527]. Moreover, Article 77 of Banking Law No 5 allows commercial banks to take an ownership stake in other joint companies.

In other words, the provision of Islamic banking will expand the basic retail banking in Libya, help attract more clients and increase opportunities for investment by using new modes of *sharia* compliant finance which, it is envisaged, will lead to the creation of more jobs. This will reflect positively on living standards and increase income over consumption. However, the Libyan monetary authorities may also take into account other countries' experiences regarding Islamic banking provision.

10.4 Further Research Directions

Not every piece of development research has immediate clear policy implication. Therefore, this study may be considered as providing additional support to those efforts that have been made to improve and diversify the Libyan banking sector. As the study has addressed the question of Islamic banking implementation in Libya, the researcher hopes that the study will help in:

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[527] Ayub, Muhammad. *An Introduction to Takaful: An Alternative to Insurance.* [On line]. Available from: http://www.islamic-world.net/economics/takaful_intro.htm. [Accessed on 17 January 2008].

1) Serving as a guide for any further attempt to introduce the industry in countries that also do not have Islamic banking, such as Oman and Morocco.

2) Encouraging future research for comparative studies in Libya and other emerging countries who might have an interest in Islamic banking and finance.

3) Stimulating potential investors to examine the social and financial features of Libyan society and participate in feasibility studies regarding Islamic banking and insurance practices.

With respect to Islamic banking, it is hoped the study will be fruitful in stimulating future research in support of the demand for Islamic banking in Libya and explore the potential implications of:

1) Devising new Islamic banking investment, strategies and opportunities;

2) Using Islamic banking modes of finance in the Libyan commercial banking sector such as *istisna, murabaha* and special investment tools;

2) Islamic insurance;

3) The issuing of Islamic bonds, or *sukuk*;

4) Promotion of *sukuk* and enhancement of the emerging financial markets in Libya;

5) Devising Islamic banking investment, strategies and opportunities;

Regarding the commercial banking sector, there were many points and questions that the study encountered during the investigation of the sector in which it became clear that further research is needed in the subject area, and which could be of interest and benefit to Libya. Below are some of the many current issues, which could be pursued. Fresh thinking is necessary on how these and other issues can be resolved in Libyan banking sector:

1) Measuring the efficiency of the sector;

2) Leadership and its effect on service quality and banking staff performance;

3) Redefinition of the legal rights of creditors and lenders;

4) Factors affecting the implementation of the Basel Rules;

5) The Basel Rules and their possible impact on banking system performance and restructuring;

6) The position of foreign banks, their entry requirements and conditions for foreign investors;

7) Development of Libya's banking infrastructure to keep pace with change in the global environment;

8) Factors affecting the privatization process of Libyan banks;

9) Redefining and evaluating the role of the Libyan Central Bank;

10) Voluntary retirement schemes and their impact on banking performance;

11) The relationship between the banks and private sector development;

12) Low domestic savings and savings awareness.

10.5. Weaknesses and Limitation of the Research Methods

As no previous attempt has been made to assess the contemporary Libyan commercial banking sector and examine the potential for Islamic banking in Libya, this research encountered a difficulty of locating literature material. Consequently, an exploratory approach was used to explore the research subject and the field.

While this study has proved that Islamic banking in Libya is developing tangible roots and has a growing level of support and demand, and hence has been successful in responding to its research question, like any other research, this study also suffers from certain limitations. First, the sample that has been analysed in this study is restricted merely to one group, namely bank clients, even though there are many other stake-holders, such as non- bank clients, and students who can be considered as potential bank customers.

Second, this study concentrated only on one city in Libya (Benghazi), which may not be considered as a representative from which generalisations can be drawn. However, it is impossible to expand the research into other areas of the country due to time and resource constraints. It is also important to state in defence that Benghazi is the largest economic, social and cultural city in Libya, which has attracted people from all over the country. This, indeed, makes Benghazi to represent Libya in various dimensions including baking related issues.

A final limitation of this study relates to the number of control factors which may have impact on banking behaviour, as this study only included to main factors: age and level of education. However, other active factors could have been considered such as gender. This as mentioned previously is due to scarcity of information, statistics regarding the Libyan banking sector, and to the lack of a National Data Base and Information Centre. It is also important to state that underdeveloped civil society in Libya undermines the process of drawing samples from various sections of the society. This is a problem in most of the developing countries, and is an important problem in Libya, which still is a traditional society.

Lastly, the answers from the respondents regarding their desire having Islamic banking in Libya is indeed based on their aspirations, as there is no Islamic banking available in the country. This might be considered as response bias. However, as mentioned, this study aimed also to explore the potential for Islamic banking; and therefore, it does not constitute this issue as a response bias.

10.6. Final Thoughts

In this study we have tried to provide a comprehensive survey of the Libyan commercial banking sector's services and products and of desirable reforms and obstacles which may

hinder development. Moreover, the study has tried to investigate the possibility of adopting an Islamic banking system in Libya.

