

CHALLENGES FACING ISLAMIC BANKING IN ZANZIBAR

A CASE OF AMANA BANK AND PBZ ISLAMIC BANKING DIVISION

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Abstract:

Passion in the working of Islamic banking has been growing worldwide, not only among Muslims but also Non-Muslims, not only among individuals but within institutions too. A growing interest has been perceived recently due to Islamic Banks' role in providing affordable services and in a just manner to the customers where an effective framework is in place for its smooth functioning. In several places, despite the usefulness of Islamic banking system, it encounters several challenges compared to conventional banks; the challenges include legal, regulatory and misconceptions or lack of understanding of their important features.

This study is aimed at assessing the challenges of Islamic banking in Zanzibar. AMANA Bank and PBZ Islamic Banking Division were selected due to their popularity in Zanzibar; while PBZ was the first to establish a separate division to offer Islamic Banking services, Amana Bank was the first full-fledged Islamic Bank. Branches in the Zanzibar Municipality were chosen as study population for collecting the data.

The study applied the purposive sampling; which gave the researchers opportunities to decide participants to be plunged in a study according to study criteria. The quota sampling was used to divide population of challenges into strata to have a good representative of other Islamic banks and increased variability; In controlling the study, both primary and secondary sources of data were used. The bases of primary data were from employees of the mentioned banks. The secondary data were collected from websites and other publications. The open-ended questionnaire was selected for data collection.

Results from the study show that some people in Zanzibar lacked awareness on Islamic banking; mmajority of the consulted were customers because of their faith. Moreover, a big segment of Zanzibar society could not differentiate between profit and interest. In addition, the study learned that there were no Islamic Banking Regulations governing their operations, conventional banking regulations are used making the former to lack a competitive working ground.

This study recommends more education and awareness on at least basic Islamic Banking Principles. Also, Islamic banks should offer services that meet affordable customer demand based on their faith. Finally,

statutory bodies handling Islamic Finance should learn from other countries how to handle these new experiences to make them appealing to the customers and contribute optimally in economic development of a country including financial inclusion.

Keywords: Challenges, Facing, Islamic Banking, Zanzibar

A- Introduction

Islamic banking is a banking system according to Shariah principles. Shariah rules prohibit interest, gambling, involving in ambiguous deals, investing in non halal products or harmful activities. From the early stages of history, Muslims were able to sell and buy without interest.

In the recent past, seeing opportunities from Islamic Finance, the United Kingdom reiterated its intention to remain not only a financial centre but “a hub of Islamic finance” in Europe. As it was preparing to launch its second sovereign Sukuk, or Sharia-compliant bonds, John Glen, the British Economic Secretary to the Treasury, at the 2019 London Sukuk and FinTech Summit stated that, “the success of our financial sector is proof that we are a dynamic country, a country of opportunity uniquely suited to Sukuks and Islamic finance”. Even after Brexit Britain remains committed to development of Islamic finance.

In Zanzibar, Islamic banking services were introduced in 2011 when the People’s Bank of Zanzibar established the Islamic Banking Division (Mzee and Ahmad, 2020). Later, more commercial banks introduced windows such as the National Bank of Commerce, Kenya Commercial Bank, which was the pioneer of Islamic Banking services in the mainland quite earlier and of recent CRDB introduced Al Barkah Banking services. Amana Bank is the only full fledged Islamic bank in Zanzibar as well as in Tanzania as a whole.

Problem Statement

Public demand and global financial trend have led to great interest in Islamic Finance, which resulted in establishment of several Islamic financing interventions in several countries including Zanzibar. Islamic banks offer Shariah compliant services to their customers. Some of these services are *Murabaha (Cost plus)*, *Musharakah* (partnership structure in Islamic finance in which partners share in the profits and losses of an enterprise) and *Mudharabah* (partnership in whereby one party provides capital and the other party provides skill and labour).

PBZ bank offers an array of products ranging from deposits to financing and investments, and money transfer to all kinds of trade financing. Islamic Banking mainly deals with deposits mobilization contracts and fund utilization (financing) products. In the year 2018, the PBZ bank approved a number of Islamic financing facilities such as *Murabaha*, *Bai Muajjala*, *Ijara*, Mortgage, *Salaam* and *Istisna*. Under deposits mobilization, the products are Current accounts (*Mudharaba*, *Wadia*, and *Qard*) and Savings accounts (*Mudharaba* and *Wadia*) (PBZ, 2018).

