THE CHALLENGES ON THE MARKETING OF EQUITY-BASED FINANCING PRODUCTS OF ISLAMIC BANKING

Abstract
We performed in-depth interview with three bankers and three bank customers to obtain their feedbacks on the new financing product offered by the Islamic banks. Although the new financing product is based on risk-sharing which is closer to the true spirit of Islamic banking philosophy, the new product does not really well-received in the market. Operationally Islamic banking are almost similar with the conventional (Western) banking products, however the objective and philosophy of Islamic banking are different. This has posed challenges to the marketing of Islamic banking products because the difference between the Islamic banking products and the conventional product is only in terms of conceptual but not in terms of operational. In this paper we explore the challenges on the marketing this new financing product of Islamic banking. Among others, we find that the marketing of Islamic banking products should reflect and highlight the philosophy and conceptual Islamic banking.

Keyword
Islamic banking, conventional banking, debt-based financing, equity-based financing
THE CHALLENGES ON THE MARKETING OF EQUITY-BASED FINANCING PRODUCT OF ISLAMIC BANKING

Azian Madun  
Department of Syariah and Management  
Academy of Islamic Studies  
University of Malaya  
Kuala Lumpur, Malaysia

Yusniza Kamarulzaman  
Department of Marketing  
Faculty of Business and Accountancy  
University of Malaya  
Kuala Lumpur, Malaysia

Nur Fatimah Zahra Roslan  
Department of Syariah and Management  
Academy of Islamic Studies  
University of Malaya  
Kuala Lumpur, Malaysia
THE CHALLENGES ON THE MARKETING OF EQUITY-BASED FINANCING PRODUCT OF ISLAMIC BANKING

Introduction

Four decades ago, in his seminal article, Kotler (1972) suggested that an organization should emphasize marketing not only because the organization wants to sell its product. As long as the organization offers a product to a particular target group, marketing is essential although the product is virtually free-of-charge to consumers. For example, police department services are free to the general public; however, the services of police department have value to someone. So, the police department still needs to study the people habits, needs and wants; hence needs marketing.

Kotler further suggested that marketing is an exchange of value and the value can be either tangible or intangible. Although this concept of marketing is forty years old, we argue it still valid even today, especially with regard to Islamic banking products in Malaysia which is relatively new. We also argue that the intangible values underlying the Islamic banking are its philosophical values and these values should be of in the eyes of the beholding market.

Like many other Muslim countries, Islamic banking system operates hand-in-hand with the conventional banking system. It means that Islamic banking has to compete with conventional banking to capture the market by offering the best rates for depositors as well as for borrowers. In its early days, Islamic banking in Malaysia might be perceived as an expensive source of financing relative to the conventional banking. However, in recent years we have seen that the difference of depositors and borrowers rates between Islamic banking and conventional banking is insignificant. Hence it makes the marketing of the values of Islamic banking even more crucial.
Since 2006, some Islamic banking has started to offer financing product based on the concept of sharing or equity-based. This concept of financing is called *musyarakah*. This is an Arabic that means sharing or associating. Prior to 2006, all financing products offered by Islamic banking in Malaysia were using the concept of sales. This concept of financing is called *murabahah* which is an Arabic word that means extra or additional. This concept of financing is basically a debt-based financing. With the introduction of the new financing product, it means that within the Islamic financing products consumers can now choose whether to take up either debt-based financing or equity-based financing (Ayub, 2007).

Although the new equity-based financing product offered by some Islamic banks is considered closer to the true the philosophical values of Islamic banking than the old debt-based financing products, it is found that the new product does not really well-received in the market. This poses another challenge in the marketing of Islamic banking.

The purpose of the research is to investigate the new equity-based financing product in particular and Islamic banking products in general. We have conducted in-depth face-to-face interviews with three officials from three different Islamic banks. We have also received feedbacks from another three officials from three different Islamic banks via telephone conversation and e-mail.

Besides the communication with banking officials, we have also interviewed three bank customers of different Islamic banks. Although we only managed to do six interviews in total within four months, the feedbacks we obtained are very useful and meaningful. Therefore, the aim of this paper is to report the analysis and provide insights on the challenges faced particularly by the new financing product and Islamic banking as a whole.
Islamic banking refers to a system of banking or banking activity that is consistent with the principles of Islamic law (Syariah). The Quran is the primary and main source of references for Syariah. The second main source is the hadith i.e. the saying, action, deed, or endorsement of the Prophet Muhammad narrated by His Companions that have collected and verified by past scholars. The Quran and Hadis are the words of divine. The third main source is qiyas i.e. a rule that is derived on the basis of analogy of another rule, and the last main source is ijma i.e. consensus of the past jurist. These are the four main sources of references for Syariah law.