The results obtained are quite satisfactory when account is taken of the limited resources and data available regarding the banking commercial banking sector in Libya. The results reflect in general the domination and interference of the state in the banking industry and the extent to which it has distracted the commercial banks from achieving their targets.

In addition, the findings show that in to implementing an Islamic banking service in Libya: a) the possibility, utilization and the chance of success of Islamic banking in Libya will be very high; b) the banks will play a significant part in enhancing their clients knowledge and understanding of banking and financial matters in general and, hence their confidence and ability to handle their financial affairs. This will greatly increase trust and reduce uncertainty in the banking sector as a whole.

Despite the fact that this study has been carried out to assess the contribution of the Libyan commercial banks to the economy in general, and the possibility of implementing an Islamic banking system in particular, it is hoped that the objectives and factual information presented together with the views of the respondents and interviewees will increase the resolve of the Libyan monetary authorities to improve the administrative machinery and diversification of the banking sector. However, the state will need to encourage research in this direction and provide facilities and information on the economy as a whole as well as on the banking sector in particular. Therefore, this research may satisfy part of the intellectual cravings of young Libyan researchers, and help them to continue with research in order to improve the country's banking system.

Finally, it is hoped that further research can also include evaluating the performance of the sector and the possibility of introducing further changes in the banking industry and its services. Consideration of the banking reforms that have taken place in countries such as

Malaysia and the GCC countries should help Libya to enjoy the benefits and avoid the hazards of implementing their models in Libya.

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APPENDICES

Appendix1

جامعة ديرام

معهد الدراسات الاسلامية والشرق أوسطية

Durham University

Institute for Middle Eastern and Islamic Studies

Questionnaire- Survey

- صمم هذا الاستبيان للإستطلاع عن خبرتك بالخدمات المصرفية بشكل عام، و لمعرفة مدى معلوماتك عن البنوك الاسلامية والخدمات التي تقدمها.

- This questionnaire is designed to discover your perspectives on banking, your experience, and your expectations on Islamic banking services.

- ليس لهذا الاستبيان أي أثر أو تأثير قانوني، فهو ببساطة وسيلة رأينا إستخدامها ونأمل في مساعدتك لنا بتمكيننا من معرفة رأيك في الموضوع وذلك باستجابتك لاستفسارت هذا الاستبيان. وسوف تذكر الدراسة النتائج والخلاصات التي تحصلت عليها من هذا الاستبيان

- This questionnaire is not a will and has no legal validity. It is simply a tool to help us draft your opinions. After completion, the study's aims measures and conclusions will be reported.

رجاءً أكمل الاستبيان بكل عناية و بكل دقة، فسوف يكون لرأيك تأثير كبير على النتائج التي سنستخلصها من هذا الاستبيان، ولك جزيل الشكر.

Kindly, complete this questionnaire. Your careful consideration will increase the efficiency and accuracy of your responses. Your participation is greatly appreciated

الجزء الأول: معلومات عامة

PART I: General Information

1.1) الجنس

☐ ذكر

☐ أنثى

1.1) Gender

☐ Male

☐ Female

1.2) العمر

☐ 29-20

☐ 39-30

☐ 49-40

☐ أكبر من 50

1.2) Age

☐ 20- 29

☐ 30- 39

☐ 40- 49

☐ Over 50

1.3) الحالة الاجتماعية

☐ متزوج

☐ أعزب

☐ آخر .....

1.3) Marital Status

☐ Married

☐ Single

☐ Other ----------

1.4) التعليم

☐ ثانوية عامة

☐ شهادة تدريب مهني

☐ الدرجة العلمية المتحصل عليها:

- o بكالوريوس أو ما يعادلها
- o ماجستير أو ما يعادلها
- o دكتوراه أو ما يعادلها

1.4) Education

☐ Secondary School

☐ Vocational School

☐ Degree Obtained:

- BSC or equivalent
- MSC or equivalent
- PhD or equivalent

1.5) مصدر دخلك

أ- وظيفة

☐ في إحدى ادارات الدولة – وظيفة عامة

☐ في شركة عامة

☐ في شركة خاصة – شركة تجارية

☐ في إحدى مؤسسات الخدمة الاجتماعية

1.5) A Source of your income

a)Paid employment:

☐ For state – governments' establishment, agency, institution.

☐ For state – governments' company

☐ For commercial company

☐ For social organization or association

ب- وظيفة خاصة

☐ مقاول

☐ محامي، محرر عقود، شرطي، فني فحص (في ورشة مثلا...)

☐ عمل ما بشكل مستقل

b) Self – employed registered as :

☐ Individual entrepreneur

☐ Notary, lawyer, officer, auditor

☐ A person executing works individually

ج- دخل من ممتلكات شخصية

☐ حدد.....

c) Income from personal property

☐ Specify type.....

