

# **Developing Strategies for Islamic Banks to Face the Future Challenges of Financial Globalization**

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*This study aims at forming strategic response to assess the ability of Islamic banks in benefiting from the opportunities that may be provided by financial globalization and limits its threats, through assessing the capability of Islamic banks to meet the requirements and challenges of financial globalization, then suggests the suitable strategies that may be adopted by Islamic banks to maximize and limit the expected opportunities and threats respectively .*

**Key terms:** Islamic Financial Institutions, Islamic Banking, Financial Liberalization, financial globalization.

JEL codes : F36,G15,G21,N25,P49.

## 1. Introduction

Islamic banks are faced by enormous challenges that are the financial Globalization and liberalization, where the financial openness nationally and internationally took various deep dimensions and effects that affect economic and financial systems worldwide.

The study concluded results such as: the financial globalization will have negative effects on Islamic banks' autonomy, profit margin and competitive position. It will also enhance the Islamic banks' ability to create new investments, liquidity management instruments and methods, and develop the existing ones. In addition, to increase its ability to take advantage of the openness IBs will expand its operations into new markets.

The researcher developed some strategies to be adopted by the IBs. These strategies were divided into three categories: single bank level (survival strategies, confrontation strategies), operational strategies on the functional activity level, and then the overall strategy for world wide Islamic banks (Globalization strategy).

After that, the researcher explained the nature, execution requirements, and the abilities of Islamic banks to adopt each of them.

Finally, the researcher provided some recommendations related to the suggested strategies, In addition to other recommendations such as: strengthen the cooperation ties between JIBs and other Islamic banks abroad, and reinforce the role of young employees in the desired strategic leadership change, in addition to moving the responsibilities of (Shari'ah committees) from the Islamic banks to the central banks to become (Central Shari'e Supervision).

## **2. Literature Review**

The issue of financial globalization and its effects on the economic regimes and financial institutions has been discussed thoroughly (Hellmann& Murdock & Stiglitz,2000; Kaminski & Shmukler ,2002; El-Issa,2002). Besides ,the Islamic Banks' as financial institutions along with their products in facing liberalization and openness took some of the interest in the recent years (El-Gamal ,1998; Errico & Farahbaksh,1998; Ali,2002; Sundararajan & Errico ,2002).

## **3. Methodology and Research Design**

The hypothesis is formulated to know the extent to which IBs were affected by financial globalization, in order to explore the opportunities and threats to these banks due to the financial liberalization and globalization; in addition to determine the ability of them to benefit from the opportunities to be achieved or limit the threats resulted from exposure to the consequences of financial liberalization and globalization.

In order to test the study's hypothesis, a questionnaire was distributed among the objective sample of personnel in the senior management in each of the IBs included in the study (Jordan Islamic Bank & the International Arabic Islamic Bank ), in accordance to availability of some characteristics such as experience, academic status, and seniority, so that they are considered representatives of their banks.

To analyze the responses and comments of the sample, the researcher used the averages; he also used T-test to test the study's hypothesis.

## **4. Main Findings**

The study concluded results such as: the financial globalization will have negative effects on Islamic banks' autonomy, profit margin and competitive position. It will also enhance the Islamic banks' ability to create new investments, liquidity management instruments and methods, and develop the existing ones. In addition, to increase its ability to take advantage of the openness IBs will expand its operations into new markets.

Depending on the derived results, the researcher developed some strategies to be adopted by the IBs. These strategies were divided into three categories: single bank level (survival strategies, confrontation strategies), operational strategies on the functional activity level, and then the overall strategy for world wide Islamic banks (Globalization strategy).

**The Main Body of the paper was devoted to discussing these strategies**

# Strategies of Islamic Banks to Face Financial Globalization

This division of the paper Contains:

Part one: Overall Strategies (Single Bank Level)

Part two: Operational Strategies

Part three: Globalization Strategy

Part Four :Policy Implementations

## Part one

### Overall Strategies (Single Bank Level)

In this part, five kinds of strategies to be developed; Consolidation, Cost leadership, Merger & acquisition (Survival strategies).Market development and Diversification (Confrontation Strategies).