The main objective of Syariah is to protect the welfare of human being and other creatures. It forms the substance of Islamic economics. As banking and finance are parts of economic functions, the philosophy of Islamic banking and finance is linked to Syariah. Debates on the philosophy of Islamic economics can be very lengthy, however these two are the main thrust, firstly that human being are created to obey to God (Quran, 51:56) and that human being are entrusted by God to govern the world (Quran, 2:30). Essentially, it means that human being should take care of the well-being of the world and its creatures by observing the words of divine in their daily lives (Kahf, 2003; Naqvi, 1997).

In tandem with this philosophy, the objectives of Islamic banking could be summarized as follows:

a. Interest charged on loans as well as deposits, regardless of the quantum of interest rate, is prohibited.

b. Business involving alcoholic drinks, gambling, pornography or any type of business that is considered harmful or that could cause disruption or harmful to the welfare of the society is prohibited.

c. The elements of uncertainty, deceiving and cheating are prohibited.
Essentially it means that the objective of Islam banking is to encourage trading of real goods and investment that will contribute to real economic growth, not only growth in credit. This is because charging interest on money is not a form of investment; hence lending money is not a form of investment. Therefore, one should not expect to earn return just by lending money to the needy ones.

Despite being a new product in the financial market, Islamic finance is seeing tremendous growth over past few years. For example, the products of Islamic finance are not only limited to banking products but also to capital market and insurance with the introduction of Islamic bonds and Islamic insurance. These products are well-received in the financial markets among Muslim players as well as non-Muslim players (Askari, Iqbal and Mirakhor, 2009).

Islamic Banking in Malaysia

In Malaysia, Islamic banking and the conventional banking operate in parallel. Islamic banking services are provided by either full-fledge Islamic bank or subsidiary. The parent of the subsidiary bank may operate conventional banking but the subsidiary is allowed to offer Islamic banking products. As of 31 October 2012, there are two full-fledge Islamic banks and 17 subsidiaries of Islamic banks. Islamic banking assets take up about 20% of total banking system (Central Bank of Malaysia, 2012).

The first Islamic bank in Malaysia was introduced in 1983 with the formation of Bank Islam Malaysia Berhad (BIMB). Like any other bank in Malaysia, the operation of Islamic banks is governed by the Central Bank of Malaysia (Bank Negara Malaysia) the jurisdiction of which is covered by the Islamic Banking Act 1983. Since the operation of the Islamic banking system is parallel with the conventional system, the government allows the Islamic banks to compete with conventional banks without favoring either.
With the opening up of the financial market, foreign banks have been allowed to open Islamic banking services since 2004. Three financial institutions from the Middle East have opened up their offices in Malaysia, namely, Kuwait Finance House from Kuwait, al-Rajhi Banking and Investment from Saudi Arabia and Asian Finance Bank from Qatar.

**Operation of Islamic banking**

Since Islam prohibits taking and charging of interests (Quran 2:275), financing in Islamic banking is offered based on two broad methods, namely via the contracts of exchange and the contracts of participation. Within the contracts of exchange, financing may involve the contracts of sale or rent. The sales or rent contracts will eliminate the practice of financing based on interest. These contracts are usually considered debt-based because of its similarity with the conventional mode of financing.

Financing may also take up in the form of participation. In this types of contract, the bank shares money with the customer to participate in a project. Of course, the bank’s portion in the project is initially big but will be gradually reduced during the course of financing tenure. This mode of financing in general is called equity-based financing.