1.6) متوسط دخلك في الشهر بالدينار الليبي

☐ أقل من 200

☐ 300-201

☐ 400-301

☐ 500-401

☐ 600-501

☐ 700-601

☐ 800-701

☐ 900-801

☐ 1000-901

☐ أكثر من 1000

1.6) Your average income per month (LD) .

☐ Less than 200

☐ 201-300

☐ 301-400

☐ 401-500

☐ 501- 600

☐ 601- 700

☐ 701-800

☐ 801-900

☐ 901-1000

☐ More than 1000

الجزء الثاني: معلوماتك عن الخدمات المصرفية

Part II: Banking Background

2.1) هل لديك حساب مصرفي

☐ نعم

☐ لا

2.1) Do you have bank account?

☐ Yes

☐ No

2.2) اذا كانت الاجابة لا هل من المحتمل أنك ستفتح حساب مصرفي

☐ غير محتمل إطلاقا

☐ غير محتمل

☐ ليس محتمل وليس مستبعدا

☐ إلى حد ما محتمل

☐ محتمل جدا

☐ غير وارد

2.2) If no, How likely is it that you will open a bank account?

☐ Very unlikely

☐ Somewhat unlikely

☐ Neither unlikely nor likely

☐ Somewhat likely

☐ Very likely

☐ Not applicable

2.3) منذ متى تتعامل مصرفيا مع مصرفك

☐ أقل من 3 سنوات

☐ من 3 إلى 6 سنوات

☐ من 6 إلى 9 سنوات

☐ من 9 إلى 12 سنة

☐ أكثر من 12 سنة، رجاءً، حدد .....

2.3) how long have you been banking with your bank?

☐ Less than 3 years

☐ 3 to 6 years

☐ 6 to 9 years

☐ 9 to 12 years

☐ More than 12 years

☐ Other, please specify ——————————

2.4) ما السبب الذي جعلك تفضل أن تفتح حسابك المصرفي في مصرفك الحالي، هل هو

☐ سمعة المصرف

☐ الخصوصية والسرية لمعلوماتك المصرفية

☐ نصيحة من أحد أقاربك

☐ نصيحة من صديق

☐ توجيهات جهة العمل

☐ دعاية للمصرف شاهدتها

☐ سبب أخر، رجاءً حدد .....

2.4) What are the most important reasons you opened a bank account in your bank

☐ Reputation of the bank

☐ Bank's confidentiality

☐ Organisation's instructions

☐ Location of the bank

☐ Advice from relatives

☐ Advice from friends

☐ Advertising through the media

☐ Other, please specify ——————————

2.5) هل حسابك المصرفي في

☐ بنك مملوك للدولة بالكامل

☐ بنك خاص

☐ بنك مملوك للدولة وللقطاع الخاص معا

☐ آخر، رجاء حدد .....

2.5) Do you have a bank account with

☐ Conventional state-owned bank only

☐ Private bank only

☐ Conventional bank and private ban

☐ Other, please specify ——————————

2.6) حين قررت فتح حساب مصرفي في مصرفك، هل إستلمت منشور يوضح لك خدمات المصرف التي ستحصل عليها

☐ نعم

☐ لا

2.6) Did you receive any leaflets, or explanation about bank services and accounts when you started to deal with your bank?

☐ Yes

☐ No

2.7) ما السبب الرئيسي الذي يجعلك تزور مصرف (رجاءً أذكر أهم سبب)

☐ للإيداع

☐ للحصول على نصيحة حول بدائل للاستثمار

☐ للاستعلام عن الرصيد

☐ للسحب

☐ آخر، رجاءً حدد .....

2.7) What is the main reason that you typically visit your bank? (Please choose the most important reason)

☐ To make a deposit.

☐ To get advice for investment options

☐ To enquire about a balance

☐ To withdraw c

☐ Other, please specify ——————————

2.8) ما معدل زياراتك لمصرفك شهريا

☐ أقل من 1 مرة

☐ من 1 إلى 3 مرات

☐ من 3 إلى 6 مرات

☐ من6 إلى 9 مرات

☐ من 9 إلى 12 مرة

☐ أكثر من 12 مرة

2.8) How frequently do you visit your bank per month?

☐ Less than 1

☐ 1 to 3 times

☐ 3 to 6 times

☐ 6 to 9 times

☐ 9 to 12 times

☐ over 12 times

2.9) ما نسبة ما تودعه من دخلك شهريا في حسابك المصرفي بغرض حفظه

☐ %

☐ غير محددة

☐ الدخل غير ملائم لحفظ شئ منه

2.9) What is the percentage of your monthly income you deposit to your bank account ?