Such division of these strategies is done in order to enhance the Islamic Banks (IBs) to focus first, on the existence, then to improve its positions in the current markets within the current environmental circumstances. These strategies will be prerequisites of the other strategies which are devoted to face the financial globalization.

#### Survival Strategies

Adopting these strategies will be vital for IBs to stay as life-capable economic units, able to stay standing, at least, in the current markets.

##### **a. Consolidation Strategy** (Johnson and Scholes, 1999)

This strategy is concerned with protecting and strengthening the current competitive position in the current markets of IBs, with the current product mix .This doesn't imply that the IBs will stand still watching the market changes or the invasion of the traditional banks on their financing or investing sectors. What's needed according to this strategy is to focus on the core competences which are encapsulated in the Shari'ah commitment, the capital structure and the abundance of funds, which give the IBs a better competitive position against the traditional ones.

The awareness of these competences and developing them will help IBs to increase and strengthen their resources.

##### **b. Cost Leadership Strategy** ( Cole,1994)

In order to help IBs to adopt the consolidation strategy, it must increase the competitive ability via achieving ratios of return for the stockholders and the depositors higher than the current ones. The best way to do so within decreasing cost of the services is provided by IBs.

Since the capital structure of IBs doesn't contain any kind of debt, this means that there's no fixed interest payment for the depositors or any other lenders, which provide them with a competitive advantage compared to the traditional banks .This releases the pressure on its management regarding risk-taking and investment decisions, hence, there will still be the managerial expenses which can be handled by a way easier than interest expenses.

**c. Merger and Acquisition Strategy.**

According to the past experience of financial and non- institutions, strategy considered as one of the most common recommended strategies, because its positive effects on the consolidated firms regarding economics of scale, competitive ability, and synergy.

In spite of the vast advantages of this strategy, it is worth taking into consideration these tow points before recommending this IBs strategy:

1. The result of just merging tow weak IBs (for example) will not produce a strong one, the opposite will happen.
2. The different nature (i.e. the nature of sources and uses of funds, and cost structure), between IBs and conventional banks which have a good record in this must be taken into consideration before recommending this strategy for IBs.

**Confrontation Strategies**

These strategies are devoted to be adapted by IBs in order to take the initiative in facing the financial globalization to maximize its opportunities and minimize its threats.

**a. Market Development Strategy ( Burns,1996 )**

The financial globalization will provide IBs with a good opportunity to enter virgin markets (in the middle east and abroad), beside the availability of new sectors of customers as micro finance projects, women financing, private banking, investing in the privatized projects, and meeting the financial needs for governmental agencies, who are not currently served by conventional banks .This will give IBs a great advantage to win these sectors.

Besides, IBs can expand its investment activities and diverse fund resources by establishing new branches or affiliate banks in the virgin markets.

**b. Diversification Strategy ( Burns,1996 )**

IBs can develop its current products in addition to innovate new financial products compliant to Islamic Shariah as a result of financial globalization; this can go concurrently with introducing new non traditional markets. This strategy includes shifting IBs toward developing new products and new markets in the same time. It can be undertaken as a related diversification or unrelated diversification. According to the first kind, IBs can navigate in new markets and new products in the finance industry, like establishing or investing in Islamic insurance companies, investment companies, or financial security dealer companies ....etc.

According to unrelated diversification, IBs can apply the concept of Islamic Comprehensive Bank by diversifying its investments beyond the financial sector, by direct investment in the economy; this is applied by Dubai Islamic Bank & Jordan Islamic Bank who is investing in factories, hospitals, and other industrial firms.

## **Part tow**

### **Operational Strategies**

The division of the operational strategies will be according to the functional activities undertaken by IBs, i.e. Finance, Marketing, Human resources, and Information management.

#### **Investment & Financing Strategies**

These strategies are related to money procurement from different resources and investing funds through proper allocation in order to achieve an acceptable profit.

