



**ETHICS OF ISLAMIC FINANCE PRODUCTS AND
SERVICES: AN ANALYSIS OF QUR'ĀNIC GUIDANCE
AND CONSUMER PERCEPTION**

BY

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**A dissertation submitted in fulfilment of the requirement for
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ABSTRACT

Islamic financial institutions (IFI) that are governed by *sharī'ah* principles are expected to have inherently strong ethical roots such as promoting justice and avoiding any illegal and unethical elements. Hence, ethics has become a vital component in order to provide “value” for consumers. Indeed, there are numerous Qur’ānic injunctions and Prophetic guidance concerning ethical principles pertaining to Islamic finance, particularly those related to the ethics of business transactions. This research emphasises Islamic revealed guidance by compiling the Qur’ānic verses related to financial transactions using selected exegeses (*tafasīr*). Furthermore, this research also focuses on how consumers perceive the ethicality of products and services offered by IFIs. It delineates the importance of ethical finance and the need for Islamic banking to align with ethical banking. Meanwhile, a quantitative research methodological approach was adopted in this study by utilising a structured questionnaire comprised of close-ended questions. The questionnaire was distributed among IIUM academic and administrative staff. The research findings show that the majority of respondents had a positive perception of the ethicality of Islamic finance products and services. This study also found that Islamic banking should formulate strategies to educate and offer unique products and services differentiated by underlying ethical values to increase its appeal to customers. The findings also suggest that ethics could be considered as a factor that encourages patronage of IFIs. Thus, this research is expected to assist IFIs to demonstrate their commitment and efforts in providing added value to customers.

ملخص البحث

إن المؤسسات المالية الإسلامية التي تحكمها أحكام الشريعة متوقعة أن تكون على أسس أخلاقية قوية مثل تعزيز العدالة وتجنب أي عناصر غير قانونية وأخلاقية. كما أصبحت الأخلاقيات عنصراً مهماً لتوفير "قيمة" للمستهلكين. حقيقة، هناك العديد من الأوامر القرآنية والإرشادات النبوية بخصوص المبادئ الأخلاقية المتعلقة بالتمويل الإسلامي، ولا سيما المتعلقة بأخلاقيات المعاملات التجارية. ويؤكد هذا البحث توجيهات إسلامية التي كشفت عن طريق تجميع آيات قرآنية مع تفاصيل من كتب التفسير المختارة في المعاملات المالية. ويركز هذا البحث أيضاً على كيفية إدراك المستهلكين على أخلاقيات المنتجات والخدمات التي تقدمها المؤسسات المالية الإسلامية. ويحدد أهمية التمويل الأخلاقي وضرورة تعامل التمويل الإسلامي مع الأعمال المصرفية الأخلاقية. يتم استخدام منهج البحث الكمي في هذه الدراسة من خلال توظيف استبانة منظم تتكون من أسئلة مغلقة. وتم توزيع الاستبانة على الموظفين الأكاديميين والإداريين (IIUM). وتظهر نتائج البحث أن معظم المجيبين لديهم تصورات إيجابية في أخلاقية منتجات وخدمات التمويل الإسلامي. ووجدت الدراسة أيضاً أن المصارف الإسلامية ينبغي أن تضع استراتيجيات لتثقيف وتقديم منتجات وخدمات فريدة ومتباينة من التمويل الأخلاقي الكامن لزيادة جاذبيتها للعملاء. وتشير النتائج إلى أن الأخلاقيات من العوامل التي تشجع على رعاية المؤسسات المالية الإسلامية. وبالتالي، من المتوقع أن يساعد هذا البحث المؤسسات المالية الإسلامية في إظهار التزامها وجهودها في توفير قيمة مضافة للعملاء.

APPROVAL PAGE

I certify that I have supervised and read this study and that in my opinion; it conforms to acceptable standards of scholarly presentation and is fully adequate, in scope and quality, as a dissertation for the degree of Master of Islamic Revealed Knowledge and Heritage (Qur'ān and Sunnah Studies).

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DECLARATION

I hereby declare that this dissertation is the result of my own investigation, except where otherwise stated. I also declare that it has not been previously or concurrently submitted as a whole for any other degrees at IIUM or other institutions.

