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DEVELOPING MECHANISM OF FINANCIAL SYSTEM FOR ISLAMIC BANKS IN SULTANATE OF OMAN

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ABSTRACT

The aim of this research paper is to study the mechanism of financial system development among Islamic Institutions, since these institutions are started late in Oman comparing to other GCC Countries. Therefore, the financial systems of these banks are under development and Central Bank of Oman playing a big role in regulating and monitoring both Islamic and Commercial Banks in terms of financial procedures & investment policies.

KEY WORDS: IB, CBO, GCC

1. INTRODUCTION

The Islamic Banking (IB) in Oman lunched after his majesty Sultan Qaboos Bin Said Al Said issued a royal decree authorized to establish Islamic banking in Oman on December 2012. After this decrees immediately Islamic Banking Service started by Nawa Bank, Al-Izz Bank, then Meethaq Islamic Banking as a window operated by Muscat Bank and Muzan Islamic Banking still operating by National Bank of Oman. The Meethaq Islamic Banking has been separated from Bank Muscat; it became semi-independent bank on December 31, 2016

In other hand, the Central Bank of Oman(CBO) is regulating, managing and controlling the all Islamic Banks, whether Islamic Windows operated by Commercial Banks or independent Islamic Banks. The Central Bank of Oman is a core internal control of these banks and windows to maintain proper Islamic financing procedures that is because the CBO issued Royal Decree 96/2012, to organized Islamic Finance Products which are provided by Islamic Banks and Windows Islamic Finance.

The Islamic Financial Services that are offered by Islamic Banks and Windows Islamic Finance under monetary of CBO, these services are;

- Murdaraba Banking Service.
- Musharaka Banking Service.
- Diminishing Musharaka Banking Service.
- Murabaha Banking Service.
- Musawama Banking Service.
- Salam Banking Service.
- Istisna Banking Service.
- Ijarah Banking Service.
- Tawaruq Banking Service.

The last one; Islamic terminology “Tawaruq” is not more allowed in Oman to be used as Islamic Financial Services by Central Bank of Oman rule.

2. FINANCIAL SYSTEM OF COMMERCIAL BANKS

The banking sector in Oman has significant role in economic growth, even though financial crisis was impacting the financial system. However, the crude prices have risen from their low of previous years, which it



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has positive impact on financial sector stability. The bank interest charge has been raised in term of tight liquidity situation and increased the competition between banks for deposit mobilization.

The weighted average rate of interest on total deposits for both local and foreign currencies rose to 143.3% in 2016 comparing to 93.1% of the previous period.

While the average rate of interest on the foreign currency designated deposit remain more or less unchanged, marginally edging up from 89.4% in December 2015 to 89.5% up to end of December 2016, the interest rate on local currency deposits went up from 93.6% to 149.3% among this period as its Central Bank of Oman Annual Report. 2016.

The local currency deposits have attracted more interest rate comparing to foreign currency deposits during 2015, 2016 and part of 2017.

Interest Rate Distribution of Local Currency Deposits

Annual Interest Rate	December 2014		December 2015		December 2016	
	OMR in Million	Share	OMR in Million	Share	OMR in Million	Share
2%	12,298.90	80.5	12,667.80	80.9	10,380.10	64.4
2% - 3%	1,613.40	10.6	1,881.30	12	1,614.50	10
3% - 4%	1,006.40	6.6	939	6	2,227.10	13.8
4% - 5%	284.1	1.9	130.2	0.8	1,444.80	9
5% - 6%	57.8	0.4	26.8	0.2	440.1	2.7
6% - 7%	9	0.1	9.3	0.1	9.3	0.1
7% - 8%	0	0	0	0	0	0
8% - 9%	0	0	0	0	0	0
9% - 10%	0	0	0	0	0	0
Over 10	0	0	0	0	0	0
Total	15,269.60	100.1	15,654.40	100	16,115.90	100
Average Interest Rate	98.60%		93.60%		149.30%	

3. FINANCIAL SYSTEM OF ISLAMIC BANKS

The actual value of total assets of Islamic Banks in Oman reached OMR3.3 Billion at the end of first quarter of 201, this is include independent Islamic Banks and Window Islamic attached with the commercial banks.

