

The History of Non-Conventional Banking



Management

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Hasan Muwadh Gaber Al-Gumaei

Ph-D Research Scholar, School of Commerce and Management science, S.R.T.M University, Nanded, India, 2016.

Madhuria. S. Deshpande

Professor, School of Commerce and Management science, S.R.T.M University, Nanded, India, 2016.

ABSTRACT

This paper is going to study the history of non-conventional banking. This study will touch the early practices of Non-conventional banking in many different stages during several periods of time and for this purpose we will refer to the practices and the products which started to be used in every stage. We will touch the actual extent of Non-conventional investment market, and for this purpose we will refer to the response of global financial institutions to this new experiment as well as the activities and services of nonconventional banking during this period. This study will also touch the opinions of the advocates of nonconventional banking, to know the awareness of the Nonconventional institutions about the opportunities in local markets and around the world, particularly those which have been practicing their transactions and in Non-conventional countries for long time.

Introduction:

Nonconventional banking is: that kind of banking which does not leave any room for any form of exploiting which may affect its customers. The orthodox Non-conventional finance leaves no room for the establishment of any type of institution which may deal with usury, Not only to avoid interest based transactions which is strictly prohibited in Islam, but also to avoid unjust or unfair practices.

The researchers suggest that the definition of Non-conventional banks is that Non-conventional banks are Non-conventional finance institutions that collect and invest money in the proper way which is in harmony with the rulings of Non-conventional Sharia, where money is exposed to profit and loss. They depend in their transactions on Non-conventional finance system that meet all the needs of economic sectors in return for a fixed share of unknown profit rate, thereby they are free of the prohibited usury.⁷

Banking has come into existence to cater for the economic needs of society and is therefore an offshoot of civilization. Surely there would be no need of a bank for a savage who lives on wild roots and fruits. It is the increase of human wants which gives rise to the efforts of man. The history of civilization is, in fact, the history of man's efforts for the satisfaction of his growing needs and he, thus, advances from stage to stage.

In nonconventional banking experiment there are many stages which this experiment went through during several period of time trying to develop its products from stage to stage.

1. THE STAGES OF THE HISTORY

1.1 THE 70'S STAGE

In the early 70's, we find that Non-conventional banking industry has taken shape. It is about 37 years old starting with establishment of Non-conventional development bank in Jeddah, Kingdom of Saudi Arabia KSA, and quickly thereafter there was Non-conventional bank in Dubai United Arab Emirates, UAE. Also, in that time some people were trying to put into practice the ideas that were contained in this early academic by writings about how the Non-conventional banking should be created and how these ideas should be implemented and in this period of time we had what is called commercial banks - Non-conventional commercial banks- and they were created in the middle east and tow very promising experiments were undertaken for full scale islamization of financial system in Iran and Sudan which are two early birds in that sense, they tried to over full scale islamization of financial system but they faced many difficulties very soon .

1.2 THE 80'S STAGE

In 80's we find more researches were being undertaken on how different other activities which are very important to financial system, for example insurance how it should be undertaken, the most of scholars were uncomfortable with that commercial insurance, they found many elements which are not sharia compliant, they didn't write in join on what sharia prescribes and this conventional insurance has been observed to be un Non-conventional but one Non-conventional solution, they held lots of conferences where alternative models have been discussed and people tried to find solution in the form of Takaful on mutual cooperative insurance which was very close to confirm Non-conventional ideal and which a kind of provided a solution where you can do insurance but at the same time do it without violating the basic norms of sharia, so Non-conventional banks and Takaful, commercial banking and Takaful or insurance were the products that were in the 80's, and the countries which were in the fore friend offering these products were mostly centered in the middle east, and southeast Asia started taking the early leadership in this field, Malaysia to the early lead in bringing about variety kinds of regulations, and in the mid 80's we find that Malaysia had already come of its regulations for Non-conventional banking as banks, and for Non-conventional insurance as companies, these regulations of regulatory support quickly saw proliferation of the number of in the kind of activities of Non-conventional banking and finance taking form roads in Malaysia and Brunei for example, southeast Asia started gaining popularity very quickly.