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*Dedicated to my parents,
for the endless loves, sacrifices and prayers,
and to my teachers,
for the guidance, advice and support.*

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In the name of Allah, the Most Beneficent and the Most Merciful,

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LIST OF ACRONYM & ABBREVIATIONS

AAOIFI	Accounting and Audit Organisation for Islamic Financial Institutions
AmBank	AmBank Malaysia Berhad
BBA	<i>Bay' bithamān ājil</i>
BIMB	Bank Islam Malaysia Berhad
BMMB	Bank Muamalat Malaysia Berhad
BNM	Bank Negara Malaysia/ Central Bank of Malaysia
BOD	Board of Directors
ed.	editor/edited by
FSBP	Financial Sector Blueprint
IB	Islamic bank
Ibid	Ibidem – in the same place
IFBS	Interest-Free Banking Scheme
IFI	Islamic financial institution
IFSA	Islamic Financial Services Act
IFRS	Islamic Financial Reporting Standards
IFSB	Islamic Financial Services Board
ISRA	International Shari'ah Research Academy for Islamic Finance
KMO	Kaiser-Meyer-Olkin
PCA	Principal Component Analysis
PWC	PricewaterhouseCoopers
SAC	Shari'ah Advisory Council of Bank Negara Malaysia
SSB	Shari'ah Supervisory Board
TH	Tabung Haji/Pilgrims Management and Fund Board
trans.	Translator/translated by
VIF	Variance Inflation Factor
vol.	Volume/volumes

TABLE OF TRANSLITERATION

Table of the system of transliteration of Arabic words and names used by the
International Islamic University Malaysia.

ء	'	ز	z	ق	Q
ب	B	س	s	ك	K
ت	T	ش	Sh	ل	L
ث	Th	ص	ṣ	م	M
ج	J	ض	ḍ	ن	N
ح	ḥ	ط	ṭ	هـ	H
خ	kh	ظ	ẓ	و	W
د	D	ع	‘	ي	Y
ذ	dh	غ	Gh		
ر	r	ف	F		

Short Vowels		Long Vowels	
َ	a	ا + َ	ā
ِ	i	ي + ِ	ī
ُ	u	و + ُ	ū

CHAPTER ONE

INTRODUCTION

1.1 BACKGROUND OF THE STUDY

Ethics is a branch of discipline that denotes “the science of conduct”, which is concerned with two different questions of moral action such as right or wrong, good or bad, and virtues or vice. It generally deals with a person’s conduct while interacting with others, and promotes good values and forbids evil.¹ In Islam, ethics refers to the divine and science of morality (*‘ilm al-akhlāq*). The Prophet SAW is reported to have said in one of his *ḥadith* that he was sent to perfect the moral characters of human beings.² In the Qur’ān, Allah SWT says that He has perfected the religion and approved Islam as a way of life for humanity.³ This shows that Islam provides guidelines in all aspects of human life including financial transactions.

Islamic finance is the provision of financial services which comply with *sharī’ah*-stipulations. This means that the products and services must inherently have a real economic purpose and are free from short selling (betting against security), and the payment or receipt of interest (*ribā*), gambling (*maysīr*), or excessive uncertainty (*gharār*).⁴ Moreover, ethics has become an important aspect of the financial service sector to increase its appeal to customers and remain relevant for the societies.

¹ Abdul Kabir Hussain Solihu, *The Islamic Worldview, Ethics and Civilization: Issues in Contemporary Interdisciplinary Discourse*, (Kuala Lumpur: IIUM Press, 2012), 100.

² The ḥadith narrated by Abū Hurayrah. See Al-Ḥākim, Muhammad ibn ‘Abdullah al-Naysābūrī, *Al-Mustadrak ‘alā ṣaḥīḥyn*, ed. Muṣṭafā ‘Abd al-Qādir ‘Atā’, (Bayrūt: Dār al-Kutub al-‘Ilmiyyah, 1st edn., 1990), vol. 2, Ḥadith 4221: 670.

³ *Qur’ān* (Al-Qalam,), 68: 4.