☐ %

☐ Don't know

☐ Not applicable

2.10) ما نوع حسابك المصرفي (رجاءً إختر أكثر من خيار إذا وجد ذلك)

☐ حساب جار

☐ حساب توفير

☐ حساب جار وتوفير معاً

☐ حساب آخر، رجاءً حدد .....

2.10) Which accounts do you have at your bank? (please tick more than one if necessary)

☐ Current account only

☐ Saving account only

☐ Current and saving accounts

☐ Other type of accounts, please specify ----------

2.11) هل استلمت أو تحصلت من مصرف على معلومات أو نصائح تخص نشاطاته

☐ نعم

☐ لا

2.11) Do you get information, knowledge or advice concerning bank activities from your Bank?

☐ Yes

☐ No

2.12) إذا كانت الإجابة بنعم

رجاءً، ما الوسيلة التي وصلتك بها المعلومات .....

2.12) If yes, in which way

Please specify ——————————

2.13) غالبا أستلم المعلومات كل:

☐ شهر

☐ 3 أشهر

☐ نصف سنة

☐ كل سنة

☐ آخرى، رجاءً حدد .....

2.13) How often?

☐ Monthly

☐ Quarterly

☐ Half-yearly

☐ Yearly

☐ Other, please specify ——————————

2.14) هل تعاملت مع أي من الخدمات المصرفية التالية

☐ الخدمات المصرفية على الانترنت

☐ آلة الدفع (الصرف) التلقائي

☐ بطاقة الائتمان

☐ بطاقة المدين

☐ كشف الحساب الشهري

☐ الخدمات المصرفية عن طريق الهاتف كمعلومات الحساب المصرفي

☐ الشيكات المصرفية العادية

☐ تحويل نقود

☐ قرض شخصي للاستخدام الخاص

☐ **تعامل مكشوف (يتجاوز فيه المدين قيمة اعتماده)**

☐ سحب مالي مكشوف

☐ الشيكات السياحية

☐ كتاب إعتماد

☐ كتاب ضمان

2.14) Have you performed any of the following activates?

☐ Internet Banking

☐ Self- service machine

☐ Credit card

☐ Debit card

☐ Monthly bank statement

☐ Telephone banking

☐ Standard cheques- banking

☐ Money transfers

☐ Personal Loan

☐ **Overdrafting**

☐ **Overdrawing**

☐ Traveller cheques

☐ Letter of credit

☐ L / G

2.15) ما هو الشئ الهام الذي في إعتقادك يحدد مدى نجاح المصرف (1= أهم شئ، 5= الأقل أهمية)

☐ أن يكون له شبكة واسعة ومتشعبة من الفروع

☐ الخدمات الجديدة التي يقدمها

☐ الأمان والسرية للمعلومات

☐ خبرة وحرفية فريق الادارة وسلاسته في التعامل

☐ إنخفاض تكلفة خدماته

2.15) What do you think is the most important issue for determining the success of a bank. (Please rank your answer: 1= the most important, 5=the least important)

- ☐ Wide branch network and convenience at nearest bank
- ☐ New customer's products and services
- ☐ Privacy and data protection
- ☐ Management team with great deal of experience and a high degree of professionalism
- ☐ Low services charges

) كزبون ملتزم للمصرف، هل أنت راضي عن خدماته التي يقدمها لك

- ☐ راضي جدا
- ☐ راضي
- ☐ لا أعلم
- ☐ غير راضي
- ☐ غير راضي إطلاقا

2.16) As a loyal Bank customers, are you happy with the services provided by your bank

- ☐ Strongly satisfied
- ☐ Satisfied
- ☐ Undecided
- ☐ Not satisfied
- ☐ Strongly dissatisfied

2.17) أيهم تراه يقدم خدمات بنكية أفضل

- ☐ البنوك العامة (المملوكة للدولة)
- ☐ البنوك الخاصة

2.17) Which ones provide better bank services

- ☐ State-owned banks
- ☐ Private banks

2.18) إذا كنت غير راضي عن الخدمات التي يقدمها لك مصرفك، فالسبب هو (إختر إذا كان هناك أكثر من واحد)

☐ ساعات دوام المصرف محدودة

☐ خدمات المصرف محدودة

☐ موظفو المصرف غير متعاونين أو غير خدومين

☐ إرتفاع كلفة خدماته

☐ مساحة المصرف مكتضة بدون توفر مقاعد للانتظار

☐ آخر، رجاءً حدد .....