Recording a solid annual base growth, the Islamic Banks Institutions provided total financing of OMR2.6 Billion till end of first quarter of current year comparing to OMR1.9 Billion year ago, according to monthly statistical bulletin announced by Central Bank of Oman. The total deposits grasped by Islamic Banks and Windows also registered as a robust growth to reach OMR2.4 Billion March 2017 from OMR1.7 Billion outstanding as at end of first quarter of the previous year.

The gross non-performing loan as a proportion of total loans and advances stood 2.1% at the end of December 2016.

In fact the Islamic Financial System is driven by demand with the local market predicted to experience growth in line with international trend. Although the Islamic finance entity exists in the Sultanate of Oman newly it is important to examine the environment into which the system shall be developed. The Sultanate of Oman prides itself on successfully implementing progressive initiatives aimed at developing the country's infrastructure, to reduce depending on petroleum revenues and providing meaningful employment for citizens. These plans have been laid out in a framework entitled 'Oman Vision 2020' giving in details the objectives of the government



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and the programs to be implemented in order to accomplish them. One of the key principles of Vision 2020 is to decline the Sultanates dependency on crude revenues through the diversification of the Omani economy.

4. THE ISLAMIC BANKS IN OMAN

There are several Islamic Banks and Window offering Islamic and products services as per Shari'a compliant. The overview of each bank and window will be highlighted below;

Meethaq Islamic Bank:

The Meethaq Islamic Bank operated by Bank Muscat initially as window banking service under their directory and supervision until December 31, 2016, the Meethaq Islamic Bank has been developed from window Islamic banking services to Meethaq Islamic Bank with more than OMR2.7 billion assets, but still under Bank Muscat regulatory.

Al Izz Islamic Bank:

Alizz Islamic Bank established on November 2012 with the paid up capital of OMR100 million. 40 per cent of this capital raised by public investors, while the rest is came from banks promoters.

Nizwa Islamic Bank:

The Nizwa Islamic Bank is known as Bank Nizwa, which is established in January 2013, the bank rendering product and services to the customers as per shari'a compliant.

Maisarah Islamic Banking Services:

The Maisarah Islamic Banking Services; established by Bank Dhofar in 2013 as a window to serve the Islamic financial transactions as per shari'a compliant.

Muzn Islamic Banking:

The Muzn Islamic Banking is a window banking services providing financial services according to shari'a compliant. It was established by National Bank of Oman in 2013 as a first Islamic window in the Sultanate.

Literature Review:

Without question the obvious starting point would be to look at religious motivations which have been found to be a significant factor. The report carried out by the IFAAS suggested that of the 86% of customers in Oman that had a conventional banking product, 60% had declared themselves to be 'bothered' by using a product based on interest. This figure could in fact prove to be higher. The lack of any existing alternative to products based on Riba could permit some individuals in the questionnaire to justify its use although if this question was put to them in an environment where a viable alternative was available, it could prove that more customers in Oman would be 'bothered' by the use of Riba based products.

Lee and Ullah (2011) found that Shariah compliance was a key factor and that any institution that was seen to be in breach of Shariah principles on more than one occasion could expect to see its customers move their accounts.

Rehman and Masood (2012) found religious obligations to be a significant motivator although they also observed that that it was by no means the only determinant as practical reasons such as a 'convenient location' also played an important role. Another potentially motivating factor that could be seen to be linked to religious devotion is that of social responsibility which was found to be important by Al-Jami (2009) and Dusuki and Abdullah (2007).