1.3 THE 90'S STAGE

In 90's the basket of products became wider and in addition to Non-conventional commercial banks and insurance companies or Takaful companies there were Non-conventional investment banks, these investment banks facilitate they don't directly interviewing the process or they don't play the role of intermediate, the process of intermediation was given to the process of direct facilitation whereby the company or the businesses who need funds they can directly approach the public and raise funds they don't have to borrow or approach a bank for that matter, and the investment bank will play the role of the facility to end process they would help the company find needing entity to raise funds from the public directly by passing the right kind of information directly by undertaking the right type of marketing and so on and so forth. Economically in the Non-conventional rule we also witnessed the both of Non-conventional investment banks and stock market investment started getting popular and Non-conventional, So that was a time for performing more discussion on what and how to go about Non-conventional in-

vesting ,how they should deal in the stock market and company should raise funds directly, these were issues which were discussed in the 90's,and sharia scholars came to the rescue with solutions and some of these solutions were deemed to be temporary as those solutions were not good enough ,So temporary solutions were found. Economy Non-conventional funds "Non-conventional equity funds" and other kinds of funds started appearing on the screen and the number very quickly increases to several hundred of equity funds all over the globe and this the time when Non-conventional banking started making its appearance in western countries to this Non-conventional finance, some smart bankers they were smart enough to find a gap in the product market in the form of housing finance. people in western countries, the Muslims were not comfortable with borrowing or taking housing loans, So you had these institutions coming up in the market with sharia compliant housing loans, So housing loans and equity funds were new product with 90's.

1.4 THE NEW MILENUM STAGE

The new millennium by the time was there :they almost had Non-conventional solution for most every possible financial need (according to their opinions) ,corporate financial need, investment need .the need of depositors, we had an answer to almost every possible need ,So as far as theory building providing solutions was concerned by the term essentially this task has accomplished then came the practice, the practices the proliferation of Non-conventional banks all over the globe and in this decade we find that Non-conventional bank is beginning in popularity the numbers are increasing as compare to the previous initially and estimate varied ,some said it's about more than 500 major institutions all over the globe already functioning as Non-conventional financial institutions, and if we look at the estimates of the funds which are under management of financial Non-conventional institutions we find that estimates differ estimates run 3 trillion ,some estimates 1.3 trillion ,some estimates 500billion to 700billion, there are different estimates, because of the definition problem no one has been able to produce a suitable estimate as people use different kinds of definition to include what kind of funds we should include at Non-conventional funds. if we look to the different countries that have been experimenting with Non-conventional banking which have been training and putting a lot of efforts to come up as centers of Non-conventional finance, in this list we can include countries like France, China which has now recently decided to cover with Non-conventional bank, Hong Kong & Singapore are trying to be the computing with London and Berlin with the traditional center of Non-conventional finance Kuala Lumpur which is playing a leadership role in Non-conventional finance(the biggest market for Non-conventional finance), all of them want a major share of the buy that is called Non-conventional finance .

2. ACTUAL EXTENT OF NON-CONVENTIONAL BANKING

This will be discussed through three points which are : how the global financial institutions response to this extension of non-conventional banking, the services which have been practiced and the intervention from western banks' services to this new experiment services and the non-conventional banking advocates' opinions. It's too early to assess the full extent of nonconventional investment market as there is no accurate figures exist as to the actual extent of this type of banking, but according to Citibank, in Bahrain, funds under Non-conventional financial institutions management are growing at an annual rate of 15 to 20 percent per year. As was mentioned up Some Non-conventional banking sources suggest that the total value of Non-conventional funds management may well be 3 trillion. In the past two decades, Non-conventional banks have recorded high growth rates both in size and number around the world. Non-conventional banks operate in over sixty countries, most of them in the Middle East and Asia. In three countries, Iran, Pakistan and Sudan, the entire banking system has been converted

to Non-conventional banking. In other countries, the banking systems are still dominated by conventional banking institutions operating alongside Non-conventional banks. Now there is a move away from the Middle East and Asian areas and a desire to spread the risk. There is diversification trend towards the United States and Europe. Non-conventional banking is the fastest growing segment of the credit market in Muslim countries with Non-conventional banks. The market share of these banks has risen from 2 percent in the late 1970s, to about 15 percent in the mid 1990's, as measured by assets in the banking system (Babai 1995). Conventional commercial banks have also started to offer Non-conventional financial contracts. Non-conventional banking is becoming stronger industry and is not just a niche financial services industry, but a niche market. Many bankers predict that Non-conventional banking could be responsible for management of over 50% of savings in the Non-conventional countries in the next decade.

2.1 GLOBAL FINANCIAL INSTITUTIONS' RESPONSE

The global financial institutions have recognized this trend and are capitalizing on the attractive niche market. Some of the western banks that have established dedicated Non-conventional banking subsidiaries or have substantial dealings in the field include, Citibank, bank of America, Commerzbank, Deutsche Bank, Merrill lynch, ABN AMRO, BNP Paribas, Pictet&Cie, UBS, Standard chartered, Barclays, HSBC, Royal Bank of Canada, American Express, Goldman Sachs, Keenwort Benson, ANZ Grindlays and Flemings. A growing number of western investment companies are now offering Non-conventional investment products to interested Non-conventional investors worldwide. However, despite the advances by western banks and investment companies, the mainstays of Non-conventional investments continue to be the Non-conventional banks themselves. Calculating the exact size of the Non-conventional banking sector is difficult. Pakistan, for example defines all of its financial institutions are still effectively conventional banking. Saudi Arabia, on the other hand, does not formally admit the distinction between conventional and Non-conventional banking. Some Non-conventional bankers suggest that the number of banks that offer Non-conventional products around the world total over 250, the asset size of Non-conventional banks has also experienced a high growth rate. Today many Non-conventional banks are among the largest banks in their respective countries (Kazarian 1993 and Ray 1995).