2.18) If you are not satisfied with the services that your bank provides, the reasons are (please tick more than one if necessary)

☐ Opening hours of the bank are restricted

☐ Only limited bank products and services

☐ Unfriendly staff

☐ High service charges

☐ Bank premises are crowded and without seating

☐ Other, please specify ——————————

الجزء الثالث: حالة وموقف الزبون من التعامل مع الفائدة المصرفية

PART III: Client Attitudes to Interest

3.1) إذا كسبت أو تحصلت على مبلغ كبير إلى حد ما، ماذا ستفعل به (رجاءً أعطي درجة لإختيارك كالتالي:

1=الاكثر تفضيل، 9= الأقل تفضيلا)

☐ إيداع النقود في مصرف تجاري يضمن عائدا معقولا

☐ يعتمد ذلك على نظام الفائدة المتوفر

☐ أبدأ في إنشاء مشروع يدر علي ربحا

☐ أشتري منزل أكبر

☐ أغير سيارتي بطراز أخر جديد و فاخر

☐ إيداع النقود في مصرف خالي من الفائدة

☐ أستثمر في الأسهم المالية

☐ أستثمر في السندات الحكومية

☐ سوف أوزع النقود على أكثر من خيار من الخيارات السابقة

3.1) If you acquired a substantial sum of money, what would you do with it? (Please rank your answer; 1= the most preferred and 9=least preferred)

☐ Deposit the money in a commercial bank which guarantees a return in

☐ Accordance with an interest- based system

☐ Start up a small business or project which would earn profits

☐ Purchase a larger house

☐ Exchange my car for a new and more luxurious model

☐ Deposit the sum in an interest-free bank

☐ Invest in shares

☐ Invest in bonds

☐ Combination of the above?

3.2) هل سبق لك وأن تحصلت على قرض من مصرفك

☐ نعم

☐ لا

3.2) Have you secured any loan from your Bank?

☐ Yes

☐ No

3.3) إذا كانت إجابتك نعم على السؤال السابق نعم

☐ لشراء منزل

☐ لشراء سيارة

☐ لغرض إجتماعي مثل نفقات إحتفال الزواج (نفقات العرس)

☐ لتمويل مشروع صناعي صغير

☐ للصرف على نفقات علاج في الخارج

☐ لإرجاع نقود سبق إقتراضها كدين شخصي

☐ أكثر من خيار من الخيارات السابقة

3.3) If yes,

☐ For house purchase

☐ For car purchase

☐ For social expenses such as weddings

☐ For financing a small manufacturing venture

☐ For financing medical treatment abroad

☐ For paying back personal loans

☐ Combination of the above

3.4) ما هو شعورك وأنت تدفع الفائدة المصرفية

☐ عادي، كإقتراضي للنقود

☐ من الظلم أن تدفع إضافة للدين الأصلي

☐ أنها شكل من أشكال الاستغلال

☐ أشعر بالذنب لأسباب دينية

☐ آخر، رجاءً حدد.....

3.4) How did you feel about paying interest?

☐ It was normal, as I borrowed money

☐ I felt it was too much to pay on loan

☐ I felt it was exploitation

☐ I felt guilty due to religious reasons

☐ Other, please specify ——————————

3.5) هل تعتبر الفائدة المصرفية كسب غير مشروع

☐ نعم وبكل تأكيد

☐ نعم

☐ لا

☐ لا وبكل تأكيد

☐ لا أدري

3.5) Do you consider bank interest an ill-gotten gain?

☐ Strongly agree

☐ Agree

☐ Disagree

☐ Strongly disagree

☐ Undecided

3.6) هل تعتقد أن الفائدة المصرفية والربا سواء (نفس الشئ)

☐ نعم

☐ لا

☐ لا أدري

3.6) Do you think bank interest is the same as riba?

☐ Yes

☐ No

☐ I do not know

3.7) إذا كنت غير موافق على النقطة السابقة، في أي الخدمات المصرفية وفي أي نوع من الحساب المصرفي تكون الفائدة جائزة

☐ حسابات الاستثمار والحسابات الشبيهه به

☐ القروض الشخصية

☐ القروض الاستثمارية

☐ القروض الشخصية وحسابات الاستثمار

☐ آخر، رجاءً حدد .....

3.7) If your response to 3.6 was no, which of these banking services, or banking accounts, do you consider lawful

☐ Investment accounts and similar accounts

☐ Personal loans

☐ Investment loans

☐ Personal loans and investment accounts

☐ Other, please specify ——————————

3.8) هل هناك دوافع معينة اذا توفرت تجعلك تقترض بفائدة بنكية

☐ نعم

☐ لا

3.8) Are there any special reasons that make you deal with interest bearing loans?

☐ Yes

☐ Specify it please .....

3.9) هل سبق لك وأن استفدت من الفائدة البنكية (عن طريق حساب توفير مثلا او غير ذلك)

☐ نعم

☐ لا

3.9) Have you ever profited from bank interests?

☐ Yes

☐ No

3.10) هل توافق على أن تعامل البنوك بالفائدة فقط مع الهيئات و المؤسسات؟

☐ نعم

☐ لا

3.10) Do you suggest that banks should only charge firms and organisations interest?

☐ Yes

☐ No

3.11) هل لديك فكرة عن البنوك الخالية من التعامل بالفائدة

☐ نعم

☐ لا

3.11) Do you know about interest-free banking?