Islamic banks in Zanzibar faced several challenges from the beginning than conventional banks. Making matters worse, shortage of Shariah scholars, non-supporting policies for the growth of Islamic Banking, limited of knowledge and awareness to the society on interest, shortage of professional Islamic bank experts cause the struggle of Islamic banking to deteriorate, thus hindering the progress of Islamic banking and financial inclusion in the country.

According to Habiba and Yusoff (2019), it has been explained that comprehensive framework of legal, regulatory and Sharia is the main essence for creating a conducive environment for the industry. The current economic goals of broad economic prosperity with full and optimum level of economic growth and justice in the distribution of income and wealth are all in line with the development of the Islamic banking industry. Though Islamic banking products have become alternatives to conventional banking in meeting the community's ever increasing needs, with these challenges also facing Islamic Banking Services in Zanzibar, it becomes difficult to maximize the benefits Islamic Banking can deliver.

Despite the increased public support to Islamic Finance, Islamic banks face several challenges inhibiting their healthy growth in Zanzibar. The aim of this paper was to show challenges facing Islamic banking sector in Zanzibar so that remedies would be sought to ensure that maximum benefits of Islamic Banking services are realised if done in an appropriate and conducive supporting environment.

The general objective of this study was to examine challenges facing Islamic banking and finance in Zanzibar. The study focused on the following specific objectives:

1. To evaluate the knowledge and awareness of Zanzibar people on Islamic banking.
2. To identify potential types of services and products offered by Islamic banking.
3. To explore the challenges facing Islamic banks.

The focus of this study was Urban District in Zanzibar from 2019 to 2021. The location is the major business area in Zanzibar.

The study applied the purposive sampling; this technique gave it opportunities to decide on the participants to the study according study criteria. The quota sampling was used to divide population of challenges to strata to have a good representative of other Islamic banks and increased variability.

Table 1: Sample area and Sample size of the Study

Area of the study	Employees	Customers
PBZ Islamic bank	09	17
Amana Islamic bank	06	09

Source: Study Data 2021

Both primary and secondary sources of data were used. The bases of primary data were from employees of the mentioned banks. Secondary data were collected from websites and books.

Data Collection Method

The open-ended questionnaire was selected for data collection. The questions were set to satisfy the study's objectives. A total of 41 questionnaires were given to the targeted people of PBZ and Amana Islamic Bank who were ready to participate after being consulted. Then the researcher gave the time to the participants to fill the questionnaire waiting for recollection.

1) CHALLENGES FACING ISLAMIC BANKING

Studies on challenges and problems of Islamic banking have been discussed all over the world in order to make sure the leaders of those institutions are attentive and ready to solve the problems facing their institutions. Some of the studies enlightened only on their settlement example (Mohamed, 2012; Jabir 2003; Faisal 2013). Other studies covered countries around the world such as Iqbal, (1998), Iqbal (2007), Naveed (2015) in which they highlighted extensively what hinder the development of Islamic banking. This study has been very specific on Zanzibar due to the specific needs as well as time and financial constraints.

2) Concept of Islamic banking

According to Saidatolakma, Zuraidah and Rahimah (2018), Islamic banks are required to run their business activities with full conformity to Shariah. They should not borrow money on interest nor keep their surplus cash in interest bearing account as well as should not be involve in any prohibited business deals. Even if the business activities are permissible, the borrowings may be based on Riba (usury), the surplus is kept in interest bearing accounts and so on.

Islamic banking is a banking system consistent with Islamic law (Shariah), principles and guided by Islamic economics. In particular, Islamic law prohibits the collection and payment of interest. Generally, it also prohibits trading in financial risk (seen as a form of gambling). It also prohibits investing in business considered haram (prohibited forbidden), such as those selling alcohol and pork.

Islamic banking is a concept that is based on Shariah principles; its structure is different from conventional banking from its essence, nature and spirit. The Shariah principles are those rules and injunctions that are derived from Quran, Hadith, Ijma and other sources which involve exercise of intelligence and reasoning based on interpretations (Mushtaq, 2015).

3) Prohibition of interest

Interest is the monetary charge for the privilege of the borrowing money, typically expressed as an annual percentage rate (APR). Interest is the amount of money a lender or financial institution receives for lending out money. Interest can also refer to the amount of ownership stockholder has in a company, usually expressed as a percentage (James, 2022).