2.2 NON-CONVENTIONAL BANKING SERVICES

In terms of services, the most dramatic change in approach has come in the past five years. In the past, Non-conventional institutions were seen merely as a place for those with strong Non-conventional convictions to place their money. Today, senior managers of Non-conventional banks believe they must compete on commercial grounds by offering a more cost-effective financial package to non-Non-conventional as well as Non-conventional customers. The main factor fueling the dramatic growth is the spread of the Non-conventional religion globally. Islam is the fastest growing religion in the world, and Muslims are increasingly searching for financial instruments that adheres to their principles. Some non-Muslims are also participating in Non-conventional banking because they consider it to be commercially sound (Brooks, 1999). Traditionally, specialized Non-conventional banks have been well positioned to attract deposits from Muslims and non-Muslims, but these institutions have generally lacked the technical ability to invest efficiently. This gap has been bridged by the services of western banks that swiftly and efficiently deploy funds into Non-conventional acceptable channels. This has often meant lower returns for Non-conventional investors due to the second layer of inter-mediation. However, this trend is changing. Non-conventional banks are becoming resourceful and are going global, in part due to their increased integration with international markets. At the same

time being aware of the potential of Non-conventional markets. Western banks are reaching out to investors directly and eliminating the middleman (the Non-conventional banks or Non-conventional windows of banks) in Muslim countries.

2.3 ADVOCATES' OPINIONS

Advocates of Non-conventional banking argue that many Non-conventional banks operate according to the profit and loss sharing principle and that the profit-sharing contracts (equity) are the superior financial security to debt for many reasons including the risk-sharing properties of equity (Ebrahim and Safadi 1995). They also argue that by providing long-term financing to growth oriented-sectors of the economy, Non-conventional banks will promote growth in the Non-conventional countries (Chapra 1992, and Siddiqi 1983). Few recent studies, argue against these two views. Aggarwal and yousef (2000) suggest that most of the financing provided by the Non-conventional banks they examined in their study do not conform to the principle of profit –and –loss sharing. Instead, much of these financing activities are offered through debt-like instruments. Aggarwal and Yousef also found that Non-conventional banks rarely offer long-term financing to entrepreneurs seeking capital. This finding is also supported by Metwally (1992), andmpourian (1995). The two studies provide evidence that the maturities of Non-conventional financing contracts offered by Non-conventional banks in Egypt and Iran during the 1980's are mostly short (one year) or middle term (2-5 years). Few of contracts have longer than 5 years maturities. The activities of Non-conventional banks tend to reflect the conditions of the country in which they are based. There are strong retail operations in Iran (though they have played comparatively small role in international markets) and Saudi Arabia. In the more secular societies of northern Africa, Non-conventional banks compete on the quality of their products, not their religious acceptability. In Kuwait, well-established Non-conventional financial institutions have been involved in substantial financing for the petroleum sector and real estate investment and in the UAE the emphasis is on trade finance. In Iran, Non-conventional banks invest in entrepreneurial projects in economic sectors that are typically viewed as growth oriented such as agriculture (Kazarian (1993) and Saffari (1995)). Bahrain, on the other hand, has enjoyed some success in marketing itself as the region's Non-conventional financial center, which was because of its internationally respected regulatory system.

In Bahrain, there is a greater emphasis on investment banking. However, more competition with international banks is expected in the future. There is a gradual change as more Non-conventional institutions become aware of the opportunities in local markets and around the world. They are no longer looking at providing funding but they also want to play a major role in the transactions.

CONCLUSION

To sum up, we have two main themes to be mentioned here, the first one is the history of nonconventional banking through many different stages, which form the most important stages in the early practice of this type of banking, which includes what products or services that were used, and how they were developed from one stage to another during that period of time, which of course will help us to understand how to develop non-conventional products and transactions or services in the next stages.

The second one is the actual extend of Nonconventional banking, through the way that the global financial institutions response to this extension of nonconventional banking during that period, the services which have been practiced and the intervention from western banks serves to this new experiment services, the non-conventional banking advocates' opinions which all give more understanding and helping us to know the right way to enhance this experiment in the future for the purpose of increasing the integration with international markets.

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