

# FACTORS OF INFLUENCE IN THE ESTABLISHMENT OF ISLAMIC BANKING AND FINANCE IN ALGERIA

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## ABSTRACT:

**Purpose** - The study of the issues on the establishment of Islamic banking and finance in Algeria is conducted. The study tries to establish factors that become hindrance to the establishment and development of the syaria'a compliance Islamic banking and finance in Algeria.

**Design / methodology / approach** - Survey data based on a set of questionnaires were distributed to employee and customers of nine selected banks in the city of Boumerdes, Algeria.

**Findings** - Results of the study show the existence of the technical, social and legal obstacles as the main factors that hamper the success of the establishment of the Islamic banking in Algeria .

**Practical implications** - This study is helpful for the investors, bankers and policy makers for formulating the future policy.

**Originality / value** - This paper is a first attempt to establish factors that effect on the establishment and development of the Islamic banking and finance in Algeria.

## Keywords:

Islamic banking, Finance, Establish, Factors, Obstacles, SPSS, Algeria.

## ***Introduction***

Financial system plays important roles in the economy of any country, which include provision of loans and credit facilities for the conduct of the production process (Gmph, Delphi, 1997).

The existing banks in most countries of the world rely on the system of interest. In Islam, the interest is called as *riba* which goes against the principle of Shariah (Maqasid al-Shariah) and therefore it is termed as *haram* (forbidden) (Larbani, 2009).

In many Muslim countries the Islamic banking system has been established to serve the needs of the Moslems communities where the practice of usury or *riba* is prohibited. This syariah compliance Islamic banking operates in parallel with the conventional banking system which was in existence prior to the establishment of Islamic banking system. Despite the many challenges, the Islamic banking system is proven to be viable and able to withstand the impacts from the economics and financial crisis. Besides, the system is well accepted by the conventional banking system with the introduction of *sya'ariah* compliance banking products and services by the major conventional banks in the non-Islamic countries (Bhatti, 2008).

Today, Islamic banking has become a substantial segment within the global financial market the Islamic and non-Islamic countries that offers a wide range of financial products and services (Dusuki, 2008). This establishment of this *sya'ariah* compliance Islamic banking and finance are concentrated mainly in the Middle East and Southeast Asia countries which are also serve as a centre for promoting the *sya'ariah* base Islamic banking and finance to western businesses and financial markets (Khan, 2008)

In Algeria despite being a Muslim country, the share of Islamic bank and finance is very small which accounts for not more than 1% of banking activity in Algeria (Ramzi, 2010; Aflou, 2011). In 1991, Banque Al Baraka d'Algérie - a private bank - became the first Islamic bank to operate in Algeria which offers only a limited Islamic financial product to its customers (Benamraoui, 2008). However, there are no Islamic banking products in all public banks in Algeria.

The introduction of the Islamic banking system in Algeria will certainly help in elevating the level of technical performance of the Islamic banking system.

The motivation of the paper is to identify the obstacles that become hindrance to the success of promoting and establishment of the Islamic banking in Algeria as an alternative to the conventional banks that is free from the element of *riba'* or interest. The paper focuses on social, technical and legal issues in relation to the establishment of Islamic banking in Algeria.

The study includes the Islamic banking and financial products in all commercial public banks operate in Algeria. However, due to the large size of the community in Algeria, the study includes only all the branches of commercial public banks in the selected city of Boumerdes.

### ***Overview of Islamic Banking and Finance***

The foundation of Islamic banking and finance is the prohibition of interest or *riba'* in its practices which distinguished it from its counterpart, the conventional bank (Iqbal, 1997). According to Muslim scholars and theologians *riba'* is similar to interest or usury and must therefore at all times be condemned (Haron & Shanmugam, 1997).