⁴ Brian Kettell, *Introduction to Islamic Banking and Finance*, (United Kingdom: John Wiley & Son Ltd, 2011), 16.

Islamic financial institutions exist in most Muslim countries. Malaysia sustains its status as the hub for Islamic finance, and the industry has been developing rapidly.⁵ The Islamic Finance Reports indicate that Malaysia is leading in the global Islamic finance charge. The data compiled by Islamic Finance Development Indicator 2014 illustrates Malaysia's total Islamic finance assets at the time, including banking, Takāful and Sukuk, totalling US\$423.29 billion or 25.53% of the global market.⁶ There are sixteen Islamic banks in Malaysia, ten local Islamic banks and six international Islamic banks offering Islamic banking schemes.⁷ Unfortunately, consumer views on the ethicality of the existing products and services are often overlooked by Islamic banks, although they are among the most important stakeholders in the Islamic finance industry. Hence, this study will examine the principles of ethics in Islamic finance mentioned in the Holy Qur'ān, while assessing consumer perceptions on the ethicality of the products and services offered by Islamic financial institutions.

There are numerous Qur'ānic injunctions and Prophetic *ḥadith* concerning ethical principles of Islamic finance, particularly those related to ethics of business transactions. This shows that Islam acknowledges morality in this pivotal human activity. Allah SWT says in the Qur'ān:

﴿يَا أَيُّهَا الَّذِينَ آمَنُوا لَا تَأْكُلُوا أَمْوَالِكُمْ بَيْنَكُمْ بِالْبَاطِلِ إِلَّا أَنْ تَكُونَ تِجَارَةً عَنْ تَرَاضٍ مِنْكُمْ وَلَا تَقْتُلُوا أَنْفُسَكُمْ إِنَّ اللَّهَ كَانَ بِكُمْ رَحِيمًا﴾

⁵ M. Mahmudi Ali & Shabana M Hassan, "Malaysia: An Indisputable Islamic Finance Hub?" *Islamic Finance News*, vol. 10, no. 133, (2013), <<http://www.islamicfinancenews.com>> (accessed February 28, 2016).

⁶ IFN Reports, "Malaysian Leads Global Islamic Finance", *Islamic Finance News*, <<http://www.islamicfinancenews.com/news/malaysia-leads-global-islamic-finance-charge>>. (accessed March 16, 2016).

⁷"BNM List of Licensed Banking Institution in Malaysia", <<http://www.bnm.gov.my/index.php?ch=li&cat=islamic&type=IB&fund=0&cu=0>>. (accessed April 6, 2016).

You who believe, do not wrongfully consume each other's wealth but trade by mutual consent. Do not kill each other, for God is merciful to you.⁸

This verse declares that business (*al-Tijārah*) is the most desirable way to increase one's wealth. Sayyid Qutb begins his interpretation of this verse with the prohibitions against devouring other people's wealth, and only through trade that people may gain monetary advantage over one another.⁹

Another example of how Islam stresses ethics in business can be gauged from the longest verse in the Qur'ān pertaining to the discussion of loans (*dayn*). The Qur'ān instructs that a book (or contract) is required between two parties involved in a loan transaction (*tadāyantum bidayn*) for a stated term (*ilā ajalīn musammā*).¹⁰ This is emphasised in Islam so as to justly protect the right and interests of humankind.

In addition, the Prophet SAW is reported to have declared war against those who impose interest on loans; "...cursed all those involved in usury based transactions, the lender, the borrower, the accountant, and two witnesses, declaring that they were all equal in terms of nature of the sin."¹¹

In the context of Islamic finance, ethics has become a vital component in the financial services sectors in order to provide value for consumers.¹² The products and services offered by Islamic financial institutions (IFIs) must meet the requirement of Islamic law, where all transactions are free from any unethical and dubious elements. In the case of financial ethics, the issues are often addressed as a matter of law rather than ethics. Ethics in finance is concerned with technical issues including the mix of

⁸ *Qur'ān* (Al-Nisā), 4: 29. Abdel Halem, M.A.S. *The Qur'an*, (Oxford: Oxford University Press, 2005). All Qur'anic verses in this research will be using this translation

⁹ Sayyid Qutb, *In the Shade of The Qur'ān Fī Zilāl Qur'ān*, (United Kingdom: The Islamic Foundation, 2001), 3:113.