Allah says “Those who eat riba will not stand (on the day of judgments) except the standing of shaitan leading him to insanity. That is because they say “Trading is only like riba” whereas Allah permitted trading and forbidden riba: So, whosoever receives an admonition from his God and stop eating riba shall not be punished for the past; his case is for Allah (to judge). But whoever returns (to riba) such are the dweller of the fire- they will abide therein”

The Prophet (PBH) said “On the night of Ascension I came upon people whose stomachs were like houses with snakes visible from the outside. I asked Gabriel who they were. He replied that they were people who had received Riba” (Ibnu Majah).

Shariah prohibits Muslims from earning income by charging interest but permits income generation through the sharing of risks and rewards between parties to the transactions. This profit sharing mechanism is believed to encourage people to become partners and work together rather than to get into a creditor-debtor relationship. Partnership promotes mutual responsibility for the outcome of the financed project, which is believed to increase the likelihood of success of the venture. A tangential aim of the partnership approach is that such increases in successful projects also provide stimulus to the economy (Balla, Zaha, Abdulbasit 2009).

Economic purpose / activities

Every Islamic banking transaction has certain economic purposes. Further, Islamic banking transactions are backed by tangible assets or real services.

Sanctity of Contract

According to Akmel (2015) IFB services providers finance business in a fair and just way and serve all customers of all backgrounds. They scrutinize the business they finance to ensure that the business owners treat their employees in just manner.

4) *Shariah Compliance*

The central focus of Islamic finance is Shariah compliance. To ensure compliance a distinctive feature of Islamic finance is the establishment of a Shariah advisory or supervisory board to advise IFIs.

5) *Some of the Global Challenges*

A review of the world challenges of Islamic banking are going to be enlighten in this area. Some of the researchers looked challenges on the general world (Iqbal, 1998). The major problem is that in several countries Islamic banking lacks support of the needed legal system, laws and government regulations. Except Iran, UAE, Malaysia, Pakistan and other Muslim countries, problems in working in non-Islamic countries due to the absence of the regulatory body that works in accordance with Islamic principles, shortage of experts including Shariah scholars and experienced bankers, as well as lack of uniformity in standards of analysis of credit (Ahmad Heyder, 2021).

According to Iqbal (2007), although Islamic banks have grown in number, the average size of their assets is still small compared to that of conventional banks, there is a shortage of products for medium to long term maturities. The reason for these shortcomings is the lack of marketing to sale, trade, and negotiate financial assets of the banks. In the absence of debt markets, under development of equities markets, and lack of derivatives markets, financial intermediaries play a critical role in the provision of Islamic financial services, weak risk management and governance framework, disparity in theory and practice.

6) Challenges facing Islamic Banking Services in Zanzibar

The process of introducing Islamic banking in Zanzibar is not different from the one observed in other countries. Majority of the residents enjoyed the opportunity and joined the services because a large number of Zanzibar community are Muslims who for a long time wanted to see the establishment of Islamic banks in their land in order to escape and avoid usury (interest). Notwithstanding that, there were numerous challenges that faced the process. These include:

Inadequate awareness and understanding

Despite the existence of the Islamic banking in Zanzibar, inadequate awareness and low understanding of the services among the members of the society are some of serious challenges facing the banking services.

Barriers of Trade on Banks

While conventional banks work mostly on speculative activities depending on the rate of interest, Islamic banks are expected to work mostly on real economic activities including in trade. With unfriendly tax regime to Islamic banks in Zanzibar and lack of dedicated Legal and Regulatory mechanism, most of these banks are working sub optimally.

7) Absence of Islamic banking court

Tanzania's legal system is based on English Common Law. Judicial functions are administered by various courts established in accordance with the law. While the court system in Tanzania is in reality adversarial in nature where litigants present their cases, the presiding officers will decide based on evidence adduced and submission forwarded by the respective parties or their respective counsels. As Islamic banks disputes fall under the same purview, all disputes arising out of Islamic bank transaction will be subject to the same procedure and process as experienced by its conventional counterpart. This situation may result into a wrong decision on Islamic banking matters keep into consideration that, many of those presiding judges and magistrates do not have the requisite knowledge of Islamic banking system (Mzee, 2016).

Lack of professional bank employees

Islamic banks in Zanzibar face lack of experts and experienced employees who are trained in Shariah while the majority of those Shariah trained individuals lack even basic financial and banking literacy.