The practices of Islamic banking and finance require the application of the provisions of Islamic law in all transactions and investments. Accordingly, all profit and loss transactions must be done according to the Islamic banking operations and this includes the method of financial intermediation. In general, the Islamic banking business must adhere to the Islamic values and ethics in the banking business (Mahmoud Abdel Hamid and Elbaali, 1990)

Financing is perhaps the primary function of an Islamic bank. Between 50 and 80 percent of the total assets in Islamic banks are used for financing activities (Haron & Shanmugam, 1997). Roughly, financing facilities can be categorized into three areas: investment, trade and lending. Different financing techniques are used to facilitate these areas, some are based on the PLS scheme, others on mark-up (commissioned purchase) and a few rely on benevolent loans. Broadly speaking, the areas in which Islamic banks are most active are in trade and commodity finance, property and leasing.

## *Algeria's banking sector*

Algeria's banking sector is dominated by government banks, which suffer from high levels of non-performing loans to state-owned enterprises (SOEs). The banking sector in Algeria comprised government with 90 percent of the total assets in Algeria and private banks that made up 12 percent of the share in banking sector (Ramzi, 2010). As of 2007, government banks-controlled 95 percent of total bank assets. There are 22 banks in Algeria today, with eight public-sector banks and fourteen private-sector banks, all of which are subsidiaries of large international banking groups (Rosenberg, 2010). Despite Algeria is a Muslim country and despite the second article of the Constitution provides that Islam the state religion, the share of Islamic banks in the Algerian market is still marginal, not exceeding 1 percent (Ramzi, 2010).

The first Islamic bank to open its doors in Algeria is Banque Al Baraka d'Algérie in 1991. The bank's operations are still limited in scale and scope. However, there is steady increase in the number of savers and borrowers of the bank. The bank also expanded its network to include 18 branches across Algeria (Benamraoui, 2008). The law on money and credit permits Islamic banking transactions and products, including mortgages, because these products do not constitute any breach of the Algerian law. Around 99% of the real estate loans disbursed by banks are based on interest rates.

There is a growing realization among the Muslims population of the need of Islamic banking as an alternative banking system in Algeria. The increase demand for riba' free financial products due to the religion conviction are on the rise in Algeria. Also, the Islamic banking system provides a platform for resolving issue with respect to the problem of the investment tax and riba-based practices that cause financial crises. Importantly, Algeria needs for legal reforms in order for sharia-compliant finance to be established (Aflou, 2011).

## ***Methodology and research design***

The study aims at investigating the factors that become hindrance to the success in establishing Islamic banking and finance in Algeria. The study embarked on quantitative research which is considered as an appropriate method in investigating business related notions in practical concept (Alex, 2010; Will, 2000). The approach also has several advantages such as possessing high rate of reliability to the collected data, indicate an assertive relationship between the subjects under study and its suitability in investigating individual opinions behind their motive of action, behavior, and attitude (Matveev, 2002; Sekaran, 2000). In applying the quantitative research design, we will examine the relationship between dependent variable (the success of Islamic banking in Algeria) and independent variables (social, legal (legislative) and banking (technical) constraints).

## ***Data sampling***

Due to the large size of the community, we select a sample of banks which includes all commercial public banks operating in the city of Boumerdes namely; Banque Nationale d'Algérie (BNA), Banque Extérieure d'Algérie (BEA), Banque de l'Agriculture et du Développement Rural (BADR), Banque de Développement Local (BDL), Crédit Populaire d'Algérie (CPA), Caisse Nationale d'Épargne et de Prévoyance (CNEP), Caisse Nationale de Mutualité Agricole (CNMA), Algérie Poste (La poste). The research survey questionnaires are distributed to the selected respondent.

The validity ensures the ability or scale to measure the intended concept. When developing a measuring instrument, for example questions in the questionnaire, the purpose is to tap and measure the concept. The way to do this is by applying certain validity test. An important factor, regarding the validity is whether the persons were asked by questionnaire were the ones possessing the most accurate and valuable information for this study.

Reliability can be defined as the degree to which measurements are free from error and, therefore, yield consistent results. In the other words, reliability concerns the extent to which an experiment, test, or any measuring procedure yields the same results on repeated trials (Carmines & Zeller, 1979).