Social responsibility can also be linked to the reputation and branding of the institution in question and has important consequences for banks in terms of reporting and general communication with stakeholders regarding its activities. Not all studies however have found religious motivations to be important. Amin et al (2011) found religious obligation and government support to be insignificant factors as predictors for the



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intention to use Islamic personal financing. What they did find however was that among the key determining factors was that of social influence. This would suggest that if there is an overall acceptance and uptake of Islamic finance among enough of the general public, for whatever the reason may be, then individuals that may be considered neither for nor against the services could find themselves swayed by the prevailing social influences around them. The consequence for Oman in particular is that the demand for the services on a national basis could well turn out to be higher than the IFAAS report (IFAAS, 2011) has suggested, should this social influence factor be significant in the Sultanate. So what does this mean for banks offering Shariah compliant products and services? The depth of product knowledge among the local population can be an important factor in this area. It could be argued that by simply having 'Islamic' in the banks title or by using what would be deemed as Islamic terminology in its literature, customers would feel that their religious obligations are being met. As highlighted above, this may not be the case. In countries with established Islamic financial systems customers have demonstrated an increasingly sophisticated knowledge of the nature of Islamic products and services and are willing to punish banks that are found to be operating outside the parameters set by the Shariah. This places a great importance on the area of compliance and as result banks operating in the Islamic finance sector can expect to incur greater monitoring costs than their conventional counterparts. In summary, while religious motivations appear to be important, the review of the literature has shown that it must be considered along with basic functions such as customer service and pricing which will now be looked at in more detail.

Problems and Issues Faced by Islamic Banks

The main concern of Islamic Banking Finance in Oman in regard of financing procedures and controlling of this process by CBO lead to slowly developing of these Islamic Industries, the issues are listed as follows;

Decentralization of Islamic Financial Services by CBO, such as offering new product of service take longer time than it is expected to get a feedback by whether accepted or rejected, which will makes banking services procedures in Oman complicated comparing to other Islamic Countries.

Lack of awareness about Islamic Banking System in Oman, as is newly started in Oman comparing wither Islamic Banks in other GCC Countries and Islamic Banks in Oman are not able convince most of local Omanis for Islamic Sharia'a (free of interest) of all financial services procedures.

Omani Islamic Banking facing challenges of professional Islamic Bankers, most of Islamic Banks employees are recruited from Commercial Banks which they don't have sufficient knowledge and experiences of Islamic Banking Services and Procedures.

Competition; the Islamic Banking Sectors are not able to compete with the Commercial Banks. This private sectors dominating majority of the customers in terms of interest, because the Islamic Banking are offering the services with high repay from customers in addition to that Islamic Industries are not attracting non-Muslims compared to Commercial Banks.

Questions on How to Develop Islamic Banking:

This research article designed to share the following questions for sake of developing financial system in Islamic Banking;

How the Islamic Banks can compete the Commercial Bank in Oman, in terms of financial services system and quality?

How the Islamic Bank can attract and retain the national professional bankers to build strong financial system? What are the flexibilities have to be provided by Central Bank of Oman to the Islamic Banking Sectors for betterment of financial mechanism?

How Central Bank of Oman can support financially the Islamic Banking Sectors, which will lead to financial stability?



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Is the Islamic Banks vision matching with the vision of Central Bank of Oman, in term of Oman economic diversification and development by enhancing strong mechanism of financial system?

5. OBJECTIVES OF THE RESEARCH ARTICLE

This research paper designed to fulfill the following objectives in order to assist Islamic entities to improve their financial system;

The Central Bank of Oman have to encourage decentralize financial banking services; this will give more flexibility of Islamic Bank to develop their banking services system.

The Islamic Banking Sectors have to develop banking marketing strategies as long-term plans to target local Omanis, expatriates and international markets.

The Islamic Banking in Oman has to adopt staff development policy audience orientation policy, such as Islamic Banking Training, Banking Service Workshop, National Conference of Islamic Banking Services and Awareness to locals and expats about Islamic Banking versus Commercial Banks.

The Islamic Banks have to minimize the profit margin of their financing services provided to customers in order to compete the Commercial Banks.

Providing high quality of Islamic Services Finance by Islamic Banks in Oman accordance Islamic Sharia 'a

Developing Human Resources of Islamic banks by integration through all of the Islamic institutions and getting support from Central Bank of Oman.