¹⁰ *Qur'ān* (Al-Baqarah), 2: 282.

¹¹ The ḥadīth narrated by Jabir. See: Muslim ibn al-Ḥajjaj, *Ṣaḥīḥ Muslim*, (Bayrūt: Dār Ma'rifah, 11st edn. 2004), Ḥadīth 4069: 28.

¹² Muhammad Adli Musa, "Ethics and Islamic Finance: A Study of Islamic Financial Ethics and Islamic Banks in Malaysia," (Ph.D. thesis, University of Melbourne, 2015), 2.

debt and equity, dividend policy, the evaluation of alternative investment projects, and swaps.¹³ At some point, ethics should be uncompromisingly infused in the finance sector to curb corruption, injustice, and exploitation.

By understanding the importance of ethics in Islamic finance in relation to the products and services offered to consumer, attempts to introduce reforms that would ensure their ethicality can be pursued. It is clear that in order to attain Allah SWT's pleasure, IFIs have to inculcate honesty and patience, and realise that doing business is not only about profit maximisation, but is a way to benefit mankind.

Therefore, this study aims to examine the ethical principles of Islamic finance as enunciated in the Holy Qur'ān, while assessing consumer perceptions on the ethicality of the products and services offered by IFIs, and developing guidelines to improve the ethics in all dimensions of Islamic finance from the Qur'ānic perspective.

1.2 PROBLEM STATEMENT

Islamic finance promotes certain ethical values such as prohibitions of unjust practices, exploitation, and fraud.¹⁴ Unfortunately, the current practices of IFIs have been criticised amongst unconvinced Muslims and non-Muslims for their failure to promote such values to the consumers.¹⁵ Moreover, the enforcement mechanism with ethical consideration in IFIs demonstrates the importance of ethics in products and services of Islamic finance.¹⁶ Consumers can create a demand for ethical finance, which is very important in influencing the supply of ethically infused products and

¹³ Haron, Abdullah, Musa, Muhammad Adli, & M Shaarani, Ahmad Zakirullah. *Ethics in Islamic Finance*, (Kuala Lumpur: Islamic Banking and Finance Institute Malaysia, 2013), 12.

¹⁴ Haron, Abdullah, Musa, Muhammad Adli, & M Shaarani, Ahmad Zakirullah, *Ethics in Islamic Finance*, 2.

¹⁵ Asyraf Wajdi Dusuki, & Nurdianawati Irwani Abdullah, "Why do Malaysian customers patronise Islamic banks?" *International Journal of Bank Marketing*, vol. 25, no. 3 (2007): 142 – 160.

¹⁶ Haron, Abdullah, Musa, Muhammad Adli, & M Shaarani, Ahmad Zakirullah, *Ethics in Islamic Finance*, 131.

services offered by financial institutions. Therefore, this study would be helpful in providing evidence in developing ethical principles related to financial transactions based on Qur'ānic guidance and perceptions of consumers.

Thus, this study intends to examine the concepts and principles of ethics in Islamic finance products and services from the Qur'ānic perspective and analyse consumer perceptions on the ethicality of Islamic finance products and services. To this date, there are a growing body of research on Islamic financial ethics among employees in Islamic banks; however, no study has been carried out to analyse perceptions of consumers based on the principles of financial ethics mentioned in the Qur'ān. This gap will be addressed by the current research.

1.3 RESEARCH OBJECTIVES

This research intends to achieve the following objectives:

1. To identify the ethical principles related to business and financial transactions mentioned in the Qur'ān.
2. To relate the Qur'ān ethical principles to modern day Islamic finance and ascertain the ethical norms underlying Islamic finance products and services.
3. To analyse consumer perception in relation to the ethicality of the products and services offered by Islamic financial institutions.
4. To explore technique to improve the ethicality of the products and services offered by Islamic financial institutions.