To test the internal consistency of the measurement, reliability analysis is conducted on the independent and dependent variables. In general, the closer the reliability coefficient gets to 1.0, the better it would be. Sekaran (2000) noted that reliability less than 0.60 is considered to be poor, that in the 0.70 range is acceptable, and those over 0.80 are good. In the study, a minimum reliability (Cronbach's Alpha) value is set at 0.60, which is the threshold recommended by Nunnally (1978).

Operationally, reliability is defined as the internal consistency of a scale, which assesses the degree to which the items are homogeneous. The composite reliability measure proposed by (Werts, 1974) which is an alternate conceptualization of reliability represents the proportion of measure variance attributable to the underlying trait. The composite reliability was used to assess the reliability of the scales for this study. According to Bagozzi and Yi (1988) a scale considered reliable if the reliability values of each instrument is more than the benchmark of 0.60.

## ***Hypotheses***

Rogers, (2003) proposes that each adopted category has different characteristic. Based on the relationship of the variables described in the theoretical framework, we developed the following hypotheses that will be tested in this study:

Hypothesis 1 Technical issues complicate the establishment of the Islamic banking and finance in Algeria.

Hypothesis2 Social issues complicate the establishment of the Islamic banking and finance in Algeria face no social obstacles.

Hypothesis3 Legal policy and law complicate the establishment of the Islamic banking in Algeria.

## ***Empirical results***

Reliability can be defined as the degree to which any measurements can be said to be error-free and hence certain to produce consistent results. Reliability can also be defined as the internal consistency of a scale which evaluates the degree to which the measurements of items are homogenous. Cronbach's alpha is used in this study to validate the reliability of each variable from the collected data (Table 1).

Table 1 Reliability

| Variables                     | No. of Items | Cronbach's Alpha |
|-------------------------------|--------------|------------------|
| Legal obstacles               | 05           | .769             |
| Social constraints            | 08           | .865             |
| Technical banking constraints | 09           | .832             |
| Islamic banking adoption      | 05           | .716             |

The Cronbach's alpha for the variables Legal Obstacles, Social Constraints, Technical Banking Constraints, and Islamic Banking Adoption are: 0.769, 0.865, 0.832 and 0.716, respectively. From this result, it can be concluded that the measures are all internally consistent and reliable as all of them have a Cronbach's alpha greater than 0.7.

Table 2 shows means, and standard deviations of each variable used in this study which were computed using SPSS.

Table 2 Descriptive Statics

|                     | N   | Minimum | Maximum | Mean   | Std. Deviation |
|---------------------|-----|---------|---------|--------|----------------|
| Legal obstacles     | 250 | 3.40    | 5.00    | 4.2592 | .44992         |
| Technical obstacles | 250 | 2.56    | 4.33    | 3.5751 | .58964         |
| Social obstacles    | 250 | 2.12    | 4.62    | 3.4225 | .73414         |
| Adoption            | 250 | 2.00    | 4.60    | 3.6440 | .62259         |
| Valid N (listwise)  | 250 |         |         |        |                |

Variable association refers to the coefficients which measure the strength of a relationship. Correlation is a bivariate measure of association (strength) of the relationship between two variables. It varies from 0 (random relationship) to 1 (perfect linear relationship) or -1 (perfect negative linear relationship). It is usually reported in terms of its square ( $r^2$ ), interpreted as percent of variance explained. The use of partial correlation is usually restricted to simple models of 3 or 4 variables, 5 at most (Zikmund, 2003).

Pearson correlation matrix will indicate the direction, strength and significance of the bivariate relationships among the variables in the study. Table 3 shows the correlations between adoption and three effect factors. The technical and social obstacles were significantly correlated to adoption of Islamic banking and finance in Algeria with positive correlation where legal obstacle has a negative correlation. The Pearson correlation for technical, social and legal obstacles are 0.16, 0.468, and 0.476 respectively which represent relationship between technical obstacles, legal obstacle and social obstacles with adoption of Islamic banking and finance in Algeria.