Poor understanding of Islamic banks to the clients

Customers cannot differentiate between conventional and Islamic banks. As a result, they are unable to distinguish in the midst of profit and interest; indeed, they think any surplus is interest.

Stereotyping and Estranging Islamic words

Some people reject to invest in Islamic banks because they relate it to Islam; according to them promoting it is similar to promoting Islam (Sulayman, 2015).

Results from this study found out that some respondents lacked awareness on what is Islamic banking. Islamic banks offer Shariah compliance financing different products and facilities for their customers. Islamic financial institutions try to initiate several products and services to ensure they meet all of their customers. Some of the answers are noted in Table 2 below.

The results show that 73.1% of the respondents agreed that they heard about products and services provided by Islamic banks in Zanzibar while 21.9% disagreed and only 4.85% of the respondents did not know the discussed matter.

About 92.6% of respondents preferred Islamic banking to have enough merchandise to avoid discomfort, followed by 7.3% who did not know the matter and 0.0% of respondents disagreed about the concept. Noted on “Measuring the perceptions of products and services” that all mean values are positive which corroborates that employees possess a positive perception towards Islamic banking products and services. It is reported that, service excellence, meeting client needs, and providing innovative products are essential to success in the banking industry.

On the issue of Islamic bank associated with interest, 43.9% of respondents agreed that Muslims are not benefited with IB's because of cetaceous of interest while 31.7% were not agree and 24.3% do not know with the concept. According to data conducted by Mudathir (2014) 79.2 of the respondents strongly agree that Islamic banking in Zanzibar prohibits interest in all forms of transactions. Rafi,Umar and Masih, Mansur (2014) based on the results of their research in the opinion of the author indicate that Islamic banks are not Shariah based; and only remain operationally Shariah compliant.

Table 2: Knowledge of Products and Services of Islamic Banks in Zanzibar

S/N	Challenge statement	Response						Total	%
		Yes		No		I do not know			
		Male	Female	Male	Female	Male	Female		
1	Knowledge on IB's services and products	17	13	04	05	02	00	41	100
		30(73.1%)		09(21.9%)		02(04.8%)			

2	Necessity of IB's to have enough merchandise to avoid discomfort	16	22	00	00	00	03	41	100
		38(92.6%)		00(00%)		03(07.3%)			
3	Islamic banking associated with interest.	07	11	08	05	05	05	41	100
		18(43.9%)		3(31.7%)		10(24.3%)			
4	IB's enlarge the economy	13	18	02	04	01	03	41	100
		31(75.6%)		06(14.6%)		04(9.7%)			
5	Knowledge on Musharakah, Mudharabah, Murabaha	08	01	11	21	00	00	41	100
		09 (21.9%)		32 (78.0%)		0 (00%)			
6	Need of IB's to continue to work	15	20	02	04	00	00	41	100
		35(85.3%)		06(14.6%)		00(00%)			
		27(65.8%)		06(14.6%)		08(19.5%)			

Source: Study Data 2021

Furthermore, the fact that Islamic banking enhance the promotion of economy, majority of respondents, 75.6% agreed to the statement, 14.6% of respondents disagreed and 9.7% of respondents did not know about the matter. The findings supported by Katherine (2013), who described that Islamic banking continue to grow up as an important financial institution in areas with big Muslim population.

On the other hand, minority of respondents 21.9% accepted to have general knowledge about *Musharakah, Mudharabah and Murabaha*, but a large number (78%) of study participants confessed that they only heard the terms, and 0.0% did not know anything about the issue. The results supported Mahdzan, Zainudin and Au (2017) proof that large numbers of people do not understand the concepts of the services categories of *Musharakah, Mudharabah and Murabaha*.

Item 6 of Table 1 shows the data in percentage, which address the chance of continuing operation of Islamic banking in Zanzibar, the higher percentage of agreed participants was 85.3%, followed by 14.6% who replied No, and none of them said do not know the matter.

B. Recommendations

This study recommends the following:

- More awareness using formal education, social media and main stream media is needed to create awareness about Islamic Banking in Zanzibar.
- Islamic banking should offer services and products that meet customers' needs; they must be innovative while considering Shariah requirements.
- Regulator of financial institutions together with Banks Shariah boards should establish needed legal and regulatory framework for Islamic banking institutions.
- In order to operate and properly implement Islamic banking according to Shariah the study plea to the Government to establish a Court in Zanzibar that will help Islamic financial institutions to resolve their conflicts amicably instead of using other non Shariah Legal systems.

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