In Malaysia, home financing by Islamic banking is usually a debt-based financing. For example, a customer needs to finance his purchase of a house. The Islamic bank will buy the house from the developer or vendor, and then the bank will sell it back to the customer at marked-up price. This type of contract is called *murabahah*. However, as the customer usually pays to the bank in installments, this type of contract in general is called *bay-bithaman ajil* (BBA) i.e. sale with a delay of payment. Basically in this contract the customer knows the total amount of money he needs to pay to the bank and the amount will remain unchanged throughout the tenure. This type of sales contract eliminates the practice of interest-based financing.
Another way of home financing is through equity-based. In this mode of financing, the bank and the customer will pool the money and then buy the house from the developer or vendor. Throughout the tenure of financing, the customer will rent the house from the bank and at the same time he will buy the bank’s share. At the end of the tenure, the bank’s share of the house will be completely sold to the customer. However, since there are elements of sale and rent, the total of money he needs to pay to the bank is not fixed as it depends on the rate of rental. This rate may fluctuate in future. This mode of financing is called diminishing musyarakah.

Therefore, the main difference between the debt-based financing and equity-based financing is the Syariah-based contracts applicable in the products. In Malaysia, debt-based financing using BBA is widely used since the first Islamic bank was introduced in 1983. The equity-based financing is rather new when it was introduced by foreign bank such as Kuwait Finance House and al-Rajhi Bank. According to the Central Bank of Malaysia, equity-based financing makes up only 5% of total financing in Islamic banking (Central Bank of Malaysia, 2012).

**Challenges of Islamic banking**

There are many challenges and issues faced by Islamic banks in Malaysia as well as worldwide (Askari et al., 2009). Some of the challenges that are closely related to Malaysia can be summarised as follows:

*Imitating conventional bank.* Kamali (2005) suggested that Islamic banks tend to follow conventional banks by avoiding taking risk and often devoted their resources to safer mode of financing. Existing modes of transactions were modified and manipulated so that all the commercial risks are transferred to the customer.
Avoiding partnership financing. Kamali (2005) also suggested that Islamic banks are reluctant in committing themselves in long-term partnership financing. It means that Islamic banks are less interested in equity-based financing. For example, over two third of financing is debt-based financing. This could be due to the lack of expertise in analyzing the risks involved in the project.

Legal weakness. Inadequate legal frameworks for regulation especially related to moral hazard and avoid arising from risk-sharing arrangements between the bank and its customer (Lee & Detta, 2007).

Consensus on Syariah rulings. Some of Syariah scholars are less restrictive than the others. So, while in certain countries a certain product is permissible, it may not be permissible in other countries (Askari et al., 2009).

Competition from conventional banking. Besides competition between Islamic banks and conventional banks, the Islamic subsidiary banks also have to compete with the conventional banks (Elfakhani, Zbib and Ahmed, 2007).

Research Method

While some researchers approach in this type of study is usually of empirical method, we employed qualitative method by undertaking in-depth interviews with direct stakeholders. This is because empirical approach will not be able to provide greater insights and deeper understanding as to why certain phenomenon exists (Weathington, Cunningham and Pittenger, 2010). In-depth interviews with bank officials and bank customers, which are the two direct stakeholders in Islamic banking, can give more useful and meaningful feedbacks as far as banking product is concern.

We managed to undertake three personel interviews with three officials from three different Islamic banks, one telephone interview with another bank official and one email
correspondence with another. In total we have communicated with five officials from five different Islamic banks. Through our own contact, we managed to conduct personnel interviews with three Islamic bank customers. In short, there were six interviews which took place between January to April 2012; three were with the bank officials and three with bank customer. The questions asked during the interviews were semi-structured which evolved around the Islamic banking products. All interviews were recorded and transcribed for the purpose of analysis.

**Findings**

In the interviews we asked the respondents regarding the Islamic banking in general and then the product in particular. The product in question is the home financing offered by Islamic banking in Malaysia. Currently there are two types of home financing available, namely equity-based which is called *Bay-Bithaman-Ajil* (BBA), and debt-based financing which is called *Diminishing Musyarakah* (DM). The equity-based is relatively new product as compared to debt-based financing. Although operationally both products are giving financing to bank customers, the underlying concept and contracts used in both products are different. The equity-based is a based on sharing, while the debt-based is based on deferred sale.

The important issues that have been raised during the interviews with the bank officials and bank customers can be summarized as follows.

**i. Perception of customers and bankers.** It seems that the bank and its customer have different perception of each other. Some banks had a view that their customers have wrong perception of the banks’ products, while some banks downplayed the market. For example, some banks were not confident that the new product will be well-accepted in the market, so the banks do not offer DM to their customers. Some banks also do not have clear
understanding on Islamic banking. For example, some bank officials are of the opinion that there is not much different between Islamic banking and conventional banking. On the other hand, some customers were of the view that the banks were not sincere in offering the financing products. For example, they were of the view that the all financing products are not really Islamic in substance, although in form the products could be Islamic. To them, Islamic banking is just interested in profit making.