According to fund raising, IBs will face a kind of disintermediation as a result of financial liberalization and openness which encapsulate more profitable choices for the depositors of IBs. Hence, IBs are invited to reduce operational costs in order to attain greater returns for the depositors as the stockholders.

Diversification of fund resources according to Liability Management Theory will be a wise arrangement that can be followed by IBs; this can be realized by relying on non-conventional resources that are supplied by Islamic financial system as Sukok (Muqarada Bonds) which can be issued in the international financial markets. Besides, IBs can benefit from the financial liberalization to issue and list its own stocks in these markets.

In addition, IBs can maximize the opportunities of financial globalization by starting to make particular arrangements to establish money market between them domestically and globally.

On the investment side, Comprehensive Banking concept considered as a viable strategy which is compatible with IBs nature as comprehensive financial institutions, this needs to decrease the dependence on fixed return modes. Murabaha (Sale Financing) for the benefit of Profit-Loss-sharing (PLS) modes. Such diversification of investment modes can be achieved by direct investment or trading on the current Islamic financial instruments that are available in the international financial markets, beside investing in Islamic-acceptable mutual funds, or establishing special mutual funds belongs to IBs.

#### **Marketing Strategies**

IBs will be faced by the problem of increasing the complications of customers' needs as a result of financial openness and availability of alternative choices for them in finance and investment.

These threats needs strategic response from IBs to face and reduce its negatives .IBs have to adopt a Customer- Oriented strategy instead of Product –Oriented one ,because the contemporary trend in bank marketing focuses essentially on the customer, the range of banking services is not enough alone. availability of a wide

Such challenge requires reviewing the current marketing strategies of IBs by pricing it properly and dissemination it to a targeted sectors of customers in a better way.

The second threat that faces IBs is the hostile propaganda against IBs in the aftermath of 11 September events, were the IBs are connected in a stereotype way to the so called "terror ". This campaign should be encountered through adapting defensive

informative strategy to explain its nature and economic role. These efforts will not be confined to the efforts of the IBs individually, rather, it must be one of the key axes of "Globalization Strategy" of all IBs around the world, which is to be discussed later on.

### **Human Resources Strategy**

Human resources constitute the corner stone in delivering banking service in all banks and IBs in particular. This element is of a great importance for the IBs to face the future challenges of financial globalization, because adopting and implementing the other strategies depend heavily on human resources. IBS strategies in this regard rest on two props (elements):

#### ***- Development and training***

This requires the IBs to meet its increasing need for employees whom have the professional abilities as bank employees, beside a good knowledge of economic matters of Islamic Shariah. Preparation efforts are needed to qualify new employees before taking place in doing their jobs, current employees are to be subject to intensive training courses to empower their professional and religious knowledge. IBs can do so by establishing specialized departments or training centers.

The other face of training and development IBs' employees are to concentrate on educating themselves to create a well- shaped perception about the phase of financial globalization and its importance, in order to prepare themselves practically and mentally to cope with the opportunities and threats that will face IBs as consequences of it.

#### ***- Change leadership***

As the targeted change for IBs to be deep and structural, the leaders of such changes must have unique traits like awareness, knowledge, and enough flexibility to adopt the overall and operative strategies, and to lead their banks to be part of "Globalization Strategy" which will contain all IBs.

The current traditional leaders of IBs are invited to take brave strategic decisions as a proper response of the degree of globalization challenges, by giving young leaders the opportunity to lead IBs in navigating toward the future and manage strategic change.

### **Informative strategy**

The vast technological developments in computer science and telecommunications, beside the developments in management science have lead to a great dependence on information, computerized activities and computerized information systems in particular. Banking industry is one of the biggest customers of these technologies. Financial globalization and information explosion enhance the abilities of banks to depend heavily on producing computer - based financial services as ATM, money transfer, automated banks...etc, and doubled the need to develop banking industry and improve its services.

The ability of IBs to adopt and implement the mentioned strategies must stand basically on a solid information structure. Hence, implementing information strategy must be pre and parallel to implementing the other strategies.