☐ Yes

☐ No

3.12) إذا أردت أن تصف ماذا يعني لك البنك الذي لا يتعامل بالفائدة ، فستقول:

☐ تحريم الربا

☐ تجارة بدون فائدة

☐ نظام صديق وبيأة إنسانية

☐ نظام مالي مقبول ويشجع على التعامل معه

☐ كل النقاط السابقة

3.12) If you define what interest-free banking means to you, which of the following statements would you choose?

☐ Only prohibition of riba

☐ Trade without interest

☐ Human-oriented and environmentally friendly system

☐ Jointly acceptable just financial system

☐ All of the above

3.13) ما مصدر معلوماتك عن البنوك الخالية من الفائدة في تعاملاتها

☐ الجرائد والمجلات

☐ االتلفزيون والراديو

☐ الأصدقاء وأعضاء العائلة

☐ السفر للخارج

☐ أخر، رجاءً حدد.....

3.13) Source of knowledge of interest-free banking

☐ Newspapers and magazines

☐ Television and radio

☐ Friends and family members

☐ Visit abroad

☐ Other, please specify ——————————

3.14) هل تعرف الفرق بين البنوك الخالية من التعامل بالفائدة والبنوك العادية

☐ نعم

☐ لا

3.14) Do you know the difference between interest-free banking and conventional banking?

☐ Yes

☐ No

3.15) إذا وفر مصرفك خدمة تمكنك من التعامل معه والاستفادة من خدماته بدون فائدة، هل ستتعامل مع هذه الخدمة

☐ عى الأرجح

☐ محتمل

☐ مستبعد

☐ لست مهتما

3.15) If your Bank were to provide a window for interest-free banking, would you use this service?

☐ Very likely

☐ Possibly

☐ Unlikely

☐ Not interested

3.16) إذا كنت موافق على النقطة السابقة، هل ستحول تعاملاتك مع مصرفك إلى هذه الخدمة الجديدة التي يقدمها (الخدمة بدون فائدة)

☐ كل قيمة حسابك وودائعك لدى المصرف

☐ الجزء الأكبر من قيمة الحساب والودائع

☐ جزء قليل من قيمة الحساب والودائع

☐ لا أدري

3.16) If you were to agree, would you transfer your banking to this window

☐ All of your deposits

☐ Most of your deposits

☐ A minor portion of your deposits

☐ Undecided

3.17) إذا قررت أن تنقل حسابك ومدخراتك إلي بنك لا يتعامل بالفائدة، سيكون السبب الذي دفعك لذلك هو

☐ ديني

☐ أخلاقي بسبب مبدأ ما

☐ إجتماعي

☐ عدة أسباب مما ذكر

☐ آخر، رجاءً حدد .....

3.17) If you decided to transfer your deposits, the reasons which would motivate you to deposit your money at an interest-free bank would be:

☐ Religious reason solely

☐ Ethical reason solely

☐ Social reason solely

☐ Combination of the above

☐ Other, please specify ——————————

3.18) إذا نقلت حسابك ومدخراتك إلي بنك لا يتعامل بالفائدة، وإذا أعلمت بأنه سوف لن توزع أي أرباح من الاستثمار على حسابات التوفير طيلة عام كامل، فماذا سيكون رد فعلك

☐ أحتفظ بودائعي وحسابي في نفس المصرف

☐ أسحب كل قيمة حسابي مرة واحدة وأضعها في في بتك يضمن لي عائد مضمون

☐ أُبقي علي قيمة حسابي في المصرف الخالي من الفائدة ، لأنه سيعود علي بالربح في خلال سنوات بسيطة

☐ أستشر من لهم علاقة و أصدقائي وأقاربي وجيراني ثم أقرر ماذا أفعل

☐ لا أدري

3.18) If you had transferred your deposits to an interest-free bank, and it announced that it had no profits to distribute on investment and saving accounts for one year, which of the following would you do?

☐ Keep the deposit with the same bank

☐ Withdraw all deposits at once and switch them to another banks which guarantee a return

☐ Retain a deposit at an interest-free bank because it could distribute high profits in subsequent years

☐ Consult relatives and neighbours then decide what to do

☐ I do not know

3.19) هل ستغلق حسابك في المصرف الخالي من الفائدة إذا كان معدل الارباح أقل من معدل الفائدة في حسابات التوفير في البنوك التجارية التي تتعامل بالفائدة

☐ نعم

☐ لا

☐ لا أدري

3.19) Would you close your account at an interest-free bank if the rate of profit was lower than the interest rates on saving accounts at commercial banks?