“... customers clearly have better understanding of BBA than DM ... BBA has to do with monthly instalment ... DM has to do with monthly instalment plus rental ... DM could be confusing ... so we don’t offer DM ...” (Bank 1 official)

“… customer will say, “The monthly payment goes up and down, so this is just like conventional product, why is it called Islamic? ...” (Bank 2 official)

“… when a customer needs home financing, his concern is whether it is Islamic or conventional ... that’s all ... those who are knowledgeable their concern will be whether it is BBA or DM ...” (Bank 2 official)

“… Islamic and conventional have the same price rates, it is just different name and different concept ... the difference between Islamic and conventional banking just is the intention of the customer ...” (Bank 3 official)

“… I think there is wrong perception ... BBA is wrongly interpreted by customer that it is expensive. In actual BBA is not ... we are more transparent compared to conventional. In Islamic financing, you know in advance how much you pay ...” (Bank 4 official)

“… it needs further understanding before we can offer DM to our customer, so we don’t have DM ...” (Bank 5 official)

“… Islamic banks are just like other banks. They have to make money ... they are not charity body ...” (Customer 1)
“… Islamic banking products are not really Islamic, but I have no choice because I am a Muslim and I believe in God, so I must use Islamic bank …” (Customer 2)

**ii. Complicated product.** The new financing product involved three different contracts, namely, participating, renting and selling. It is complicated in nature, so explaining this product to customers is not an easy task. This is the reason why some Islamic banks do not adopt the new financing product. As a result, many financing products are still adopting debt-based financing.

“… the product is rather new, so it is quite difficult to promote DM unless the person (customer) did his homework and find out about DM … public acceptance is rather slow because they don’t really understand the product …” (Bank 1 official)

“… BBA has been used when the first Islamic bank operates, so we are not sure how solid the response is for DM …” (Bank 2 official)

“… it is difficult to explain DM to customer. Customer only understands monthly installment which is used to pay sale price … when they do not understand, they will not be comfortable with DM …” (Bank 3 official)

“… I don’t think people who have zero knowledge on Islamic banking can really understand this product …” (Customer 1)

“… it is not really complicated … as long as it is cheaper than BBA, then I go for it …” (Customer 2)

“… I think BBA is more straight forward than DM … the selling price is fixed, I know how much in total I am paying …” (Customer 3)

**iii. Risky product.** The new product is seen to have higher risk than old product. This is because the banks are taking ownership of the house. In the event that the house is still under construction, the banks are taking higher risk because there is possibility that the house will not be delivered to the banks’ customer. However, some banks do not want to bear the risk
when they are adopting DM. In this case, the banks do not really comply with the philosophy of DM, which is to risk sharing between the banks and their customer. In principle, the maintenance of the house is shared between the banks and their customer. This principle in DM is also not observed by the banks.

“… DM is highly risky to the bank ... decided not to adopt …” (Bank1 official)

“… we must be careful because if the product (DM) fails, then we are finished …” (Bank 2 official)

“… in DM, if the house developer fails to deliver, the customer has to bear the cost ... customer has to pay back to the bank ... in DM, the customer has to maintain the house ...” (Bank 3 official)

“… in the event of default, the bank does not make profit …” (Bank 5 official)

iv. Legal restriction. As DM is a new product, legal documentation of the contracts used in DM is still lacking and relatively not as perfect as compared to BBA. Since the documentation of contracts is important to ensure that the legal right of the bank is protected, it is plausible that the new product is not well-conceived at the bank level. Directly, the operation and marketing of the products will be affected. Besides legal issue, transactions of land are not the matter of federal government. Each state government has its own rulings and procedures that involve the sale and purchase of land. This poses problem to foreign banks that are operating in Malaysia. This is because the land title has to be registered under both names, namely the bank and its customer. Since the bank is registered as foreign entity, it will be problematic for the bank to finance the home.