Table 3 Correlation between the adoption of Islamic banking and the independents variables

|          |                     | Legal<br>Constraint | Adoption | Technical<br>Obstacles | Social obstacles |
|----------|---------------------|---------------------|----------|------------------------|------------------|
| legalob  | Pearson Correlation | 1                   | -.169**  | .171**                 | .124             |
|          | Sig. (2-tailed)     |                     | .007     | .007                   | .051             |
|          | N                   | 250                 | 250      | 250                    | 250              |
| Adoption | Pearson Correlation | -.169**             | 1        | .468**                 | .476**           |
|          | Sig. (2-tailed)     | .007                |          | .000                   | .000             |
|          | N                   | 250                 | 250      | 250                    | 250              |
| Tbc      | Pearson Correlation | .171**              | .468**   | 1                      | .938**           |
|          | Sig. (2-tailed)     | .007                | .000     |                        | .000             |
|          | N                   | 250                 | 250      | 250                    | 250              |
| Soc      | Pearson Correlation | .124                | .476**   | .938**                 | 1                |
|          | Sig. (2-tailed)     | .051                | .000     | .000                   |                  |
|          | N                   | 250                 | 250      | 250                    | 250              |

\*\*. Correlation is significant at the 0.01 level (2-tailed).

From the above table we can conclude that for our hypothesis testing all of our hypotheses are accepted: These are summarized in the following table.

Table 4 Results for test Hypotheses between Adoption of Islamic Banking and its  
Independent variables

| Number | Hypothesis                                                                                                         | Conclusion | Sig   |
|--------|--------------------------------------------------------------------------------------------------------------------|------------|-------|
| H1     | Technical issues complicate the establishment of the Islamic banking and finance in Algeria                        | reject     | 0.000 |
| H2     | Social issues complicate the establishment of the Islamic banking and finance in Algeria face no social obstacles. | reject     | 0.000 |
| H3     | Legal policy and law complicate the establishment of the Islamic banking in Algeria.                               | reject     | 0.007 |

Table 4.8 depicts that all the sig Value is less than 0.05 that concludes that all hypothesis in this study is accepted.

## ***Conclusion***

The primary objective of this study was to propose the Islamic bank as the alternative to the conventional bank especially in Muslims countries such as Algeria. Our contributions in this study are to identify the obstacles that hamper the implementation and the establishment of the Islamic banking practices in Algeria.

This study divides the obstacles into three types: social, banking (technical), and legal obstacles. The results indicate that more than 70 percent of respondents agree that legislation is most important factor in determining the success or failure of the establishment of Islamic banking in Algeria. Also, the lack of legislation laws pertaining to the Islamic banking in Algeria forms a main barrier to the establishment of the Islamic banking system in Algeria. Additionally, about 80 percent of respondents agree of the non-existence of the Islamic technical and development plans as well as the mechanisms in promoting the Islamic banking and finance system.

There is a short in the pool of qualified individuals in the field Islamic banking and finance is determined as a main factor that hinders the development of the Islamic banking in Algeria.

The failure of media in playing their roles in educating the public on Islamic banking system and finance in Algeria is also recognized as one of the factors contribute to the delay in implementing the Islamic banking in Algeria. It is clear from the study that the existence of the social, Banking (technical) and legal obstacles to the implementation of the Islamic banking and finance in Algeria. We conclude that by overcoming the above identified obstacles will provide greater incentive in the establishing a successful Islamic banking and finance in Algeria as an alternative to the conventional system.

It is therefore recognized the important of the roles that should be played by the media in highlighting and educating the people in Algeria with Islamic banking and finance as the alternative to the conventional banking and finance. This will help in bridging the people and the successful of the establishment of Islamic banking and finance in Algeria. On the other hand, the central bank of Algeria should provide new set of regulations and policies pertaining to the establishment of Islamic banking and finance.

Moreover, central bank must provide the mechanisms and facilities to the development of Islamic banking and finance similar to commercial banks. Increase the number of trained and qualified individuals in the field of Islamic banking and finance will help expedite the establishment of Islamic banking and finance in Algeria.

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