☐ Yes

☐ No

☐ Undecided

3.20) هل توافق على أن تفتح البنوك الخالية من التعامل بالفائدة في كل أجزاء البلاد، وتعتقد أن الناس سينتفعون بالخدمات التي تقدمها

☐ أوافق بشدة

☐ أوافق

☐ لا أوافق

☐ لا أوافق بشدة

☐ لا أدري

3.20) Do you agree that if interest-free banks opened up throughout country, people will utilize the services provided by these banks?

☐ Strongly agree

☐ Agree

☐ Disagree

☐ Strongly disagree

☐ Do not know

3.21) إذا كانت البنوك الخالية من الفائدة ستفتح في البلاد، فمن تراه مخولا لأن يقدم ذلك

☐ الدولة

☐ البنوك التجارية

☐ القطاع الخاص

☐ البنوك الأجنبية

☐ آخر، رجاءً حدد.....

3.21) If interest-free banking is to be provided in the country, who would you like to provide the services?

☐ The state

☐ Commercial banks

☐ Private sector

☐ Foreign banks

Other, please specify ——————————

3.22) ماذا هو الاسم الذي تفضل أن تطلقه على الخدمات المصرفية خالية من الفائدة

☐ خدمات مصرفية إسلامية

☐ خدمات مصرفية خالية من الفائدة

☐ خدمات مصرفية تجارية اسلامية

☐ خدمات مصرفية خاضعة للشريعة

☐ خدمات مصرفية إجتماعية

☐ خدمات مصرفية تراعي الأخلاق

☐ آخر، رجاءً حدد.....

3.22) What would you prefer interest- free banking services to be called

☐ Islamic banking services

☐ Interest-free banking services

☐ Muslim commercial banking

☐ Shariah compliant banking

☐ Social banking

☐ Ethical banking

☐ Other, please suggest———————————

3.23) إذا كان إختيارك سيكون المصرف الاسلامي، فحدد رجاء ما هي أكثر العوامل التالية أهمية

☐ معدل ربح أكبر ومصاريف أقل

☐ حنكة ودراية المصرف بما يقدمه من خدمات

☐ موقع البنك

☐ حجم البنك

☐ سرية تحويل النقود

☐ آخر، رجاءً حدد.....

3.23) For your choice of an Islamic bank, please indicate how much each of the following factors (were) are important for you:

☐ Better rates and lower services charge

☐ Bank familiarity

☐ Bank location

☐ The size of the bank

☐ Security of transaction

☐ Others

الجزء الرابع: معلومات إضافية

من فضلك أستخدم هذه المساحة في إضافة أي معلومات أخري بالتفصيل ما أمكنك

PART VI: Additional information:

***Please use this area to add additional information. Please be as descriptive as possible*.....**

.....

.....

.....

Appendix 2

The Semi Structured Interviews

Subjects and Questions

General Information:

Case number----------, Interviewee code ----------, Date of the interview----------.

Place----------,Remarks----------

Interviewee Information

Age----------, Gender ----------, Present occupation---------- -------,

Past occupation----------,Remarks ----------

Experiences (a brief history of operations?). ----------

Subjects and Questions

1

The Banking Market

1.1) In your experience do you think the number of the bank is too many or too few?

1.2) If you consider them too few, what do you think more the obstacles that hindered the expansion of the banking sector?

1.3) Under normal circumstances, who decides when and how the gross profits and net profits are to be distributed in a bank?

1.4) Would you please reflect on the performance of the banking sector in Libya? Particularly compare the state banks with the private banks?

1.5) Marketing research is considered one of the basic panels in the development of a service organisation. Do Libyan banks consider this fact and have departments specializing in investment appraisal and marketing studies?

1.6) What are the methods adopted by Libyan banks to raise the awareness of people about savings and savings accounts?

1.7) Do the banks have any collateral system to secure their advance?. If yes please provide details?

1.8) Do the Libyan banks collect *zakah* from clients and the public and distribute it to needy people?

1.9) Do you think that the Libyan banks have adopted practices, which could be considered as part of corporate social responsibility?

1.10) If yes, please indicate such practices?

2

Account Services

2.1) What are the types of account offered by the Libyan banks?

2.2) What other financial services are provided by the Libyan banks?

2.3) In general, banks consider small savers as one of the basic sources of funding banking operations. In your opinion, to what extent do you think that Libyan banks are capable of encouraging small savers to save and invest?

2.4) How do Libyan banks calculate gross profits (of depositors), and net profits (for shareholders)?

2.5) Are any conditions for depositors to be entitled to profit such as a minim contract period?

3

Staffing

3.1) One of the basic factors in any organisation's development and success is suitable staff

a) How do you view the role of bank staff in terms of providing and developing banking services?

b) Do you think that the Libyan banks suffer from a lack of suitable staff?

c) If the Libyan banks suffer from this problem, what are the approaches adopted by them to overcome this problem?

4

Potential for Interest-Free Banking

4.1) In many societies there are people who refuse to deposit or invest their money in a banking system which includes interest due to ethical or religious reasons. Do Libyan banks offer interest-free facilities?