1.4 RESEARCH QUESTIONS

This research will attempt to provide answers to the following questions:

1. What are the principles related to business and financial transactions mentioned in the Qur'ān?
2. How ethical principles derived from the Qur'ān are related to modern day Islamic finance and what are the ethical norms underlying Islamic financial products and services?
3. What are consumer perception in relation to the ethicality of the products and services offered by Islamic financial institutions?
4. How can Islamic financial institutions improve the ethicality of their products and services?

1.5 SIGNIFICANCE OF THE STUDY

Islam emphasises on ethics and values in all aspects of human life. There are many ethical principles mentioned in the Holy Qur'ān which are applicable to financial transactions. This study will analyse these principles from the Qur'ānic perspective. The evaluation of consumer perception on the ethicality of products and services offered by IFIs will assist them in understanding and taking their perceptions into consideration. The study will potentially educate consumers about ethical finance, enhance ethicality of Islamic finance through specific standards, and encourage IFIs to demonstrate their commitment and efforts in providing added values to consumers.

1.6 LIMITATIONS/SCOPE OF THE STUDY

This study will concentrate on examining ethics in Islamic finance from the Qur'ānic perspective. Selected Qur'ānic verses will be the focus of this research in order to

critically evaluate the ethicality of products and services offered by IFIs. In order to make an assessment of consumer perception, the researcher has selected the consumers among academics and administration staff of the International Islamic University Malaysia (IIUM) as a case study. This study will investigate their perceptions on the selected three Islamic bank branches in IIUM Gombak Campus, which are Bank Islam Malaysia Berhad (BIMB), Bank Muamalat Malaysia Berhad (BMMB) and Am Bank Islamic Berhad, due to the fact that most (if not all) of them deal with the banks mentioned. It is expected that their familiarity in dealing with IFIs will assist in the collection of unbiased information. The data collected will serve as objective findings in identifying significant issues related to the ethicality of products and services of Islamic finance, and later offer guidelines for improvement of IFIs operations.

1.7 RESEARCH METHODOLOGY

The study employs a mixed methods approach: combining both, qualitative and quantitative methodologies. The main methods of collecting and analysing data will be as follows:

1. Qualitative Analysis – by critically examining the concept and framework of ethics in Islamic finance based on the Qur’ānic verses that are related to financial transactions. The existing research works, articles, journals, theses and books are to be analysed. This is to gain a fundamental understanding of ethics in Islamic finance, and to assist in understanding its relationship to the ethicality of products and services offered by Islamic financial institutions.
2. Quantitative Analysis – by surveying consumer perception on the ethicality and Islamicness of Islamic finance products and services. A structured questionnaire

comprising close-ended questions will be used to conduct the study. The questionnaire is divided into two sections. Sections 1 contain questions related to the respondents' background, Section 2 will be divided into five parts: - (i) the general ethics of the bank, (ii) code of ethics in term of products; (iii) code of ethics in term of services; (iv) understanding the differences between Islamic and conventional banks; and (v) disclosure of information in relation to marketing and product rates. The researcher will use Statistical Packages for the Social Science (SPSS) which officially named as IBM SPSS Statistics since 2015 to analyse the data.

1.8 LITERATURE REVIEW

There are a substantial number of studies discussing the details of business ethics, morality in business dealings, and conditions and legislations concerning business transactions in Islam. However, the discussion is limited to various forms of literature pertaining to business ethics in Islam, Islamic finance, and consumer perceptions, which are the main thrust of this study.

Mushtaq Ahmad, through his book *Business Ethics in Islam*,¹⁷ explains the principles and guidance that the Qur'ān lays for Muslims involved in business. He identifies the Qur'ānic concepts of business, which provide insights into the nature of business from an Islamic perspective. These Qur'ānic concepts of business are discussed in detail in the third chapter of this book. The author mentions three indicators; the Qur'ānic concept in gainful business,¹⁸ losing business,¹⁹ and

¹⁷ Ahmad, Mushtaq, *Business Ethics in Islam*, (Islamabad: The International Institute of Islamic Thought, 1999).