## **Part three**

### **Globalization Strategy**

Unifying the efforts of IBs and orienting it toward dealing properly with the phenomenon of financial globalization in an integrated way constitutes the main issue of this strategy in order to globalize IBs practices beyond local geographical boundaries.

As a conclusion of the study, the cooperation between IBs has a great importance in facing the future challenges of financial globalization to maximize its opportunities and minimize its threats.

Globalization strategy gain a special importance as a means for translating the awareness of the forthcoming era to an actual cooperation, a comprehensive strategy that unify all IBs in one front to face the challenge of financial globalization; moreover , merging IBs as a natural and effective element in the current global financial system. The role of IBs on the global economic scene depend essentially on the degree of " globalization " of Islamic financial modes and instruments which are provided by IBs, and its contribution to meeting the finance and investment needs for the different sectors world wide ( Ali,2002 ) .

Globalization strategy is to be distinguished out from the individual pre-discussed strategies in its comprehensiveness and global-wide range, which it covers. Besides, this strategy has clear features and well identified principles which are established by IsDB solely or with cooperation with other international establishments to enable IBs to adapt with the requirements of financial globalization, alongside with merging in the global financial environment

The main landmarks of this strategy include:

#### **1- *Institutional framework***

Many international organizations have been founded to organize the works of IBs, besides helping them in accounting aspects, liquidity management, and control...etc. The Accounting and Auditing Organization for Islamic Financial Institutions (AAOIFI), the International Islamic Rating Agency (IIRA), the Islamic Financial Services Board (IFSB), and the General Council of Islamic Banks and Financial Institutions (GCIBFI) are examples of these organizations.

These organizations represent an infrastructure to build on by IBs in its attempt to be part of the international financial environment. Unifying accounting standards, and availability of an international auditing and supervision body, for example; will ease and organize the process of controlling, supervision, and revision the performance of IBs. Besides, availability of Islamic financial markets can be a great opportunity to enhance the ability of IBs regarding liquidity management effectively.

#### **2 - *Religious (Shariah) framework***

This side of globalization strategy is related to unifying (or converging) religious viewpoints regarding a lot of new dilemmas and problems related to investment, financing



instruments, and modes that currently face IBs, and is still unsettled. International religious standards can be prepared by Assembly of Islamic Jurisprudence to be followed by local IBs.

### **3 - Human resources**

All professionals and scholars agree that IBs are in need for employees who have the required qualifications as bank professionals beside the Islamic background and religious commitment. Preparation of IBs employees for this will be a first class priority for it in the globalization era.

In fact, it's not expected nor needed from each individual bank to build a university or institute to qualify its employees, because this is not feasible. Hence, collaborative work in this side which can be achieved by establishing research and training centers in a country or region will be with a great usefulness in preparing IBs employees scientifically and practically.

### **4 - Promotional framework**

Promotional efforts had taken its importance in the aftermath of 9/11 events, since all IBs are subject to a hostile propaganda that distrusting goals and activities of IBs through linking it with "terrorism".

IsDB and other IBs are working in an opposite media campaigns via conferences, seminars, press releases, and other ways to correct this view about IBs' goals and activities. The positive results of such efforts became obvious through consideration of the government agencies in the west (US & UK in particular) for the goals and activities of IBs. Moreover, the monetary authorities in these countries promised to adapt its financial legislations to cope with the IBs and other Islamic financial institutions and accept them as ordinary members in their financial systems.

### **5- Research & studies**

Scientific research and strong approaches that IBs can rely on to develop its abilities in facing financial globalization is essential. The need for creating new financial instruments and modes, and developing the current ones; besides, amelioration employees' skills and knowledge can be met by scientific research.