4.2) Do the Libyan banks offer interest-free loans for needy people?

4.3) If yes, are there any conditions in which clients are entitled to this kind of loan?

4.4) Have Libyan banks adopted any microfinance scheme to help people to form a business?

4.5) If yes, what criteria do banks seek in distributing funds to such people?

4.6) Can this project be financed in an interest-free manner?

5

The Banks Relationship with the Supervisory Authority (CBL)

5.1) From your experience how do you see the relationship between the CBL, the state and the banks?

5.2) Does the CBL supervise all banking system activities and approve new banking services?

5.3) Does the CBL have the right to inspect the operations and the records of the banks at any time?

5.4) The banking sector was owned and controlled by the government following the nationalisation program of 22/ 12/ 1970. This has led to a number of problems such as moral hazard, mismanagement and poor performance. The CBL has moved towards liberalising and privatising of the banking sector, in order to construct transparency in the banking system

a) To what extend do you think this step will help in reforming the Libyan system?

b) In your opinion have recent circumstances helped the banking sector too prepare for privatisation?

5.6) The banking system in Libya has witnessed the establishment of new banks under the name of domestic banks (Al-Massaraf Al-Ahliya), to play an active role in development projects. To what extend do you think these banks have succeeded in achieving their targets?

5.7) Do you think that the existence of the Domestic Banks has created competition between them and the state-owned banks in terms of attracting deposits?

5.8) Are there any facilities given by the CBL, as the regulatory authority, to state-owned banks rather than to private or domestic banks?

5.9) Do you think the CBL discriminates against private banks in favour of state-owned banks?

5.10) Are the private banks liable to pay more taxes than state-owned banks?

5.11) Do you think interest-free banking can play an important role in the development process of the Libyan banking sector? Please explain your answer?

5.12) From your point of view, are there any obstacles in the banking regulation system which particularly hinder banking operations? Please specify

6

The Relationship Between the Libyan Banking System and the International Banking Institutions, and the International Banking Society in General

6.1) Are the Libyan banks members of any international associations?

6.2) If yes, can you specify these Associations?

6.3) In what way does this membership benefit the Libyan banks?

6.4) If not, what are the reasons which restrain the banks from being members?

6.5) Are the Libyan banks involved in investing part of their capital abroad?

6.6) If yes, in which countries?

6.7) Do the Libyan banks have any business dealings with other foreign banks or financial institutions either locally or internationally?

6.8) To what extend are Libyan banks subject to the regulations and decisions of international committees such as the Basel Committees?

6.9) For more than a decade, the UN sanctions had a severe impact on Libya, particularly on the country's economic and social spheres. One consequence were in banking sector that was the lack of modernisation. In your opinion

a) To what extend can you blame the UN sanctions for this situation?

b) Do you think that overcoming the obstacles, can this help to transfer the Libya move from a cash society to a credit society?

6.10) In an interview with the Times Newspapers, on 15 May 2005, Mr Mohamed Layas, the chairman of the Libyan Arab Bank, commented on the law issued by the CBL, regarding encouraging the foreign companies and banks to invest in Libya. He said, "Libya is not in need of foreign investment to provide funds". In your opinion

a) What can the foreign banks and companies offer to the Libyan economy.

b) To what extant do you think that the future existence of foreign investment can help in establishing a financial market in Libya.

7

The Potential of Islamic Banking

7. 1) In the light of the new baking regulation system, do you think in the near future Libyan bank clients can enjoy new banking services, such as ethical banking and interest-free banking?

7.2) From your experience how do you see the role of the *Sharia* institutions and scholars in the Libyan Society?

7.3) In the light of recent circumstances, do you think that Libyan society is ready to accept Islamic banking?

7.4) To what extent do you think that Islamic banks can achieve their targets if they can establish themselves in Libya?

7.5) In the light of recent Libyan legislation do you think that Libyan banking Law is now able to supervise Islamic banks, or are separate legislation and regulation needed?

7.6) Do you think that Libyan society suffers from a lack of scholars in *fiqh Almua'mat*, and knowledge of contemporary financial markets and practices?

7.7) If Libyan society is suffering from a lack of scholars, in your opinion what approaches can be adopted by future Libyan Islamic banks to overcome this problem?

7.8) In general there are two forms of sharia boards practising Islamic banking. First, the national sharia board, second, the sharia boards for every Islamic bank and window. In your opinion (in case of its existence) which one do you consider more suitable for the Libyan banks?

7.9) Who do you think should have the right to appoint and approve the sharia board members in the event of Islamic banking implementation in Libya?

7.10) Who do you think should have the right to provide the Islamic banking services in Libya, and in which form should it be provided?

7.11) In a society used to a banking sector built on interest-based credit, how do you view the key principles of Islamic banking products and mode of finance?

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