¹⁸ But those who spend their wealth in order to gain God's approval, and as an affirmation of their own faith, are like a garden on a hill: heavy rain falls and it produces double its normal yield: even if no heavy rain falls, it will still be watered by the dew. God sees all that you do. *Qur'ān* (Al-Baqarah), 2: 265.

¹⁹ These are the people who buy the life of this world at the price of the Hereafter; their torment will not be lightened, nor will they be helped. *Qur'ān* (Al-Baqarah), 2: 86.

maintenance of records²⁰ in terms of reward and punishment, which are directly related to a brief discussion on the Qur'ānic attitude towards *tijārah*. Meanwhile, the third chapter underlines the attributes of Allah that are the divinely ordained principles, wherein those who are involved in business must be conscious of. In the fifth and sixth chapter, the author establishes four areas of wealth from the Qur'ānic view of wealth; general appreciation, ownership, the concept of *ḥalāl* and *ḥarām*, and the concept of *barakah*, which are related to the system distribution of wealth and a healthy economy. After emphasising on *infāq* and methods of distributions, the author distinguishes the approved and disapproved business conduct as sanctioned in the Qur'ān. It is noted that the explanation of the Qur'ānic revelation are too general without reference to the interpretations of the Qur'ān. This study will refine the Qur'ānic concepts of business from *tafāsir* and modern scholarly commentaries.

S.M. Hasanuzzaman, in his book *Islam and Business Ethics*²¹, discusses Islamic ethical values and moral issues that have emerged as a result of the general decline in faith and practice. He identifies justice (*'adl*) and benevolence (*iḥsān*) as the most important values which constitute the essential of Islamic business ethics. He states that Islam visualises market mechanism without any negative impacts on the interests of others. He also elaborates on the specific issues of criticism such as advertisement policy, salesmanship, pricing, the interest of trader, and consumer satisfaction as safeguarded under Islamic law. They are presented as the components of ethical values in business that the Qur'ān and the Prophet SAW have laid down, which are aimed at training the inner self of man, so as to become a motivation in

²⁰ If they spend a little or a lot for God's cause, if they traverse a mountain pass, all this is recorded to their credit so that God can reward them in accordance with the best of their deeds. *Qur'ān* (Al-Tawbah) 9:121.

²¹ Hasanuzzaman, S.M. *Islam and Business Ethics*. (London: Institute of Islamic Banking and Insurance, 2003).

abandoning selfishness in favour of social interest. This study would be helpful to provide evidence in developing the ethical principles related to financial transactions.

*Al-Iqtisad wa Akhlāq*²² (Economics and Ethics) by Rafiq Yunus al-Misri is a worthy book. The author brought together between Islamic and Western thought to the knowledge of the readers. This is good exposure to identify the philosophy and principles of religion between Islamic and Western economy. He states that ethics is the soul in the economics system. He explains that there are places in the economy that are morally neutral and can be shared between both systems. However, there are also other place that are incompatible with Islamic morals that must be reconciled and avoid that may be ethical in the eyes of the Western perspective. The author recommends that both Muslims and Western economists to have a sense of impartiality to determine the ethical aspects in the treatment and investigations of certain issues of economy in the scientific approaches.

Another book worth mentioning is *The Foundations of Islamic Banking: Theory, Practice and Education*²³ by Mohamed Ariff. In the first chapter of his book, he explores the foundations of ethical financial transactions in Islam. He describes the profit sharing and risk-sharing contract in financial transactions as being ethically consistent with human welfare. He explains that ethical rules are generally applied in a wide range of financial transactions (banking, insurance, and investment funds) in conventional markets. He also stresses that business activities must be guided and regulated by the concept of oneness and unity of God (*tawhīd*), goodness (*ihsān*), and trust in God (*tawakkal*). The author discusses three basic values: justice (*‘adl*), the ban on interest (*ribā*) and the prohibition of hoarding (*ihtikār*) as they are related to ethical

²² Al-Misri, Rafiq Yunus, *Al-Iqtisad wa Akhlāq*, (Dimashq: Dār al-Qalam, 2007).

²³ Ariff, Mohamed. *In the Foundations of Islamic Banking: Theory, Practice and Education*, (Cheltenham: Edward Elgar Publishing Limited, 2011), 11-49.