“… we have has more expertise in terms of legal documentation and Syariah in BBA as compared to DM. That is why we do not adopt DM …” (Bank 1 official)
“… we do not have enough people to do legal documentation for DM financing, so it affects the operational of DM …” (Bank 3 official)

“… land matter in Malaysia is under state jurisdiction, so we have to approach every state ... sometimes it takes longer to register the land …” (Bank 4 official)

“… when first I applied for home financing, I was not encouraged to take DM. The lawyer advised me to take BBA because it is more stable in terms of legal standing …” (Customer 3)

v. Lack of promotion. It is also noticed that the new product is not well-marketed by the banks. This is especially true for the Islamic banks that run as a subsidiary. This is because Islamic banking division is sharing the facility of the parent bank. For example, most of the front-line employees are more familiar with the conventional banking than Islamic banking, so Islamic banking will be less promoted. This problem could be inter-related with the characteristics of the product itself that have been explained above. In general the marketing of Islamic banking products is not seen as active and aggressive as compared to the conventional banking.

“… not all staff in the branch are doing sales, only dedicated staff will be involved in sales... we do not have many agents to explain and promote DM, so not many customers take up DM …” (Bank 2 official)

“… we are subsidiary that runs Islamic bank, so our own staff are more familiar with conventional products... the staff will be more likely to promote conventional banking products because they are more knowledgeable with conventional products …” (Bank 3 official)

“… we do have direct sales team, and also we promote through all branches ... online application as well as promotion through website…” (Bank 4 official)
“… I rarely see or recall any advertisements of Islamic banking ... nobody promote to me ... but I will still use Islamic banking …” (Customer 1)

“… like I said before, I have no choice although I don’t really like Islamic banking ... I am not really sure about DM ... better wait for the bank to explain to me …” (Customer 2)

“…with or without marketing I still use Islamic banking ... it’s whether which one is cheaper between BBA and DM …” (Customer 3)

Conclusions and Discussions

This paper has evaluated the new home financing product called Diminishing Musyarakah (DM). Based on our interviews with the bankers and their customer, there are issues with the product that the banks need to sort out due to the different features between DM and BBA. Firstly, there is different of perception of the product among the bankers and consumers. The bankers are assuming that the market is not ready for the product, while the consumers have the perception that the new product is merely imitating the conventional product. This argument arises because DM uses rate of rental which will fluctuate and affect the tenure of the financing. Secondly, the product is claimed to be complicated and it will be difficult for consumers to comprehend. This is because there are three contracts involved in DM. Thirdly, the risk attached to the product is high because the bank is taking ownership of the house with the customer. Fourthly, legal documentation of DM is still poor and has not been challenged yet in the court of law. Fifthly, the promotion of DM is still lacking despite its feature being closed to the true philosophy of Islamic banking.

As a result, there are four challenges to the marketing of the new product in particular and Islamic banking in general, as suggested by Aker (2010).

Getting a seat. Marketing is not only selling a product, but also selling a good image. Full-fledge Islamic banking should increase its marketing effort. Islamic banks run by a subsidiary should be given higher priority by the parent bank. Since subsidiary bank is
sharing resources with its parent, there is a tendency of negligence. Therefore, the marketing of Islamic banking should be given greater position in the organization.

**Dominant in social issue.** In line with the philosophy and objective of Islamic banking, the marketing of Islamic banking should emphasize on its philosophy. While Islamic banking is showing increase profits year after year, the image of Islamic banking could be enhanced by increasing its effort in local community and social issues. It means that Islamic banking should project its image closer to heart of the community.

**Define a new category of banking.** As can be seen from our findings, Islamic banking customers are usually loyal customers especially among Muslim customers. There is opportunity to create a new category or sub-category within the Muslim customers. Therefore, marketing effort to break barriers or hostile feelings should be of another emphasis.

**Energize brand.** Although it seems that there is no real need for the marketing of Islamic bank, the values attached to Islamic banking need to be re-energized. However, since the financial market is the most regulated industry, the room for innovation may be limited. The financing products of Islamic banking should not completely imitate conventional banking. This is the image that many Muslim customers have with regard to Islamic banking. Although Muslim customers do not have majority control in the wealth of the country, ignoring them will affect the energy of the brand.

The challenges on the marketing of Islamic banking especially new products can be listless. The list above is only partial. Of course, the challenges will change as Islamic banking evolves over time. Nevertheless, understanding the challenges is essential so that we are well-prepared for the evolution.

**References**