#### **Expected Success of Globalization Strategy depends on:**

- ▶ Degree of cooperation that IBs can achieve between them, compliance to principles and instructions passed by international establishments that organize its activities, and overcoming the problems of " Sensitive (negative) Competitiveness " (especially in the same country ) to look forward to a strategic relationship based on " Cooperative Competitiveness " .
- ▶ Flexibility of monetary authorities in adjusting its legislations to consider the unique nature of IBs, and the cooperation in monitoring and imposing IBs to obey the instructions of the International Islamic institutions that organize Islamic financial activities around the world.
- ▶ The extent to which international financial society can accept Islamic finance & banking, and cooperate with its institutions.
- ▶ The efficiency of IsDB of playing its role as an international Islamic financial organization.

The IsDB can be the leader in this strategy, supported by the following factors:

- 1 - IsDB has a great degree of flexibility that helps in working beyond local and regional borders.
- 2 - IsDB is far away from dominance of a single or a group of countries (politically autonomous).
- 3 - IsDB is a non-profit organization; hence, it doesn't compete with other IBs.
- 4 - Most of IBs are working in member countries of Islamic Congress Organization, which IsDB belongs to. This helps in enhancing further acceptance and confidence in IsDB more than any international financial organization.
- 5 - IsDB have built a deep-rooted and solid network of cooperative relations with the international financial organizations and gained their confidence, which made it seen as an ambassador of the Islamic financial institutions, through which they can deal with IBs

## **Part Four**

### **Policy Implementations**

#### **First: About the suggested strategies**

- 1 - On the individual level, each of IBs **MUST** adopt consolidation and cost-leadership strategies in order to stay alive, viable as banking financial institutions - at least - in its current markets.
- 2 - A strategic change must be done in performing the functional activities through adopting the suggested operational strategies.
- 3 - IBs must adopt globalization strategy and work seriously to implement it in an effective way.
- 4 - Individual strategies implementation should be parallel with globalization strategy implementation to maximize expected benefits from strategic change.

#### **Second: Other recommendations**

- 1 - The role of IsDB as a leader of IBs in facing future challenges of financial globalization should be supported and developed to play the role of the International Central Islamic Bank (ICIB) for other IBs.
- 2 - The previous point evokes the need for restructuring IsDB by splitting it for tow organizations, the first as an International Central Islamic Bank for other IBs, and the other is to be devoted for development. The example of dividing roles between IMF & WB can be helpful in this regard.
- 3 - In order to play the role of ICIB , IsDB must be assisted by local central banks via establishing departments specialized in supervising and auditing the works of IBs ,to insure it's compliance with Islamic principles , which will produce ( Central Shari'ah Supervision ) that will occupy the place of the current Shari'ah committees of IBs. This will lead to reducing the conflict in religious opinions about dealing with financial instruments and modes between IBs in different countries.
- 4 - Making room for the young professional bank leaders to lead the anticipated strategic change, through adopting them by the current administrations.

5 - Building a new kind of relationship between IBs through establishing a "Cooperative Competition " based on a religious and economic interest between them.

6 - Establishing departments for research & development in IBs will be essential, along side inviting specialized scholars to conduct studies in marketing, finance, and other areas related to IBs activities, and supporting these studies financially from IBs sources.

## **5. Conclusion**

The study concluded results such as: the financial globalization will have negative effects on Islamic banks' autonomy, profit margin and competitive position. It will also enhance the Islamic banks' ability to create new investments and liquidity management instruments and methods, and develop the existing ones. In addition to increasing its ability to take advantage of the openness by expanding its operations into new markets. The researcher developed some strategies to be adopted by Islamic banks. These strategies were divided into three categories: single bank level (survival strategies, confrontation strategies), operational strategies on the functional activity level, and then the overall strategy for world wide Islamic banks (Globalization strategy).

After that, the researcher explained the nature, execution requirements, and the abilities of Islamic banks to adopt each of them. Finally, the researcher provided some recommendations related to the suggested strategies, In addition, to other recommendations such as: strengthen the role of the Islamic Development Bank as a fundamental financial institution, and reinforce the role of young employees in the required strategic change of leadership in addition to relocating the responsibilities of ( Shari'ah committees ) from the Islamic banks to the central banks to become the(Central Shari'ah Supervision).

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