Attracting and developing posits of funds from different sources according Islamic Sharia'a.

6. THE MOTIVE OF THIS RESEARCH ARTICLE

The Banking Sector in Sultanate is structured as Islamic and Commercial Banking Services as a one sector, the researcher will express all of them separately;

The future of Islamic banking sector in Sultanate of Oman is expected to grow faster comparing to its previous generation, the reasons for that is Central Bank of Oman increased significant support to this sector in order to compete the commercial sector, which is this competition between these two sectors shall help in growing of banking sectors in general by supporting economy of Sultanate. Therefore, the motivations of this paper are representing; minimizing the gap between Islamic and Commercial Banking Sectors, encouraging Omanis to deal with Islamic Banking Sector and distinguishing between Islamic and Commercial Banking Financial Services specifically to the local people.

Majority of Omanis, considering both sectors are dealing with interests in providing financial services. While the facts of these sectors are exactly differ from each other, the differences are coming from the private sector providing financial services with interest (Riba) e.g. rendering cash to customers as loan and charging interest. But Islamic Banking Sector, lending loan (financial services) as products only, then reselling the same products to the customer by higher amount. These two points are to be conveyed to populations for making Islamic Financial Culture much clear to them.

Moreover, to highlight that the Islamic Banking are providing the financial services to their customers in order to get the profit, so they are profitable sector that means all the services are rendered with intention of a profits margin, this margin might be higher than the interest which is charged by commercial banks. From profit margin (Islamic Bank) and interest (Commercial Bank), the customers feeling of similarities are arising¹.



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7. CONTRIBUTION OF THE RESEARCH STUDY

This research study is expected to provide Islamic banking and their customers with Appropriate Islamic financial information needed to support both banks and customers.

Also, the research will be designed to inculcate culture of Islamic finance among local and expatriates and it's distinguish between non-Islamic finance rendered by commercial bank.

The research study might help Central Bank of Oman in setting up future strategy plan of Islamic finance to align with other GCC Islamic Banking Services such as KSA and UAE.

This research study prepared in such a way to enrich the information and knowledge among young generation by conducting workshops, seminars and presenting research papers in this regards.

The research study intended to study and analyze the financial instruments as per Islamic Sharia assist Islamic Banks to generate funds from different type of resources such as; investing, financing and Takaful Insurance.

To help Islamic Institutions to manage the liquidity situation by adopting short-term Islamic finance instruments similarly to the commercial institutions.

The researcher plans to join hand with all Islamic Banks in Oman such as Bank Nizwa, Dhofar Bank, Sohar Bank, Al-Ezza Bank and Al-Methaq Bank for the purpose of betterment of Islamic Institutions Services. The plan integration between researcher and theses Islamic Institutions is to convey the vision of central bank of Oman in regard of financial services by conducting conferences to the banks staff.

Moreover, the researcher plan to link between Islamic Industry as it's mentioned above and Educational Institutions, the idea is to be suggested for the Academic Institutions to send their students to the Islamic Banks for field trips, training, OJT, internships, especially in the banking and financial sciences specializations. Since, no single academic institutions have the Islamic Finance as specialized field it's strongly recommended by researcher to lunch these kinds of specializations, by this way the academic institutions could provide the numbers of graduates to Islamic Institutions in the field of Islamic Finance.

8. CONCLUSION

The Islamic banks financial system and their development mechanism in Sultanate of Oman moving align with economic situation, development of Islamic financial system required source of fund, government and government entities playing major role in funding banking sector. Therefore, fuel prices stability is vital point in government resources, which have direct impact to banking service.

In other hand, a part of government and government entities funds, the private sector plays minor role in funding of banking sector, whether Islamic or conventional, but still this sector affected by government projects.

Eventually, the financial system development in Sultanate is depending on other institution's financial stability. To build strong banking financial system it's necessary to have economic liberalization adopted by government authorities through implementing economy diversification strategic plan.

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